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THE LATIN AMERICAN DEBT CRISIS AND THE CANADIAN COMMERCIAL BANKS

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CIDA	Canadian International Development Agency
DFI	Direct Foreign Investment
IMF	International Monetary Fund
NGO	Non Governmental Organization
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
LIBOR	London Inter-Bank Offered Rate

Chapter One: Introduction.

1.1 Analytical Overview.

After a period of optimism concerning the external debt of Latin America during the mid 1980s, the debt issue has resurfaced raising new concerns since 1987. As a region in the developing world, Latin America has the largest problem in gross terms regarding its external debt. The large majority of this debt is owed to the commercial banks of the OECD countries. The fact that much of this debt is private in the sense that it is owed to commercial institutions, raises a series of issues concerning repayment and terms of negotiation which are distinct from those associated with official or public debt. This paper will attempt to trace the development of the debt problem in Latin America and will focus on that external debt which is owed to **commercial interests.**

Most commentary to date regarding the debt has concerned itself with the position of the American banks as the largest portion of the Latin American commercial debt is owed to them. This paper will examine the case of a smaller creditor, Canada, and will discuss the scope of the debt owed to Canadian institutions as well as their arguably more limited options to reducing banking exposure. Compared to a major power like the United States, Canada is certainly more limited in its ability to initiate or sponsor major debt relief proposals. It is not without options however, and following the deregulation of the financial industry in Canada, new options are now open to the Latin American creditors.

In the wake of the debt crisis, the Latin American countries themselves have undergone a period of severe economic contraction and face enormous structural problems currently and in the future. It will not be the task of this paper to discuss the adjustment process in Latin America however.[1] Instead the discussion will focus on the **mutual benefits to both the Canadian commercial banks and the debtor countries in achieving viable debt reduction mechanisms.** In the initial phase of the crisis from 1982 to 1985 it will be argued that the main obstacle to achieving real improvements in debt reduction was the rescheduling mechanism itself. At this time the heavy emphasis on rescheduling was based on the misguided belief that the debt problem was a short term crisis in liquidity. Since 1985 there has been a growing consensus that the problem of debt in Latin America is of a longer term, structural nature and hence alternative approaches to debt reduction have been embraced. This shift in emphasis supports the notion that the problem is not one of illiquidity but more likely insolvency, and as such, demands more comprehensive measures for debt reduction.[2] These measures, characteristically, are taking on a more shared approach to debt reduction with both the commercial banks and the debtors bearing the costs. This is not to say that things have become cost free or even significantly less costly for the debtors, rather, that there is an added dimension to debt relief that did not exist, and was perhaps not thought possible, in the initial stage of the crisis.

The central issues which relate to the debt problem are those of **time frame, mutuality of interests and the institutional framework for debt negotiation.** First, as stated, it is necessary to shift the emphasis to the long term regarding rescheduling, repayment and even refinance for the region. This has begun to take effect but more movement is needed towards the recognition that the economic recovery and development of Latin America can only be achieved through long term support and economic adjustment. Rescheduling and refinancing arrangements must take this into account. To date, focus on the short term has helped neither debtors nor creditors in achieving improved positions regarding the debt. This rather ad hoc approach has been referred to as 'muddling through' and though one may argue that ultimately financial collapse has been avoided by the process[3], recovery in Latin America has not likewise been supported.

The second point regarding the mutuality of interests in debt reduction is important in two respects. On the first level it is clear that in terms of reserves and non-performing assets it is becoming increasingly costly for the Canadian commercial banks to carry their Latin American assets. For the debtors the costs are very clear in terms of export activity and foreign exchange which must be devoted solely to the servicing of the commercial debt. This is on top of the lack of new finance to the region which is seriously undermining not only consumption levels in the short term, but even more importantly, investment and the future productive capacity of the countries. On a second level the long term becomes even more important and clearly will affect creditors such as Canada, as Latin American export markets continue to collapse due to lack of demand stemming from the foreign exchange constraint associated with the debt.[4] Because Canada is a trade dependent nation which would benefit greatly from improved Latin American markets for stimulating production and employment in Canada, this mutuality of interests in debt reduction must be taken into account in Canadian policy formation.

Finally, the third central consideration which will be highlighted by this discussion is the weakness in the institutional framework for the renegotiation of commercial debts which is presently employed. Generally the approach is referred to as 'case by case', underlining the lack of consistency which results from dealing with individual debtors on a one by one basis within a dynamic framework. Creditors, on the other hand, negotiate en masse as a sort of creditor bloc which distorts the reality of the many different interests with their varying levels of exposure. It will be argued that both debtors and creditors stand to benefit from a less one sided, and at times covert, approach to debt renegotiation. This may also serve to reduce the 'debt fatigue' of which creditors and debtors now complain.

1.2 Structure.

The paper will begin with a discussion of the evolution and background of the debt crisis and the developments which have taken place from 1982 onwards. It will go on to examine the differing reasons put forward as to the causes of the debt crisis as these underlie the various approaches to debt relief and reduction supported by the different interests. The specific position of the Canadian commercial banks will then be discussed as well as some of the options now open to Canada following a series of legal changes in the financial industry. Finally the different approaches to debt relief undertaken to date will be discussed and will highlight the change in perspective regarding the debt since the crisis surfaced in 1982. Changes in negotiating positions and the movement toward market oriented debt reduction measures suggest an increasingly innovative approach to debt management by both creditors and debtors. This gives hope for new options with positive aspects for both sides in a situation which after six years of 'muddling through' has not reduced the overall level of commercial debt faced by the debt weary Latin American economies.

Chapter Two- Background of the Debt Crisis.

2.1 The Making of a Crisis.

The most recent World Bank debt statistics record the total external debt of the Latin American region in 1987 at US$ 442.5 bil.[5] In 1982 when the external debt of the region was first considered to be a problem, it stood at US$ 332 bil.[6] This would seem to indicate a continuing deterioration in the situation in gross terms since it reached crisis status in 1982. By any standard, the debt situation facing the Latin American countries remains very serious and, after seven years of crisis management, shows few signs of real improvement. Though the general sentiment towards the status of this debt has changed from one of financial hysteria in the early 1980s to a more cautious optimism over the successes yielded thus far by the 'muddling through' process, there remain little grounds for belief that we are truly any closer to a resolution of the crisis. That fully 75% of this debt is owed to private creditors also gives cause for worry in a world in which concerted action by governments remains one of the few, if tenuous, grounds for international economic coordination. Despite one of the longest periods of sustained economic growth in the OECD countries during the past five years, there has not been enough steam in the international economic engine to provide the demand side impetus for net improvements in the overall debt situation facing Latin America. This has been underscored by lack of agreement among Western leaders over issues of economic coordination regarding interest rates, exchange rates and international trade. With few expectations of accelerated, or even prolonged, Western economic growth during the next five years, one wonders at the likelihood of positive developments in the international debt milieu. This milieu finds the Latin American region at its very centre, accounting for the largest share of the world's US$ 1 tril external debt, at 40% of the total outstanding debt in 1986.[7] The era of the 'receiver state'[8] has begun to take its toll politically as well as economically. The future challenges posed to the democratic institutions of these debt burdened nations have raised new fears for the future of Latin America.

For more than fifteen years, commercial borrowing had been the main source of external finance in Latin America and had become the chief source of development finance. On 20 August 1982 a wave that had been building for more than a decade in Latin America, crested and broke when Mexico announced that it was unilaterally suspending payment on capital of public sector debt for ninety days.[9] This marked the onset of the crisis and was followed shortly after by a similar announcement by Brazil, the region's largest debtor. Reaching its zenith between 1979 and 1983, borrowing accounted for 87% of external finance for the region.[10] In this way many countries had come to rely on the capital account rather than the current account as the main foreign exchange earner for the economy. Ironically this led to a situation whereby exports were needed to service a debt which, in lieu of trade, had been originally contracted to finance development. Brazil alone was using 89% of its export earnings in 1982 to service its debt.[11] The debts contracted during this time were attached to very low, but floating, real interest rates on short term basis. Increasingly however, the financing of development depended on obtaining new credits to sustain the servicing of the older debts. In this way according to the World Bank, "the vital link between the service cost of a loan and the income from the investment stream it financed had been broken."[12]

With rising debt/GNP ratios, external financial inflows peaked at US$ 51.6 bil in 1981.[13] At the onset of the crisis, the debt problem was viewed to be one of short term liquidity problems. Most commentators agreed that the region had the economic potential to grow its way out of the crisis.[14] As the Western countries grew their way out of the recession of the early 1980s, the Latin American countries did not similarly attain improved economic solvency. By mid 1985 the perception that renewed growth would solve the economic problems of the region had changed. A second period of debt management began in which the dominant view is now that the crisis is of a longer term, structural nature.

2.2 The Crisis: Stage One.

Characteristically in this first stage, a crisis management approach was adopted by both the commercial banks and Latin American governments. Hence private sources which accounted for roughly 2/3 of the total external debt, continued to lend to Latin America until the change of perception in 1985. Most of this 'new lending' was in fact, merely the conversion of short term private credits into long term public debt as the governments increasingly accepted responsibility for debt contracted by private agents. New flows of commercial credit virtually ceased due to the psychology of 'herding' among the banks as confidence in the region rapidly eroded.[15] This was also a period of large scale rescheduling by the debtor countries which found Mexico, Brazil, Argentina, Chile, Uruguay, Peru and Bolivia and others rescheduling their commercial debts not once, but in many cases, several times.[16] The commercial creditors renegotiated the private outstanding debt under the auspices of the London Club[17], a creditors group which insists on dealing with Latin American rescheduling using a case-by-case formula. As many of the commercial loans to Latin America were of a large syndicated nature, the banks were forced to accept collectively the renegotiated terms (thus giving rise to the term 'forced lending'). This included the Canadian banks' exposure to Latin America which was often as a component of the many syndicated loans. Due to this, new Canadian lending was largely determined by the shape of the rescheduling packages concluded through the London Club process. Lending by the major Canadian banks totaled $18.1 bil in 1983 while loans to Mexico and Brazil alone accounted for $11.2 bil of this.[18] Table 1 gives a concise overview of the amount of commercial credit outstanding to the region's largest debtors in 1982.

Table 1. L.A. Commercial Debt 1982 (bil $US)

		Commercial Bank Debt				Total Debt	
	Total Debt	Long Term	% Total	Short Term	%Total	Commercial	%Total
Argentina	42.3	19.1	45.2	12.5	29.6	31.6	74.7
Bolivia	3.3	0.9	27.3	0.2	6.1	1.1	33.3
Brazil	94.9	56.2	59.2	14.8	15.6	71.0	74.8
Chile	17.9	10.9	60.9	4.6	25.7	15.5	86.6
Colombia	10.9	3.5	32.1	3.5	32.1	7.0	64.2
Costa Rica	3.2	1.2	37.5	0.6	18.8	1.8	56.3
Ecuador	7.0	2.2	31.4	2.6	37.1	4.8	68.6
Jamaica	2.9	0.3	10.3	0.1	3.4	0.4	13.8
Mexico	96.0	41.3	43.0	29.9	31.1	71.2	74.2
Peru	12.6	2.0	15.9	4.1	32.5	6.1	48.4
Uruguay	3.5	1.2	34.3	0.8	22.9	2.0	57.1
Venezuela	33.2	15.4	46.4	15.1	45.5	30.5	91.9
Total	327.7	154.2	37.0 ave.	88.8	25.0 ave.	243.0	62.0 ave.

Source: OECD 1986 Survey: Financing and External Debt of Developing Countries
NB: Jamaica is included here as it is one of the highly indebted countries of the region though it is not properly a Latin American country.

Rescheduling was conditional upon the acquisition by the debtor countries of an IMF supported stabilization program (such as Standby Loan agreements and Structural Adjustment Facilities) which dictated a series of short term economic conditions to be met by the countries to prove that they were indeed credit worthy.[19] New lending by banks was often referred to as 'involuntary' as it was, in many aspects, not new money but funds enough to cover the interest payments due to the banks themselves. Cline has for this reason described the banks as being in a "lender's trap".[20] Involuntary lending was a mechanism by which the commercial banks extended new loans to debtors, allowing them to continue to pay interest due on their loans, and preventing them from dropping into arrears. Interest rates however continued to remain high from 1982-1985 (peaking at 21.4 % in 1982). This served to further compound the debt problem by making servicing more expensive since many of the loans were attached to floating exchange rates.

During this time there were strong worries about the threat to solvency of the large creditor banks posed by spectre of default by any one of the large Latin American debtors. Worries over the possibility of collapse in the Western financial system were voiced during this period.[21] Comparisons were drawn with the situation of the 1930s,[22] and the responsibility of the Latin American debtors to act in such a way as to avoid a crisis was impressed upon them.

Just as it was Mexico which first announced a repayment moratorium, it has been Mexico which has set the pattern and precedent in debt rescheduling in 1982, 1986, 1987 and again in 1989. The first Mexican rescheduling in 1982 was of course tied to an IMF package which stressed the need for Mexico to get its domestic economy under control. Policy measures included wage restraint, large scale devaluation, and cuts in public spending, all of which contributed to the decline in real GNP subsequently in 1983.[23] These foretold of things to come for the other Latin American countries as did the conditions accepted by the commercial banks in the rescheduling of almost US$ 50 bil of external debt. These conditions included a multi-year rescheduling agreement (MYRA)[24] for the first time, an extended period of repayment up to 14 years, waived commission fees in some cases, as well as lower interest rates and spreads. In subsequent debt renegotiations by other major debtors such as Brazil and Argentina, demands were voiced for restructuring mechanisms of the same sort. That these countries owed so much to the Western banks gave them a degree of bargaining leverage that was not to be had by the smaller debtors in the region. As by 1984 the banks refused to undertake further involuntary lending, rescheduling packages came to include new concessions designed to actually reduce the flow of repayments demanded of the debtors. Effectively these actions allowed the banks to avoid the immediate effects of writing down the same loans.[25] Even so, the period from 1982 to mid 1985 served to quell the fears of bankers regarding the debt 'crisis' and many commentators even began to talk of the debt 'problem' suggesting that there had been progress towards resolving the crisis.[26]

During this same time, severe contractions in the Latin American economies were being experienced, making the overall economic situation if anything, more of a crisis in the South. During the period 1981-1984 the GDP/cap 'growth' rate for the region was on average -10.5%.[27] With falling per capita consumption, plummeting investment levels, rising unemployment, and falling output and real income in Latin America, the credit worthiness of the region once again became highly suspect. Cline has attributed the region's inability to find new sources of credit to the negative psychological effect upon the banks due to the disruption of debt servicing by some countries.[28] Thus the pro-cyclical nature of bank lending served to worsen an already deteriorating situation after 1982.[29] Net transfers to banks for the first time became negative in 1982 when a net US$ 9.2 bil flowed out in repayments, compared to a US$ 21.3 bil inflow during the previous year.[30] The Latin American countries were forced to return to the current account as a means of not only financing development, but increasingly as the only venue for continued debt servicing. As a result there was a trend toward change in the region from a position of deficit to surplus on the trade account after 1982. By 1985 imports to the region had fallen by 30% in volume compared to the 1982 level.[31] While growth in exports was pursued and attained in many countries, there was a strong trend toward protectionism in the United States which is the main export market for Latin American goods. This market nevertheless absorbed 87% of the increase in exports between 1982 and 1984.[32] Table 2 reflects the level of economic deterioration in the region during the 1980s expressed through net economic aggregates of the most heavily indebted countries (HICs). In 1980-87 all but Colombia, Brazil and Panama were facing falling real GDP/cap, a trend underemphasized by the aggregates which include the short term successes in growth by some countries in the early part of the decade. The severe deterioration in investment, an average annual decline of 4.6% for the region, raises the greatest concerns for Latin America due to the long term impact it will have on the region's economies due to decapitalization and the erosion of capital investment. Falling consumption levels underscore the fears of increased political unrest in the future.

Table 2. Latin American (HIC) Economic Indiors (%)

	Average Annual Growth Rates 1980-1987				
	GDP	Exports	Imports	Investment	Consumption
Argentina	0.0	1.4	-11.0	-9.5	-1.2
Bolivia	-3.5	-0.3	-2.4	-2.5	-5.1
Brazil	3.4	3.2	-4.4	-1.1	1.1
Chile	0.9	4.1	-6.8	-4.6	-2.2
Colombia	2.8	8.0	-3.3	0.9	0.2
Costa Rica	1.5	2.1	-2.4	1.3	-1.4
Ecuador	1.4	5.9	-2.6	-4.7	-2.2
Jamaica	0.2	-5.4	-2.2	1.3	-1.4
Mexico	0.3	6.4	-7.7	-6.7	-2.7
Peru	0.7	-0.6	-5.7	-12.6	-0.2
Uruguay	-1.4	-0.1	-8.1	-13.8	-2.4
Venezuela	-0.7	-0.9	-5.7	-3.4	-4.6
AVERAGE	0.5	2.0	-5.2	-4.6	-1.8

Source: World Debt Tables, 1987-1988, Vol.1.
NB: Jamaica is included here as it is one of the highly indebted countries of the region though it is not properly a Latin American country.

Unable to sustain such continued economic deterioration, Bolivia, a small debtor in the LA debt milieu, unilaterally stopped debt service in 1984. In June of the same year the first signs of collective action by the Latin American debtors emerged when eleven of the region's largest debtors gathered in Cartagena, Colombia to discuss debt issues. These eleven debtor countries (Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Peru, Uruguay and Venezuela) together represent 95% of the region's outstanding external debt and their meeting again raised worries over collective regional default, despite the group's reassurances that this was not their objective. Their objective was and is to implement a multilateral debt rescheduling mechanism for the region's nations to collectively take part in debt renegotiation.[33] This in itself was seen as a significant threat to the 'case by case' approach which is promoted by private creditors including the Canadian banks.

2.3 The Crisis: Stage Two.

When the OECD, and especially American, economic recovery abruptly slowed in 1985 the situation looked even worse for the region. Improved economic performance in the industrial countries could be less depended upon to support the recovery process in Latin America by providing demand for the region's exports. In June of 1985, Fidel Castro of Cuba called on the other Latin American countries to undertake collective debt default as a remedy to deteriorating domestic economies drained by debt service on a growing and unmanageable external debt. The net outflow of capital from the region during this phase was described as 'perverse'[34] but had not given grounds for renewed crisis cries from the commercial bankers. In fact, external finance by private sources substantially declined, accounting for only 60% of the total in 1985.[35] A cry came from Peru however in July when the newly elected president Alan Garcia announced that Peru was unilaterally limiting its debt service payments to 10% of the value of the country's exports. This 'conciliatory default'[36] signalled a new phase in debt management as it was the first unilateral action by a debtor country to challenge the conventional covenants of debtor-creditor relations. Subsequently the IMF was asked to leave and, in an act of solidarity, the World Bank followed suit.

In light of all of these events, the belief that the debt problem was one of a short term nature, due to a temporary crisis of liquidity, began to shift. It became more widely believed that the ongoing economic trends were not such as to allow the region to grow its way out of crisis. Rather there was growing support for the view that the problem is of a longer term nature, demanding renewed focus on issues of structural adjustment, growth and development. This change in attitude, and very likely renewed worries over the possibility of large scale defaults, led to the October 1985 Baker Plan initiated in Seoul at the annual meeting of the World Bank and IMF. This package, announced by then American Treasury Secretary James Baker, targeted fifteen of the most heavily indebted countries (in gross terms) for a type of international Keynesian, demand side growth policy. This included the injection of new money, and re-emphasis on structural change.[37] Ten of the 'Baker 15' were Latin American debtors inspiring new hope in the region that relief to growing economic stagnation and deterioration was in sight. For a number of reasons which shall be discussed further on, the Baker initiatives were not fully successful.

Again it was Mexico in 1986 which set precedents in debt rescheduling when it successfully managed to secure a new feature in its relief package which linked debt servicing to economic growth and specifically, oil export revenues. This was significant in that it marked a movement somewhat closer to a shared responsibility for the debt burden which Latin America had been calling for since the crisis began. Yet the US$ 12 bil of new money, which was also a component of that package, was not indicative of future trends pertaining to other heavily indebted Latin American countries. By 1987, the most recent World Bank figures record the net transfer from Latin America and the Caribbean to private creditors to stand at US$ 17 bil, indicating increasing 'perversion' or negative capital flows. The total debt outstanding and disbursed meanwhile stands at 46% of the region's GNP and 275% of exports.[38] As Table 3 emphasizes, the data relating to those countries most heavily indebted presents an even more serious picture showing many individual countries such as Jamaica, Bolivia and Chile with debt to GNP figures well in excess of 100%. As both oil and commodity prices fell sharply in 1986, the overall economic situation of the region became distinctly worse, in part due to the negative effects of these price decreases on exporters. The failure of the Cruzado Plan for economic recovery in Brazil also contributed to this economic destabilization and set the scene for new shock waves launched in 1987. Arguably this action may also mark the beginning of a third era in the debt crisis.

On 20 February 1987 the region's largest debtor, Brazil, announced that it was suspending interest payments on US$ 63 bil of commercial debt, again threatening the balance sheets of the commercial banks including those in Canada. Ecuador also reneged on its debt payments in February, forcing the banks to put the loans to these two countries on non-accrual status in March. On a more positive side, Bolivia began a buy-back scheme of its own debt which waved signs of hope to the smaller debtors of the region but did little to encourage the debt giants. Things continued to heat up when in June the eleven heads of state of the Cartagena group sent a joint letter to the Western economic summit in Venice calling for a political dialogue on the region's debt crisis. This clearly underlines a further movement towards emphasis of the perception that the problem is of a more complicated and longer term nature than was believed at the onset.[39]

The action by Brazil led the American Citicorp bank to announce in May that it was increasing its reserve provisions against the Latin American debt risks to 25% of the value of assets. Canada and the U.K. took similar actions subsequently leading banks in all three countries to declare net losses for that year as a direct result. This action by Citicorp gave a clear signal to the financial community and the world at large that these debts are of a very high risk; the level of which inspired the banks to take action to protect themselves against the possibility of future losses. This was also true in the case of Canada. Though this action incurred a very high financial cost on the banks, they in no way served to lessen the debt burdens of the debtor countries. On a more positive note, what these actions may affect in the future is the margin for multilateral debt forgiveness by the banks, finding themselves more financially protected collectively. Previously, the differing levels of reserves held by commercial banks on these loans internationally, served to undermine the possibility of collective positions by the banks. Similarly, as shall be discussed further on, the increased level of reserves may provide new incentives for the commercial banks to reduce their overall level of Latin American assets in ways that may also be beneficial to the debtors. Mexico meanwhile, after three London Club reschedulings entered its fourth and completed in December 1987 a new debt conversion scheme in cooperation with Morgan Guarantee which again may give cause for hope in the region.

Finally 1988 continued as a 'wait and see' period with respect to the Latin American debt situation. Despite advances made on debt relief for the most impoverished African debtors, no major new initiatives have been successfully launched in aid of Latin America. The recent (March 1989) Brady proposals acknowledge the need for a new approach though it may be too soon to assess the likely success or failure of the proposal.[40] Not surprisingly it was the deteriorating debt situation in Mexico combined with debt related economic crisis in Venezuela which served as the background to this recent initiative. Economic aid volunteered to the region by Japan at the July 1988 economic summit in Toronto under the Miyazawa Plan was rejected by the other G-7 leaders.[41] This likely reflects a hesitancy to pose any challenge to the geo-political hegemony enjoyed by the United States with respect to Latin America. To date, grace periods have increased, repayment horizons have lengthened, interest rates have shown some improvement and financial managers have shown more innovation in methods of dealing with debt and rescheduling. Yet Table 3 shows that debt service in the form of payment on principle and interest is expected to total US$ 177.8 bil during 1988-90 for the twelve largest debtors alone. Interest as a percentage of exports stands at 26.5% on average for the region's largest debtors and long term debt outstanding and disbursed (DOD) as a proportion of GNP has risen to more than 90%.

Table 3. Latin American Highly Indebted Countries (bil US$)

	Total Debt		Debt Service		1987 Debt Ratios	
	1988	% Private	1988-90	Interest	DOD/GNP	Int./XGS
Argentina	59.6	79.4	17.7	11.4	73.9	41.5
Bolivia	5.7	27.3	1.8	0.8	133.7	44.4
Brazil	120.1	76.8	63.4	21.8	39.4	28.3
Chile	20.8	73.3	7.0	5.2	124.1	27.0
Colombia	17.2	48.0	10.3	3.6	50.2	17.0
Costa Rica	4.8	53.2	2.2	0.7	115.7	17.5
Ecuador	11.0	63.6	5.5	2.1	107.4	32.7
Jamaica	4.5	17.6	1.6	0.7	175.9	14.2
Mexico	107.4	78.1	43.5	24.0	77.5	28.1
Peru	19.0	61.5	7.4	2.4	40.5	27.2
Uruguay	4.4	77.1	1.8	0.8	58.6	17.7
Venezuela	35.0	99.3	15.6	7.8	94.5	21.9
TOTAL	409.5	62.9 average	177.8	81.3	91.0 average	26.5 average

Source: World Debt Tables, 1988-1989, Vol.1.
NB: Jamaica is included here as it is one of the highly indebted countries of the region though it is not properly a Latin American country.

One can at most expect steady to slowing economic growth in the West and in following the American presidential elections, the international economic environment hangs in suspense as to the future course of American economic policy especially regarding trade policy and protectionism. This is obviously crucial for the determination of economic scope in Latin America and in the case of Canada, may set the limits of maneuverability as well. On August 1, following the March 1988 call by the Argentinean opposition for debt service suspension, the banks in Argentina were closed. Mirroring the pattern in Brazil before their 1987 default, one may reasonably expect some disruption in Argentinean debt service this year. Growing political unrest in Chile may also give rise to further debt repayment problems in 1989.

'Muddling through' and the case-by-case approach, terms applied to the current ad hoc approach by creditors to debt management, may have reached their limits as Western bargaining approaches.[42] Within the region there are few signs of solidarity, the Cartagena Group losing some of its vigour as deteriorating economies force countries into more competitive, rather than conciliatory postures. Within the Latin American countries, development planning and industrialization plans have virtually been shelved while the issues at hand force a short term crisis management style within ministries of economy and finance. Economic indicators have improved somewhat since 1986 but the situation remains grave as illustrated by the data presented here. Debtors complain of 'debt fatigue' brought on by yearly negotiations and the demands of short term austerity policies. If the economists and negotiators are fatigued, so too are the populations of these countries which have been facing deteriorating economic conditions that show no signs of future improvement.[43] Massive foreign exchange constraint, de-capitalization, cuts in government spending and falling real wages have taken a heavy toll and with the resurfacing of inflation, there are renewed economic worries. The 1987 external debt reportedly stands at US$ 421 bil representing 362% of the region's annual export earnings.[44] Even according to the World Bank, after five years none of the Latin American countries to have rescheduled has significantly reduced its debt. With fifteen governments due to change in Latin America in the next two and a half years there would seem to be an increasingly political dimension to this debt 'problem'. This dimension must be watched and assessed with caution in a region with a long history of a highly politicized and divided populations.[45]

Chapter Three: Reasons for a Crisis.

3.1 Overview.

Though the debt situation facing Latin America began to receive international media attention following the onset of the crisis in 1982, the trend towards mounting debt levels had its roots in the 1970s. As discussed above, the overall level of commercial debt had increased drastically during the decade and there are a variety of reasons commonly put forward to explain this trend. Though the explanatory factors underlying the debt crisis are almost universally agreed upon among bankers, economists and the Latin Americans themselves, there is a very large variation in the relative weight that each influence is allocated depending on the point of view of the analyst in question.[46] Hence the underlying reasons for the debt crisis must be briefly discussed here and, in an attempt at clarity, will be sub-divided into three broad catagories.[47] These fall along the lines of factors influencing 1) supply of and 2) demand for commercial credit as well as 3) exogenous shocks which have had impact upon the two.[48] Similarly in a geographical sense, these influences correspond to 1) conditions within Latin America itself, 2) conditions present within the international banking milieu of the industrialized countries and 3) factors which affected the overall international economic environment during the 1970s and early 1980s. Attempts to place blame upon agents involved in the formation of the crisis are not helpful. From this discussion it will become obvious that **both debtors and creditors** have a share in the responsibility for the problem. This will serve to underline the main argument here that **both** have mutual interests in the reduction of the overall debt situation of the region. Likewise, exogenous shocks which adversely affected the debt situation, especially the recession of 1980-82, must be recognized so that measures to safeguard against such factors in the future may be embraced in debt relief packages.

3.2 Supply Factors.

Two broad themes underlie the supply side factors responsible for the debt crisis. The first is the large increase in liquidity in the international commercial banking system resulting from the influx of petro-dollars following the large oil price rises of the 1970s. The second is the internationalization of capital and finance corresponding to deregulation in the financial industry which facilitated the massive increases in private lending to Latin America.

It was during this time that commercial lending took over as the main source of external finance to Latin America. Emminger has argued that even before the petro-dollar surpluses entered the commercial banking system there were fears voiced among American commercial bankers that lending to Latin America and other Third World countries had become excessive.[49] By 1973 the oil surpluses had surged into the Western banking system and these dollars were recycled through the loan market to borrowers. The emergence of the Eurocurrency market allowed large scale lending to be undertaken by commercial banks that were rapidly entering the highly competitive and highly lucrative international lending business. As a result, between 1965 and 1984 the size of this market increased from US$ 55 bil to US$ 2100 bil.[50] The Euromarket, based in London, did not at the time rely only on OPEC surpluses but provided a venue for syndicated lending and concentrated very much on short term loans at variable interest rates.[51] Between 1975 and 1980 commercial bank lending to the Third World was increasing 25% per annum on average and by 1982, 25% of all commercial debt in Latin America carried maturities of less than 1 year.[52] Because real interest rates were low and even negative during the 1970s,[53] these loans were attached to floating interest rates by which the borrowers carried the risk associated with interest rate rises which would occur in the OECD. This made international lending very attractive to the commercial banks. By 1980 75% of the Latin American commercial debt was attached to floating interest rates.[54] The high rate of borrowing also benefitted the OECD economies in the 1970s as Latin America proved a lucrative export market, having the foreign exchange capacity to finance imports from the OECD.

Less fettered by central bank reserve requirements which could be by-passed through international operations, the banks entered into fierce competition to book Latin American loans.[55] As demand for loans was sluggish at that time in the OECD countries, the Latin American market provided a convenient outlet for petro-dollar recycling and at the same time yielded a very high rate of return for the banks. During this time Brazil and Mexico were perceived as future economic miracles waiting to take off with Brazil opening up the Amazon and Mexico undertaking rapid industrialization with the support of the oil boom. In the case of Canada, Third World commercial loans were heavily concentrated in Latin America. Loxley has argued that by 1981 the Canadian commercial banks were earning almost 50% of annual profits from their Third World lending activities.[56] Much of the money was imprudently lent as the commercial banks did not apply the same performance criteria to lending activities as do official lenders. In many cases the banks had relatively little experience in Latin American lending. Complicating matters further, much of the credit extended was to governments or official agents in the belief that they were of a lower risk.[57] It became evident at the beginning of the 1980s that much of these loan portfolios were of considerably greater risk than had originally been expected.[58] When the supply of available loans rapidly began to dry up for the Latin Americans, severe liquidity problems were experienced. It is now obvious that in many respects the privatization as well as internationalization of capital and finance in the end, may not have proven so beneficial for borrowers as it once may have seemed. Certainly for the once willing commercial banks it has proven to be a Damocletian threat to their overall stability and certainly to profits. Among banking circles it is now recognized that a degree of imprudence and poor commercial practices employed by the banks themselves, were in part, responsible for the crisis.

3.3 Demand Factors.

Within Latin America during the 1970s there were, in many cases, national governments which depended on foreign borrowing to finance the activities of the state and to fill the domestic savings gap.[59] It was also a period in which many countries maintained policies of import substitution, in some cases supported by over valued exchange rates. In retrospect, it has been argued (most strongly by those analysts adopting a monetarist approach) that these policies allowed consumption to continue at insupportable levels, possible in the short term due only to foreign borrowing. Thus it was in both the "bloated public sector"[60] and the external sector that ongoing deficits were run and easily available foreign credit from commercial banks was employed to finance these deficits. Between 1975 and 1981 the deficit on the current account for the region rose from US$ 14.3 to US$ 41.3 bil.[61] Weisner has argued that both loose domestic monetary and fiscal management combined with high public and private spending were the two main internal, or regional, causes of the Latin American debt crisis.[62] Partly as a result of this poor fiscal management, by the period 1978-1982 fiscal deficits as a proportion of GDP had more than doubled in the three largest debtors: Brazil, Mexico, and Argentina.[63] Krueger has also stressed the significance of poor macro-economic management in Latin America which resulted in unsustainable levels of debt build up during the 1970s. Table 4 highlights the slower growth of exports relative to GDP during the decade.[64] Though some of the countries listed here show higher growth in exports than debt, it must be underlined that World Bank debt data does not generally include private non-guaranteed debt and therefore debt figures here are understated. This is especially true in terms of short term commercial credits which, as stressed earlier, accounted for a large share of the debt by the turn of the decade. In short it can and has been argued, by monetarists and non-monetarists alike, that many countries, in terms of the macro-economic policies employed, were simply living beyond their means.

Table 4. Debt Build-up 1970-79 (ave. % change p.a.)

Country	Exports	Debt	Real GDP
Argentina	17.9	11.7	2.2
Bolivia	15.3	16.5	4.8
Brazil	21.0	29.7	8.4
Chile	14.7	12.7	2.4
Colombia	18.3	10.3	5.9
Costa Rica	16.8	24.3	5.8
Ecuador	30.6	33.5	8.8
Jamaica	10.3	24.9	-1.1
Mexico	24.7	24.5	5.2
Peru	13.9	11.6	3.0
Uruguay	14.5	15.8	3.5
Venezuela	18.1	33.0	5.0

Source: Krueger 1987-generated from World Debt Tables, W.B.

This argument which is a caricature of the dominant IMF/World Bank approach to the problem, stressing poor economic mangement by debtor governments, is often tempered by Latin American analysts who argue that the story presented above ignores a series of important factors associated with politics and corruption in the region. In relation to the political atmosphere which prevailed in Latin America during the 1970s, it must be emphasized that many countries were under the rule of military dictators during a period not characterized by high levels of democratic participation. It is argued that ambitious development schemes, high levels of public expenditure and short sighted macro economic management were a function of the overall political environment. Related to this in some cases is the large scale capital flight which occurred in many countries. Commercial loan funds from Western creditors often traveled a rapid, return route to Western banks and were never profitably invested in the debtor countries. The Bank for International Settlements (BIS) estimates that between 1977 and 1981, US$ 60 bil of capital left the region in the form of capital flight.[65] Other sources argue that for some countries the figure is closer to 30% of the total debt.[66] The World Bank echoes this and has estimated that between 1976 and 1985, US$ 123 bil flowed out of the ten largest Latin American debtor countries.[67] Lever and Huhne attribute these high levels of capital flight to the "problem of fungibility" of foreign currency loans whose use is difficult to trace.[68] In this respect it is arguable that in many cases the benefits and revenues from external borrowing were also privatized. As the economic situation continues to worsen in Latin America, many groups (in opposition to IMF conditions and the terms of repayment adopted through rescheduling) argue that the poorest segment of a population which was neither responsible for, nor benefitted from, the large scale capital inflows should not now be expected to finance its repayment.[69]

3.4 Exogenous Factors.

By 1979 a series of exogenous shocks began to have an impact upon not only Latin America, but the world economy at large. Within Latin America, for internal and external reasons which were discussed, the economies had reached a condition of heavy dependence on capital inflow to finance not only development, but government expenditure and consumption as well. It is therefore arguable, that the conditions were set for a crisis in liquidity which would have occurred in any event. Two primary factors were responsible for speeding up the inevitable however. These were the onset of the recession and the second oil price rise. The structuralist critique of the debt crisis had tended to lend most emphasis to these important external factors upon which the monetarist school has been less willing to focus.

OECD economic policy stressing monetary restraint and anti inflationary measures from 1979-1980 brought about a rapid slow down in Western economic growth. By 1982 average growth in GNP in the OECD stood at only -0.3%.[70] This had a severe negative impact on Latin American export markets and sent real interest rates skyrocketing.[71] This combined effect had a severe negative impact on the crucial debt service ratios used by banks to assess a country's credit worthiness. Expressed as $\frac{P + Ip}{X}$ where P is principle, Ip is interest payments and X is export earnings, it is clear that all three components moved adversely against the debtors. As discussed, the rate of borrowing had been increasing causing principle levels outstanding to rise. As a result of restrictive OECD monetary policy real interest rates rose from -0.8% in 1979 to in excess of 20% by 1982.[72] These crippling rates, attached to short term loans carrying variable interest rates, forced enormous increases in debt service payments.[73] ECLAC records this increase as a change form US$ 6.9 bil in 1977 to a massive US$ 39.0 bil in 1982.[74] This increase was very heavily concentrated on the seven largest debtors of the region.[75] These high rates of interest also accelerated the level of capital flight in many countries. The recession which ensued further undermined the denominator of this equation. Export earnings which were already outweighed by import levels, plummeted as falling demand from the OECD sent primary commodity prices on a sharp downward trend. This was further entrenched by the protectionist policies of the OECD which were a product of the recession. Hence with both components of the numerator rising and the denominator falling, this crucial ratio rapidly increased resulting in what Kuczynski has termed the "scissor effect".[76] As credit worthiness deteriorated, the extension of new bank credit to the region rapidly declined. These effects combined to produce a severe crisis in liquidity for the debtors which ultimately led to the 1982 debt service suspension by Mexico.

Finally, the second oil price shock of 1979-82 had a third role in the creation of the debt crisis, and set the terms of trade against the Latin American exporters.[77] Mexico, Ecuador and Venezuela are the only large scale oil exporters. For the large debtors such as Brazil and Argentina, these oil price rises had a severe negative impact upon the balance of payments, more than doubling oil import bills. This of course forced further increased, short term and hence expensive, foreign borrowing. For the oil exporters, perceptions of increased credited worthiness led the banks to extend large amounts of credit to develop their oil industries. Following these severe negative external shocks, the already precarious debt levels were 'pushed over the brink' into the current crisis.

From this discussion it is clear that there is a shared and multi-dimensional responsibility for the debt crisis which must be acknowledged by both the structuralists and monetarists in order to move forward.

Chapter Four- The Canadian Position.

4.1 The Canadian Economy and Banking Industry.

The 1980's has been a period of sustained economic growth for Canada despite its being one of the hardest hit OECD countries during the recession. Since 1982 Canada has been in fact the fastest growing of the G-7 countries with an annual growth rate of 4.2%,[78] topping that of Japan and averaging a full percentage point above the OECD mean. Canada remains the largest trading partner of the United States, completing in 1987 an historic free trade negotiation with the Americans, and is currently the fourth largest capital market in the world. Despite these features of the Canadian economy, Canada a relatively unpopulated country, heavily trade dependent and highly penetrated by American direct investment, attracts little attention in the international press concerning matters of economy and finance. It is not surprising then that relatively little notice has been paid to the stake claimed by Canada in the current international debt crisis and especially that of Latin America.

The Conservative government under Prime Minister Brian Mulroney took office in 1984 following sixteen years of almost uninterrupted Liberal rule during the Trudeau era. During this time Canada's image and trade linkages with Latin America and the Caribbean were entrenched. Due to government spending, the national budget deficit hovers around $30 bil (6% of GNP),[79] thus fiscal policy recently has begun work on the reduction of the deficit using increased taxation as one policy measure. Overall Canada maintains a trade surplus which has contributed to its economic success. It is therefore interesting that with respect to Latin America, Canada in 1987 had $716.5 mil trade deficit. This was even larger in 1984 at $1.8 bil.[80] This narrowing deficit has occurred despite a decrease in Latin American importation of Canadian goods by 23% since the onset of the debt crisis which the North South Institute has estimated to have cost 135,000 lost jobs in Canada.[81] That the Latin American countries recognize Canada as an important future export market is evidenced by the recent opening of trade offices in Canada by Mexico, Brazil, Peru and Nicaragua.[82] Canada also sees Latin America as a future growth market for Canadian exports. Regarding direct investment, the region currently attracts more than 50% of all Canadian DFI in the LDCs. Unfortunately, a 10% limitation on the investment abroad of some $120 bil of Canadian pension funds prevents additional potential portfolio investments. Finally, Canada shares some important economic characteristics with Latin America. It is a primary commodity exporter, greatly affected by deteriorating commodity prices, as well as US protectionism and the negative effects of oil price fluctuations.

In 1987 the Canadian banking industry suffered three major shocks; the effects of the Brazilian debt moratorium and the resultant special provisions requirements, the stock market crash and the historic deregulation of the banking industry. The Big-6 Canadian Schedule A banks (the Royal Bank of Canada, the Bank of Montreal, the Canadian Imperial Bank of Commerce, the Bank of Nova scotia, the Toronto Dominion Bank and the National Bank of Canada) dominate banking in Canada and until recently, have been somewhat insulated from the effects of foreign competition. The last ten years has been a period of continuous growth and profit making for the Big-6 which together represent assets totalling $346.5 bil in 1987.[83] Following the collapse of two Western Canadian banks in 1985, there were a series of shock waves sent through the financial community and a general caution instilled against imprudent lending. Despite this, the effects of inter-bank competition in the early part of the decade led to large increases in international lending activities which were heavily focussed on Brazil, Mexico, Argentina and Venezuela. The Latin American and Caribbean region as a whole accounts for the largest share of the bank's foreign assets after the United States. Finally on June 30, 1987 as announced by the Minister of State for Finance Tomas Hockin, the deregulation of the Canadian financial industry began. The industry historically had seen the activities of banking, brokerage, insurance and trust companies maintained as four separate 'pillars' of finance in Canada. This means that for the first time banks can enter the market of stocks domestically and internationally, opening up a variety of new financial possibilities. Starting in June 1988 the industry was further opened to allow the full participation of offshore interests to compete in the Canadian securities markets. This will doubtlessly see the increased participation of Japanese investors in banking activities in Canada which has for a long time served as a sort of back door for Japanese access into the more protected American financial and production markets. The Japanese have historically been a major buyer of Canadian bonds, purchases totalling $7.3 bil in 1986. The Canadian government has actively sought to enhance Canadian-Japanese relations on an ongoing basis.

4.2 Big-6 Exposure to Latin America.

After the Mexican default in 1982, the Canadian banks, like their American counterparts, found themselves heavily exposed to the Latin American and Caribbean region. In 1983 the Big-6 collectively held $18.1 bil in outstanding loans to Latin America alone. Individual banks held assets at a level comparable to those of the large American banks (the Royal for instance having outstanding loans of a similar level to that of J.P.Morgan). This figure at the time represented on average 131.2% of base capital[84] for the five largest banks and 255.2% for the National.[85] This meant that collective default by the big Latin American debtors could effectively have threatened the solvency of the banks as loans were heavily concentrated on four countries.[86] Outstanding loans to Mexico alone were in the order of $6 bil while those to Brazil were a close $5.2 bil.[87] As discussed, during the period 1982 to mid 1985 the Latin American debt crisis was viewed to be a problem of short term balance of payments difficulties. To keep assets current, the Big-6 also undertook involuntary lending: providing new loans essentially to pay themselves the interest payments due. Through this process outstanding loans to the region reached $24.74 bil by 1986 while, in fact, new Canadian capital flows had dried up. Loans to Latin America represent the vast majority of the total Third World portfolios of the Canadian banks. Appendix 1 gives a more detailed account of the position of the Big-6 banks during 1986 and 1987 including the exposure of each bank to the individual debtor countries.

As the general perception of the crisis changed to one of longer term structural difficulties, the Canadian banks began to increase their provisions on the LDC debt while writing down (through partial write offs) their existing loans. Short term assets were rescheduled to longer term debt in order to maintain sound book keeping and the appearance to share holders that all was well under control. Between 1985 and 1987 the Toronto Dominion Bank, one of those least exposed, rescheduled $7.7 bil in Latin American loans. The larger of the Canadian banks participated in London Club reschedulings of their outstanding assets in the large syndicated Latin American loans and in their Annual Reports still maintain support for the 'menu' approach to refinancing. The Royal Bank alone during 1983-1987 suffered loan losses to the region in the order of $670 mil. Due to the standard accounting practices required of the banks, loan losses were averaged over a five year basis, in this way allowing the banks to understate their actual losses to Latin America in the year in which they were incurred. Banks and their directors were nervous however due to the increasingly deteriorating debt situation. Neither were they encouraged by actions such as that of Peru's Alan Garcia in 1985 which signalled that the debtor countries might be entering a more active phase in debt management. By 1986 the average level of voluntary provisional reserves held by the Big-6 against the LDC debt had increased and stood at 12.2% of outstanding loans.

Table 5. Canadian Bank-6 exposure to group-32 LDCs (bil Cdn $)

1986	Total bank assets	LDC loans as % assets	Loans to 32 LDCs	LDCs as % all loans	Reserves on LDC loans	Reserves as % LDC assets	Loans to LA and Car
Royal Bank	99.61	5.72	5.70	8.60	0.62	11.00	6.17
Bank of Montreal	87.18	6.88	6.00	11.00	0.77	12.80	5.40
CIB Commerce	80.84	3.80	3.10	5.40	0.45	14.50	4.09
Bank of Nova Scotia	64.01	7.12	4.56	10.60	0.43	9.40	4.56
Toronto Dominion	51.45	5.81	2.99	7.80	0.30	10.00	2.67
National Bank	27.87	8.97	2.50	12.60	0.38	15.30	1.85
TOTAL	410.96	6.38 average	24.85	9.33 average	2.95	12.17 average	24.74

Source: Complied data from Annual Reports.

Meanwhile they continued the process of writing down many of their outstanding Latin American assets. This does not release the debtor from interest payment obligations. Even after a loan has been written of a country must continue to service its debt at face value and these payments are recorded as direct income to the bank in question. Several of the banks began to participate in the secondary market either swapping debts for those of lesser risk countries, or by debt securitization in conjunction with Canadian multinationals operating in the region. In sum, 1986 was a bad year for the Big-6 with respect to the Latin American debt situation.

The next year, 1987, did not dawn much brighter due to the February announcement by Brazil that it was calling a moratorium on its international interest payments while it put its financial house in order.

Table 6. Canadian Bank-6 exposure to group-34 LDCs (bil Cdn $)

1987	Total bank assets	LDC loans as % assets	Loans to 34 LDCs	LDCs as % all loans	Reserves on LDC loans	Reserves as % LDC assets	Loans to LA and Car
Royal Bank	102.17	5.29	5.40	7.80	2.02	37.00	5.97
Bank of Montreal	84.23	6.88	5.80	11.00	2.06	35.50	4.47
CIB Commerce	88.38	3.62	3.20	5.00	1.28	40.00	4.14
Bank of Nova Scotia	71.43	4.62	3.30	6.90	1.17	35.50	3.27
Toronto Dominion	54.53	2.77	2.54	6.30	1.03	40.00	1.47
National Bank	29.98	7.84	2.35	10.90	0.85	36.00	1.30
TOTAL	430.72	5.17 average	22.59	7.98 average	8.41	37.33 average	20.62

Source: Compiled data from Annual Reports.

For the Canadian Imperial Bank of Commerce alone this meant lost interest payments of $10 mil, while $1.1 bil of Brazilian loans were put on non-accrual status. This led their administration to state that reducing non performing loans was their "number one priority" in their 1987 Annual Report.[88] With Ecuador also put on non-accrual, the Bank of Nova Scotia finished fiscal 1987 with $1.2 bil of non performing Latin American claims. Even the smallest of the Big-6, the National, sustained lost interest payments resulting from the Brazilian action of $44 mil. In May of 1987, Brazil's moratorium led the American Citicorp bank to declare that it was increasing its provisions against LDC loans to 25%. This was a development in the crisis that represented a public admission that these loans were neither worth their face value nor, in many cases, recoverable. Canada took similar action and on August 17 the Superintendent of Financial Institutions, Michael MacKenzie, announced that Canadian banks were required to increase their provisions on 34 LDC debtors to 30-40% of outstanding assets.[89] This represents either a higher degree of conservatism within the Canadian banking sector or, more likely, an admission that much of the Canadian exposure is of an even more perilous nature than that of their southern brothers with perhaps fewer hopes of repayment. Subsequently, loan loss reserves which totaled $2.9 bil in 1982 were increased to $8.4 bil by the end of fiscal 1987. This represents on average 37.3% of loans to the 34 high risk countries listed by the Superintendent of Financial Institutions. The majority of these loans are to the Latin American countries in the group. Table 6 gives details of the position of the banks with respect to LDCs, and Latin America in particular, at the end of fiscal 1987.

Significantly, the announced changes included a mandatory reform in accounting practices so that the banks in 1987 were required to record their losses as a direct charge against income in the year in which they occur rather than the previous five year average system. This, in addition to the mandatory reserve increase above the general prudential level that the banks already held, led all but one of the six,(the Toronto Dominion which did suffer a fall in profits) to record net losses in 1987 for the first time in a decade. For some of the larger banks it was the first time to ever declare a loss. Together these losses of the Big-6 totaled $1.02 bil as a direct result of the Special Provision on LDC debt precipitated by the Brazil action. These mandatory provisions are taxed by the Federal government at a collective amount of more than $2.6 bil.

Table 7. Canadian Bank-6 exposure to Latin America and Caribbean (mil Cdn $)

1987	Total loans (assets)	Region as % earning assets	Special Provision	General Provision	as % loans LDC-34	Net income before SP	Net income after SP	Y tax on provision
Royal Bank	5971.00	8.70	800.00	2019.00	37.00	541.00	-259.00	600.00
Bank of Montreal	4471.00	5.50	765.00	2060.00	35.50	413.00	-352.00	534.00
CIB Commerce	4142.00	4.70	450.00	1275.00	40.00	387.00	-63.00	400.00
Bank of Nova Scotia	3273.00	8.20	693.00	1174.00	35.50	381.00	-312.00	481.50
Toronto Dominion	1470.00	2.80	475.00	1032.00	40.00	528.00	53.00	415.00
National Bank	1303.00	4.40	298.00	846.00	36.00	214.00	-84.00	202.00
TOTAL	20630.00	5.72 average	3481.00	8406.00	37.33 average	2464.00	-1017.00	2632.50

Source: Compiled from Annual Reports.

Table 7 presents the amount of general and special provisions held against Latin American assets as well as the tax and profit summary of the Big-6 Canadian Banks. This data shows that the banks are not only forced to hold a high level of unprofitable reserves but are, at the same time, taxed well in excess of $2 bil by a government that has been heralded as an international ground breaker in debt reduction at the recent economic summit held in Toronto. Concerns over cash flow problems which will result from the high levels of required reserves have been voiced. As tax relief on reserves is given on a five year rolling average, the amount of provisions held in 1987 will remain understated in terms of the tax relief they are eligible for. Changes are expected from the Inspector General of Taxes to deal with this.[90] The Superintendent of Financial Institutions further announced in March 1988 that reserve requirements were likely to be raised to 45% in fiscal 1988.

4.3 Final Thoughts.

While the banks are heralded as more secure due to their increased reserve holdings, and proclaim themselves to be so to their shareholders, one must wonder at the logic of this. In the first instance new financing to Latin America has virtually ceased as discussed. In addition, new high reserve requirements which are applied retroactively to include the entire Latin American loan portfolio of the bank in question, mean that any new lending would be distinctly unattractive to the banks despite any revised Baker-type proposals. As this is the case, new loans to Latin America look increasingly less likely from commercial sources. Faced with this, the Latin American countries finding themselves in ever worsening economic conditions are forced to service first that debt owed to multilateral creditors such as the World Bank. This is because, by definition, these loans are not reschedulable. In comparison with the commercial banks in a less 'protected' reserve position one would wonder what is the disincentive for the debtor countries to default completely on this portion of their external debt. Hence Dornbusch though supportive of reserve holding does venture to suggest that they may become "self-fulfilling prophecies" which invite default.[91] The Canadian Big-6 being more 'protected' than all other major creditors and being less powerful overall in a political-economic sense, may be particularly at risk. Certainly the traditionally flouted response that debtor countries cannot afford to alienate commercial creditors would no longer seem to apply as these banks are no longer a source of credit for the region.

The Canadian banks recognize that in all likelihood their position vis a vis the big Latin American debtors is not likely to improve in the near future and have increased their participation in a secondary debt market which finds Brazilian paper trading at less than 50% face value.[92] The Banker however predicts that the Canadian banks will be back to full profitability in 1988,[93] a claim that may a hope rather than the realistic prospects for banks facing further mandatory reserve requirements. Finally, there is nothing to indicate that the actions of banks have in any way improved the prospects of the region's debtors. In addition to the faux logique of the security of increased reserves, the fact that the banks have written down or written off outstanding debt, does not in any way reduce the burden on debtors. Thus the beneficial effects of reserve holding have been passed on exclusively to the creditors. That is, these debtors are not released from interest payment obligations. The longer the banks are forced to hold expensive reserves on a debt that will likely remain outstanding, the more one must wonder whether we are in fact moving any closer to a 'solution'. With deteriorating Latin American export markets continuing to affect Canada, it is clear that new approaches must be undertaken not only by the banks, but by creditor governments as well. In Canada this could well be done through assistance to the tune of $2.6 bil in recycled tax money through multilateral lending agencies to Latin America. This would echo the progressive approach taken already to the less heavily indebted (in absolute terms) African debtors, an approach not likely to be offered to the Latin Americans.

The deregulation of the financial industry also opens venues for debt conversion heretofore not possible in the Canadian banking milieu. The possibility for a bank's financial wing to accept debtor country securities, exports as well as a range of new financial innovations being brought on stream, has increased. This may prove to be especially useful in the case of exit bonds as shall be discussed in the upcoming section. Finally, Canadian cooperation with Japanese finance, which has already expressed interest in the region, may now be possible because of the deregulated financial environment in Canada. The scope for new approaches to mutual debt reduction is only as limited as the creativity of the financial innovators. The Canadian government could facilitate the innovative capacity of bankers by making the official development agency CIDA as well as the Export Development Corporation available as conduits for debt forgiveness to Latin America.

Chapter Five: Approaches to a Resolution of the Crisis.

5.1 Debt Rescheduling and Beyond.

The initial phase of the debt crisis was a period of large scale rescheduling of interest and principle in the case of Latin America, not only by official creditors but by commercial banks as well. This was in support of the belief that the problem was of a short term nature and could be successfully dealt with if only the indebted countries were given some economic breathing space and time to get their balance of payments to respond to the obligations of debt repayment. According to Nunnenkamp "the rescheduling approach implicitly assumes that the debt problems of the major debtors are of a liquidity nature rather than of a solvency nature."[94] As discussed, the perception of the debt problem had changed by 1985 to a belief in a longer term, more serious and structural problem. In this second phase there was a shift in emphasis from rescheduling debt to restructuring debt; actual modifications of not only the time frame but the conditions of debt repayment. This was in accordance with the change in emphasis from the short to the longer term. Griffith-Jones and Sunkel have outlined three general catagories of debt restructuring proposals in the 1986 debt context which remain no less valid in 1988.[95] Proposals for debt reform can be divided as follows:

1) those aimed at the reduction of debt overhang (or that debt already contracted),

2) proposals to encourage new financial flows,

3) attempts to enhance the stability of the international banking system.

This general framework will help to discuss the debt relief mechanisms currently being employed. Those aimed at the reduction of debt overhang (1) are most recently the growing use of secondary market transactions in Latin American debt. Though there have been a variety of proposals to encourage new flows to the region (2), the Baker Plan will be the primary package discussed here. To date it has been that taken most seriously internationally and, despite its weaknesses, is still that which offers the greatest hope for the future. Finally, measures to enhance the security of the international banking system (3) include the recent increases in provisional reserves on Latin

American assets held by the commercial banks as well as the growing emphasis on exit bonds in the region. A critical assessment of rescheduling and these three major debt relief categories may provide the basis for ways forward from the present debt situation considering the interests of the Latin American countries as well as the Canadian commercial banks.

5.2 The Rescheduling Era.

By 1985 the volume of debt being rescheduled had decreased substantially. Before this, the rescheduling of public and private debt was the main debt relief measure undertaken in Latin America with the objective of decreasing repayment pressures which were believed to be mostly a function of time. Initially, only payments on interest were rescheduled though later, it became necessary to reschedule principle payments as well. The renegotiation of debt owed to official and multilateral sources were, and are still, handled by the Paris Club, an intergovernmental group gathering in Paris whose meetings are chaired by the French Treasury. More relevant in the case of the commercial debt discussed here, is the role of the so-called London Club which is assumed to be the private debt equivalent of the Paris Club.[96] Much mystery surrounds the functioning of this group whose actual name is the Commercial Bank Advisory Committee and which is as likely to meet in New York as it is in London.[97] Unlike the Paris Club, there is no regular group of creditors at the meetings but a shifting coalition of representatives of commercial banks depending on the loan and country in question and the exposure of the particular bank to that country. Meetings are chaired by a representative of the bank with the largest exposure to the debtor in question.[98] Normally only principle is rescheduled and arrears on interest are expected to be paid at current LIBOR rates when the new agreement goes into effect. One objective of the Club is to pre-empt repayment difficulties by rescheduling loans before a crisis point is reached. By this mechanism much of the short term debt outstanding to the banks was converted into longer term credits from 1982 to 1984. Due to reciprocal default clauses employed in syndicated lending agreements, the commercial bankers have a vested interest in maintaining a group bargaining position during the proceedings.[99] The debtor is represented by a government delegation as the private debts contracted in Latin America have mostly been backed by the central banks. The process itself may span several months and incur large costs to the debtor country.

Debtor countries are dealt with on an individual basis giving way to the so called 'case by case' approach. In some of these cases new finance has been extended while in others it has not. The conclusion of a rescheduling package has in almost all cases been conditional upon the attainment of an IMF restructuring package by the debtor country. In the early stages of rescheduling, new credit extended was implicitly forced upon the commercial banks given their acceptance of the overall package, due to the involuntary lending the pattern discussed earlier. There is no guarantee of equal or consistent treatment of debtors. The conditions of rescheduling tend to vary according to the economic importance of the debtor country to the banks in question (ie. size of outstanding assets and future prospects for repayment) as well as other longer term economic performance expectations. There are also differing levels of expertise among the Latin American negotiators and for a variety of reasons, some have exercised their debtor power less than others. The Cartagena Group has continued to voice strong opposition to this case by case process and has argued in favour of more equal treatment of debtors. They have proposed collective debt renegotiations to consolidate negotiating leverage and benefits for the region but to date have not been successful in achieving collective bargaining. It is, in fact, unrealistic even to expect there to be a harmony of interests among the various Latin American debtors given their differing priorities and the internal dynamics of the region. As the crisis is prolonged and the characteristics of the national economies and debts diversify, there would seem to be even less likelihood of a debtor's cartel forming.[100]

According to the World Bank, between 1980 and 1985 there were 74 commercial debt reschedulings in Latin America alone, the peak period being 1982-1984.[101] Commercial bank debt relief typically has covered three areas: restructuring of principle repayments, extension of new longer term loans, and the maintenance or extension of short term credit lines.[102] Only the larger debtors such as Mexico, Brazil and Argentina have tended to receive significant new money packages to date. Chile has also received new financing, less due to the size of its outstanding debt (and hence leverage), than because of the general perception that it has a less severe debt situation overall. As discussed, several of the Latin American debtors have rescheduled numerous times, never meeting the conditions of the prior agreements. None have significantly reduced the level of their overall debt despite the rescheduling process. Since 1985 there has been a marked decline in the number of reschedulings coinciding naturally with the decrease in involuntary lending. The Canadian banks have taken part in the rescheduling mostly as co-financiers in the many large syndicated loans outstanding to the region and have, since 1983, been undertaking mainly involuntary lending to the region. The Toronto Dominion is one of the few Canadian banks to publish figures on the volume of Latin American debt rescheduled and, even as one of those least exposed, it has renegotiated almost $8 bil since 1984 alone.[103]

In 1987 there were seven commercial reschedulings to Latin America; Argentina, Chile, Honduras, Jamaica,[104] Mexico, Panama and Venezuela, which resulted in only Argentina and Mexico receiving significant new money loans. With interest rates rising once again and the countries themselves calling for debt relief rather than debt deferment (implying a bigger problem waiting down the road), there has been a shift away from rescheduling as the main form of debt relief. Debtors and creditors find themselves in a type of prisoner's dilemma of debt; any single bank unwilling to make concessions unless the others follow suit while all debtors want the same concessional terms as have been offered to the large debtors. As rescheduling became less of a panacea and banks became increasingly less willing to extend involuntary credit, there has been a trend toward more concessionality in debt restructuring. The banks have begun to accept new measures for actual debt reduction rather than merely delayed repayment. This has given rise to the so called 'menu' approach to refinancing which gives the banks increased options for reducing exposure and/or reducing the repayment committment of the debtors. These measures have included interest capping[105] and lower margins over LIBOR, the 1986 Mexican growth 'contingency clause', the MYRA or multi year rescheduling clause, interest capitalization, exit bonds, debt conversion and repayment accepted in local currency.[106] The banks however have become less willing to continue to extend repayment periods or adopt multi year rescheduling mechanisms as the economic capacity and future potential of the region comes into question. It is no longer a question whether these countries can pay later but rather, if they can pay at all.

These concessionary features reflect an important change in approach to the overall debt situation. They indicate a slow progression to a more shared responsibility for debt reduction and a de facto admission that many of the

Latin American assets may not be redeemable at their original value. The Cartagena Group has come out strongly in favour of the contingency clause as a mechanism of risk sharing between debtors and creditors. These concessions have not however resulted in increased real flows to the region to stimulate renewed economic growth. Hence there is a growing belief that the market (ie. private sector) left to itself will not provide enough finance for sustained development in Latin America. There has been renewed emphasis on multilateral and official lending to relieve the problem but in 1987 multilateral lending to Latin America showed the largest decrease compared to that of any other region of the world.[107] In view of the limitations of rescheduling, it is now helpful to look at some of the other debt relief measures mentioned above which have gained increased importance since 1985 and which will likely become more important.

5.3 Debt Relief.

1) The secondary debt market:

In the three broad catagories of debt relief efforts that have been attempted to date, programs to reduce debt overhang have the longest history. By debt overhang one refers to that commercial debt already contracted by the debtors which has run into repayment difficulties. Such programs refer primarily to the existence and growth of the secondary debt market in the case of Latin America which has facilitated debt capitalization and has been a growing debt relief mechanism since 1985. Also referred to as the debt for equity swap, this mechanism essentially allows a commercial bank holding Latin American assets to sell them through a competitive market system. The purchaser may convert that debt into local currency via the central bank for the purpose of capital investment; direct or portfolio. Host governments charge conversion fees to buyers for the completion of these transactions and a variety of other legal conventions apply depending on the country in question.[108] This usually includes a time period in which no capital can be repatriated to the country of the investor.

A second mechanism employed in the secondary debt market is the sale of one country's debt for that of another country giving rise to the term debt swapping (a debt for debt swap). This mechanism has primarily been employed to reduce the exposure of the commercial banks to certain countries and may not constitute a reduction in debt overhang for the debtor country as they are still expected to service the debt at the originally contracted value. It is a self protecting measure for the banks as they can effectively diversify their assets away from heavy concentration on few countries. The commercial banks in fact earn transaction fees from these swaps which may then be added to their reserve provisions. In some cases the larger debtors have been able to buy back portions of their own commercial debt at reduced rates but this has been limited and would not be likely to be applied on any large scale.

Unlike pure debt swaps, the debt for equity swap provides debt reduction for the Latin American debtors and has been employed since 1982 by Brazil, and later by others. Mexico and Chile remain the largest users of this mechanism.

In 1987 Argentina, Brazil (for the second time) and Venezuela also undertook debt for equity swaps on a large scale though critics maintain that compared to the overall size of the outstanding debt, this mechanism is a small scale vehicle for debt reduction.[109] The use of this mechanism continues to grow in any case and more countries have adopted it during recent years. The volume of debt traded on the secondary market has increased by a factor of 150 since its inception in 1983 when US$ 100 mil was traded.[110] Standing at US$ 10 bil in 1987 the volume of trading has increased significantly since 1985 and is expected to increase to US$ 40 bil in 1988.[111] Mexico has the largest program and retired US$ 2 bil of its commercial debt in 1987.[112] The debtors stress that the importance of this mechanism is in its investment stimulating function (as such Brazil has made up to US$ 66 bil eligible in their new program[113]) and in this sense one can see the two pronged benefit of such transactions. Not only can the commercial banks reduce their outstanding loans (albeit at a loss) providing external repayment relief to the debtor, but much needed capital investment can be generated within the economies through the conversion of debt into equity. Investors are usually multinationals and large companies such as Chrysler, Sony, Nissan, Volkswagen and Alcan have used the secondary market to finance investment in the region. The secondary market finds sovereign debt trading at lower than face value, in many cases less than 50% of the original value contracted. This reflects the degree of confidence of the market in the prospects of repayment by the country in question. Between August 1987 and the year end there was a large fall in the value of most countries' paper which may be associated with failing stock market confidence at the time.

Table 8. Secondary Market Rates for Latin American Debt.[114]
(as a % of face value of commercial loans)

Country	August 1987	November 1987	September 1988
Argentina	45-47	33-37	22
Brazil	52-54	37-41	46
Chile	64-66	50-53	60
Colombia	80-82	72-76	67
Ecuador	41-43	31-34	21
Mexico	51-53	48-52	47
Peru	7-10	2-7	na
Venezuela	65-67	49-53	51
AVERAGE	51-53	40-44	45

Source: Euromoney, Special Supplement, January 1988, pp.26-27, and World Debt Tables, 1988-89, Vol.1, p.24, 1988.

Prices have rallied in some cases, especially those countries to have successfully renegotiated debt in 1987-8.

The Canadian banks have also participated in this secondary market. The Bank of Montreal initiated in early 1987 a US$ 100 mil equity conversion scheme with Brazil to reduce the volume of their outstanding loans while enhancing foreign investment in Brazil. This represents almost one tenth of their $1.2 bil of Brazilian loans given non-accrual status in 1987. This bank has also established a 'Special Country Unit' to manage exposure to those countries considered high risk and to promote actively debt/equity swaps and asset sales.[115] The National has also taken part in debt for equity swaps and debt sales reducing its Latin American exposure by 30% (or 2.5% of total assets) in 1987. The Toronto Dominion entered the secondary market on February 1, 1988 and had sold $409 mil of LDC loans by the end of fiscal 1987 at an average price of $0.66 on the dollar[116]. Most of their outstanding LDC assets are Latin American so it is reasonable to expect that a large portion of these transactions were in Latin American debt. The Bank of Nova Scotia has taken part in debt capitalization and has established a specialist team similar to that of the Bank of Montreal to promote further swap deals and has begun to enter debt for goods swaps with the less conventional Peruvian debtors. The other Canadian banks do not make explicit reference to the use of the secondary market but have also reduced their exposure to the area probably with some employment of this mechanism. The key determining factor in a bank's willingness to participate is the secondary market value compared to the expected value (rather than book value) of a bank's Latin American assets. If the secondary market find a country's loans trading at a 30% reduction and a bank judges its assets to be worth only 70-75% of their face value, then it is feasible for the bank to market its assets and minimize its losses. In many cases they can also reduce the level of non-performing loans which they carry. In the case of the Toronto Dominion, secondary market transactions were discontinued in late 1987 when the market price fell on Brazilian paper.

A critical assessment of the debt for equity mechanism finds that it is not a 'no cost' solution because it essentially converts external debt into national debt in terms of the government's responsibility for financing. Fears of inflationary pressures as a result of the increase in investment if financed through money creation by the central bank have also been expressed. Because of inflationary pressures, Mexico temporarily suspended its program in October 1987. Critics also argue that there is a very limited capacity for the implementation of such swaps due to the limited investment potential in even some of the larger countries.[117] According to The Economist the secondary debt market is currently determining "the shape of rescheduling agreements and is putting the burden of refinancing back on the big banks".[118] This is true in the sense that those banks able to decrease their outstanding assets through the debt swap mechanism are increasingly less willing to extend future credit in rescheduling agreements and in some cases may no longer consider themselves to be creditors at all. Nationalist concerns have also been expressed in Latin America over the large scale use of this mechanism. As equity investment opportunities rest dominantly in the private sector, governments are being forced to consider the privatization of national or public enterprises. The willingness of the governments to offer up the productive capacity of their countries to foreign investors following two decades of anti multinational sentiments and industrial nationalizations is the basis of this concern. Mexico has for this reason imposed large scale restrictions on the degree of foreign ownership permitted since 1987, hence the demand for swaps from multinationals have subsequently fallen. There has been large scale political opposition to the mechanism in Brazil for the same reason. Chile has encountered a different variety of problems stemming from its own citizens buying up secondary market debt with foreign held dollars, converting the debt into local currency which was then exchanged on the black market for significantly more dollars than entered the process in the beginning. This process of 'round tripping' caused the adoption of more stringent foreign exchange controls to attempt to deal with the problem. Finally, the argument can also be put forward that direct foreign investment can only provide short term relief in terms of growth and capital inflow. In the medium to long term, profit repatriation will surely contribute to net capital outflows. In fact, policy makers must now be concerned with the short term as problems of negative investment are so acute that alternative solutions may offer too distant reprieve for the failing economies.

An overview finds that the secondary market for debt does provide some relief in the short term from the severe liquidity problems generated by the long term demand of large scale foreign exchange payments despite inflationary worries. The debtor countries themselves have tended to emphasize the mechanism more as a tool of investment promotion in the face of the severe deterioration in investment levels experienced throughout the region. It is also a mechanism manifesting the risk sharing element called for by the Latin American debtors as the banks take some book loss while the debtors face reduced repayment streams. Multinationals are very often the investing agents of the converted debt and they too share some of the risk associated with the uncertain returns to their investment. As the commercial banks continue to increase the levels of their reserve holdings one can expect to see an increased demand for debt conversion. To date this has been true in the case of Canada and, as future mandatory increases in reserve levels are expected, one could also expect further Canadian participation in this market. The holding of reserves is a costly affair for the banks as well as an admission of expected discounted value of loan assets. Hence there are increasing incentives to accept less than face value for these loans. So while there may be fewer hopes for new lending there may be more hope of debt resale due to the holding of provisionary reserves.

2) The Baker Initiative:

By 1985 the majority of the Latin American countries had failed to resume sustained economic growth. There were growing worries concerning the possibility of debtor default. In this context, then US Secretary of the Treasury, James Baker, set in motion a refinancing plan with the objective of providing new debt relief for the most heavily indebted countries in the region.[119] Announced at the joint meeting of the IMF and World Bank held in Seoul in September 1985, the so called Baker Plan has been the predominant large scale relief package adopted in the second phase of the crisis. This proposal put renewed emphasis on the provision of new liquidity for the region through a kind of international Keynesianism. The dominant theme being 'adjustment with growth,' the Baker Plan continued to support the orthodoxy of IMF adjustment policies but put increased emphasis on the longer term and the need for renewed economic stimulation in Latin America. An active plan calling for more multilateral participation by the commercial banks, the Bretton Woods institutions and the debtor countries themselves, the Baker Plan can be summarized in its three main initiatives. First, it emphasized that a successful program could only be implemented through the adoption of comprehensive structural and macroeconomic policies by the debtors in line with the IMF and World Bank approach. These measures would focus attention on growth promotion through outward orientation, balance of payments adjustment and anti-inflationary policies. Second, the World Bank was called on for larger scale (an increase of 50%) and more effective structural adjustment lending to support the reform policies under the continued supervision of the IMF. Third, the commercial banks were called upon to renew lending flows to the region and provide US$ 20 bil of new loans over three years. The program placed heavy emphasis on a return to free market orthodoxy with an increased role for the private sector, foreign direct investment and the further development of financial markets. Brazil, Mexico, Argentina, Venezuela, Chile, Peru, Colombia, Ecuador, Bolivia, and Uruguay were the ten Latin American countries designated for assistance through the Baker initiative.[120]

Response to the Baker initiative must be assessed as disappointing at best. Though there has been a large scale, and one could in some cases say rigorous, implementation of structural adjustment in the region there have not been commensurate financial flows from either the multilateral or commercial banks. Four crucial assumptions upon which the plan was based are helpful in assessing reasons for its lack of success. First, it was thought that the marginal productivity of new money lent, and subsequently invested, would be high enough to generate new export revenues to service both the old and new debt. Second, it was held that the IMF and World Bank would be able to maintain enough political pressure on the debtors to have them adhere to adjustment policies. Third, it was believed that the commercial banks would be willing to provide additional finance while fourth, it was hoped that the global trade environment would facilitate an increased volume of LDC exports.[121] The third assumption may be the most seriously flawed as commercial bank lending showed a net decrease in 1986 with negative flows from the region actually increasing. The multilateral agencies increased lending to Latin America by very little, though some larger countries such as Mexico did receive significant new financing. The global trade environment has not improved for LDC exporters with commodity prices falling and protectionism in the US rising. Finally, though great advances were made in some cases in terms of stopping inflation and implementing currency devaluation, adjustment policies are becoming increasingly more difficult to enforce in the face of overall economic deterioration and growing political opposition to what is seen as the external management of the Latin American economies. It has been suggested that to make any private refinancing possible the liability of impaired assets must be shifted from the commercial banks to the international securities market through a special 'Debt Restructuring Facility'. Weinert also has suggested that the secondary market could successfully overcome some of the weaknesses in the Baker Plan by giving sufficient incentives to carry out short term, painful economic adjustment.[122] In effect, liability has shifted to some extent, in an informal way, through the debt for equity swap and as the next section will show, through the exit bond mechanism.

The more positive significance of the Baker plan lies in two main points. First, it recognized the debt situation to be of a more serious and longer term nature than had originally been believed from 1982 onward. Second, it affirmed that the process of debt management adopted at the time was not resolving the crisis and that coordinated international intervention was required.[123] This is true, not just of the debt situation, but of the problems of economic misalignment among the large (G-5) economies manifested in trade imbalances, unstable exchange rate fluctuations and the instability of international capital markets. These influences continue to have direct effects on the Latin American debtors and future 'solutions' must take these factors into account as well. In this sense the underlying analysis of the Baker Initiative remains valid though international economic conditions are to date, not conducive to such an arrangement. In regard to the fact that the majority of the commercial debt is outstanding to American banks, it is clear that any future initiatives to deal with the private debt must have US support. The commercial banks are unwilling to send more good money after bad and to date, only the Japanese have expressed interest in initiating renewed large scale flows to the region. Elements of reduced bank liability, renewed financial flows and (some would argue), less stringent economic orthodoxy in short term adjustment policies, are the essential features for successful international Keynesianism to improve the external debt situation in Latin America.

3) Provisionary Reserves and Exit Bonds:
These two mechanisms represent risk reducing measures adopted by the commercial banks to protect their outstanding assets in the case of reserves, and to decreases the overall level of assets in the case of exit bonds. As discussed in some detail in Chapter 2, there has been a trend toward increased provisional reserve holdings by the North American banks since 1987. In Canada the banks hold between 35 and 40% of Latin American assets in reserve while in the case of the United States the figure is closer to 25%. Provisioning has added to the disincentives banks face in extending new loans to problem debtors because they will immediately be required to hold further costly reserves. Reserve holding does not provide any debt relief to the debtor and as discussed is a purely self-protecting mechanism of the banks. They may however enhance a bank's willingness to participate in the secondary debt market as discussed. With more banks holding reserves in 1988, there are improved prospects for multilateral debt relief to be considered by the more protected banks.

Exit bonds were first used in the 1987 Argentinean rescheduling package and have subsequently been offered by both Brazil and Mexico in 1988 as a feature of their rescheduling packages. Chile is also considering issuing exit bonds, expanding the 'menu' available to the banks. Exit bonds are a mechanism which allow banks with relatively small exposures to avoid future new money obligations (ie. involuntary lending) by exchanging their assets for negotiable, low interest, long maturity bonds. These have also been described as 'junk bonds', reflecting dim hopes for the future potential of the region, but they occupy a growing market and provide a useful mechanism for the reduction of 'bad loan' portfolios by many banks. The exit bond is an alternative offered by a national debtor government to its commercial creditors. A bank can bid on exit bonds by offering up its sovereign loan exposure at a particular reduction. If accepted by the debtor government, usually through an auction system which allocates bonds, the loan is exchanged for low yield bonds backed by the central bank. Due to the large number of small banks with syndicated loan exposure to the region, the introduction of exit bonds provides a useful exposure reducing mechanism for many banks with relatively small assets (compared to the largest American banks). In this sense, the exit bond market could prove a useful arena for reducing the Canadian bank portfolio in the region and is a more realistic possibility following the deregulation of the Canadian banking industry. The use of the exit bond mechanism by a commercial bank allows it to reduce its exposure as well as rescheduling obligations to a debtor. As exit bonds are usually offered through a market mechanism, the banks receive less than face value for their assets. The sales value of a loan is in many cases directly related to the secondary market value for loans to that country. To date, many have been willing to accept a loss on these assets just as in the case of the debt for equity swap. Japanese banks offered bids totalling US$ 1 bil in the February 1988 Mexican bond auction but only US$ 200 mil were accepted.[124] It is probably too early to assess the success of this mechanism to reduce bank exposure but, in principle, it represents another market oriented, debt reduction mechanism which shows potential. For the countries themselves it extends the repayment horizon and at a reduced rate, indicating mutual benefits for debtors and creditors.

5.4 Final Thoughts.

It is clear that as the debt crisis is prolonged, both debtors and creditors are becoming more creative in the forms of debt relief which they are adopting. Almost all of these measures discussed show a clear emphasis on the longer term with a more shared responsibility for a resolution to the problem. This is true of the conditionality clause being employed in rescheduling as well as extended periods of consolidation. The secondary market allows changes in the ownership of claims and may provide some much needed investment flows to the region. Other creative secondary market mechanisms to be employed for debt reduction in Latin America include debt for exports/goods swaps, debt for tourism swaps, and even debt for nature swaps. There also are signs that national development agencies and the NGOs are considering entering the secondary market to buy up the reduced rate assets and essentially double or triple their money in terms of the local currency which they will receive. As short run liquidity problems are becoming more acute, and the main barrier to growth in the short run as foreign exchange reserves become stretched to the limit, new financial flows are needed in the short term as well as in the long term. This has been recognized by the Baker initiative as well as subsequent proposals put forward by Bill Bradley, Alfred Herrhausen and Jeffrey Sachs.[125] The exit bond also shifts emphasis to the longer term and though it does not provide new finance, it does free some of the valuable foreign exchange currently employed in debt service. As real interest rates have been on the incline in 1988-89 one can expect further debt pressures in the region and an enhanced search for viable relief proposals. Successful approaches to debt resolution will depend on the mutual acceptance by debtors and creditors of any schemes or mechanisms put forward. At this stage of the crisis there are very clearly incentives for the debtors as well as the creditors to secure viable debt reducing mechanisms. To this end the theme of "debt reduction" has recently been taken up by the international financial community following the announcement March 10 of the American debt reduction proposal embodied in the Brady Plan.

1) The Brady Initiative:
Startlingly similar to the Miyazawa Plan proposed by the Japanese, the new American Treasury Secretary's scheme for debt relief for the debtor countries has acknowledged the need to reduce the overall levels of external debt faced by the developing countries for the first time (though an upper limit of a 20% overall reduction has been indicated). Though it is too soon to tell, this development, if only in the change in thinking that it represents, could signal the beginning of a fourth phase in the resolution of the crisis. Like the Baker Plan, the new approach stresses economic growth in the highly indebted countries as the key factor for overcoming the burden of debt. The prerequisite IMF structural adjustment programs and the case by case approach to debt renegotiation are also continuing themes in the new plan but in other significant aspects it does propose a change in operating procedure. This refers primarily to the new emphasis being place on voluntary debt reduction by the commercial banks. The main theme of the plan is that banks should be encouraged to reduce their claims for principal and interest in exchange for improved security on their reduced assets. Under the new plan, the creditor banks (which collectively hold US$ 240 bil worth of Latin American debt)[126]

are being urged to reduce their debt portfolios in order to bring about net decreases in repayment obligations for the debtors. To date, efforts have focussed on lengthened repayment horizons, as discussed, but the total amounts due to the banks have continued to grow. In view of the provisionary reserves now held, and the menu of market oriented debt reducing mechanisms available to the banks (discussed in Ch.4), the Brady Plan has stressed increased debt reduction by the banks. To this end it is suggested that the Bretton Woods institutions could provide interest relief, finance for debtors to buy back their bank loans at a discount, and/or guarantee exit bonds issued by the debtor countries to the creditor banks through the redirection of up to 35% of World Bank adjustment lending programmes.[127] As discussed, this would allow banks to exchange their loans at a discount and avoid future involuntary lending associated with rescheduling agreements. Emphasis is also being given to reforms in banking laws, accounting practices and tax disincentives which inhibit banks from undertaking debt reducing measures. "Negative pledge" clauses in rescheduling agreements which have given equal claim to repayment by creditor banks (and forced losses to be shared equally) are also being challenged to allow those banks that are willing, to reduce their assets and involvement with debtor countries.[128] Noises have also been made about increasing outright the levels of lending undertaken by the IMF and World Banks themselves. This aspect of 'the Plan', however, remains the most poorly articulated and would certainly stand to receive the most opposition due to the implicit liability transfer of bad debts and the threat to the World Bank's credit ratings. The use of additional money volunteered by Japan for revitalizing the Latin American economies has also been left unclear due perhaps to that country's new position following its quota increases with the IMF. It is clear, however, that a new and perhaps substantial role for Japan in the international institutions will occur in the future due to the reality of the need for new capital inflows. The need for Japanese finance in the American dominated Bretton Woods institutions will be unlikely to decrease American resistance to increased Japanese involvement in the American geo-economic sphere of influence.

Though the Brady proposal remains hazy on many points it has already come under heavy criticism from several sides. The strongest economic argument made against the plan is that debt reductions would be negated by even small increases in dollar interest rates as roughly US$ 5 bil is added to total debt for every one percent increase.[129] Likewise, a rising US dollar also gives cause for concern as this too will tend to counteract debt forgiveness results. West Germany, the Netherlands and Great Britain have expressed opposition to the plan, arguing that a greater role for the multilateral institutions runs the risk of transferring debt liability from private commercial banks to the public sector, and therefore, OECD taxpayers. The moral hazard argument has also been loudly expressed as under this plan those countries to have most rigidly applied structural reform programs will not necessarily be the main beneficiaries. In fact, those who have 'gotten themselves into the deepest trouble' may stand to gain the most in terms of debt reduction as the banks are most eager to unload the worst loans. From the perspective of the Latin American debtors, it has been argued that perhaps unrealistic expectations of relief have been raised while others have argued that this plan offers too little, too late. Substantial debt reductions would need to be achieved to bring about significant relief. Many countries, including strategically important Mexico, remain opposed to large scale equity swapping and hence there may be built-in limitations to the successful implementation of the plan. The banks themselves which have already de facto undertaken voluntary debt reduction through their participation in the secondary market and have voiced support for the plan though they seem less supportive of renewed large scale lending.[130] Others have argued that they are being used as instruments of US foreign policy, a concern that may apply to the Canadian commercial banks if they too must accept waiver of negative pledge clauses.

As has been the case to date, Mexico will be the trial case when US$ 73 bil of commercial bank debt comes up for negotiation in the early part of the summer.[131] Many questions must be asked about the likely success of such a plan but in common with the Baker Plan, this initiative rests upon a voluntary framework. As in the Baker Plan, commercial banks are being asked for more lending and new money. Like Baker it asks banks and OECD governments to take a loss. The past has shown that these may be overly optimistic aspirations and as the main objective is to lower past exposure levels it would seem unlikely for the banks to be a source of new investment flows to the region in the future. Finally, the significance of this proposal is that implicit recognition has been given to the fact that at least some of the Latin American debt stands no chance of repayment. It may, therefore, be in the banks' best interest to reduce their exposure now through voluntary means, than to continue to play a waiting game and run the increasing risk of defaults. Underlining this are American fears of increased political instability in the region raised following the Venezuelan riots in the spring. Success will depend on mutual agreement between debtors and creditors over commitment to debt reduction and as the Brady Plan is to be finalized at the July 1989 world economic summit, one must just wait and see. To date "the plan that isn't"[132] has already served to raise both expectations and controversy.

Chapter Six: Conclusion.

In view of the complex nature of the debt milieu described here, it is clear that black and white proclamations regarding the blame, injustices and intransigence of the present situation remain unhelpful. Though the region and the debt problems of the component economies have often been discussed en masse here, there are very clearly internal divisions and dynamics within Latin America that would present an even more complicated debt picture than outlined. So too are there large differences among the banks stemming from the country of origin and laws governing the banks as well as the relative size and exposure of the banks involved. What is useful to consolidate here is the position of Canada in this complex debt situation and the short and long term ramifications for economic progress in Latin America stemming from the commercial debt. To do this one can emphasize the four dominant themes illustrated in this discussion.

1) Primarily one must emphasize the need to focus on the longer term to promote economic recovery in Latin America. This applies especially to the rescheduling process and adjustment policies associated with the IMF and the World Bank.

2) There are significant mutual benefits to the banks and debtor countries, especially Canada, in decreasing the overall level of outstanding commercial debt and in promoting economic recovery in Latin America.

3) This emphasis on the longer term and mutual benefits of economic recovery suggests that there must be a shared approach to the search for, and implementation of, viable debt reducing mechanisms.

4) Finally that a more systematic, or one may dare say institutionalized, approach to debt management in a more multilateral and consensual framework may be the best method by which to achieve the goals of debt reduction and economic recovery in Latin America.

Ignoring these broad themes as guiding principles in future debt negotiations may result in unwanted and negative political ramifications in the region which will improve the overall situation for neither debtors nor creditors. A review of some of the main points put forward in this discussion lends support to these arguments and provides the basis for future directions and thinking in terms of debt management in Latin America.

In the initial stages of the crisis, the concentration by banks, debtor countries and the IMF on short term approaches to debt management were helpful in avoiding accelerated and immediate crisis but were not helpful in providing real and workable alternatives to increasing indebtedness and economic decline. This is the most serious criticism of the muddling through process that has characterized much of debt management to date. The commercial banks were able to fend off threats of collapse but short term and involuntary lending did not provide improved repayment prospects for them. Consequently, the willingness of the banks to continue to undertake these measures has sharply declined. Despite large scale import reductions and, in some cases, rigid application of austerity policies, the debtor countries themselves have not experienced real improvements in their domestic economies. They currently face negative economic 'growth' and most seriously, negative investment or capital transfers. Griffith-Jones has argued that all of the largest debtors except Venezuela and Argentina had, by 1986, began paying **net positive transfers** to the international financial system.[133] This raises serious concerns regarding the increased likelihood of default as this situation is prolonged. IMF policies, in many cases, have proven unworkable and have not brought about the results targeted by austerity policy. This has brought the IMF at times into conflict with the World Bank and has forced policy designers and implementors to re-think the appropriateness of short term adjustment.[134] Arguably the growing political opposition to the measures endorsed by the IMF is also a function of fixation on the short term. Not until the second stage of the crisis, with the shift in emphasis to the longer term, have there been movements by debtors, creditors and mediators towards more viable approaches to debt management that provide real prospects for an improved debt situations for the parties involved.

The move to longer term emphasis in rescheduling and adjustment in the second phase of the crisis has been a positive development for the debtor countries, though from the perspective of commercial banking, long term lending appears almost antithetical to commercial interests and is not likely to be voluntarily extended. In this sense one clearly sees the conflict in time horizon due to the short term objectives of banks for profit making and the longer term needs of development assistance and finance. This is one of the reasons why there has been growing emphasis on the need for increased multilateral lending to Latin America by proposals such as the Baker Plan as well as suggestions that commercial assets should be taken over by multilateral institutions as proposed by Rohatyn, Herrhausen and others. Multi year rescheduling arrangements also serve to entrench the wisdom of longer term focus and may serve to relieve some of the debt fatigue of both debtors and creditors associated with seemingly endless rescheduling negotiations. Longer term emphasis in adjustment policies as supported by the World Bank has also been a positive improvement in this vein and may allow the return to emphasis on development and growth. Overall in the recent stage of the debt crisis there has been a general acceptance that the problem is of a longer term, structural nature and as discussed, subsequent approaches to debt management have begun to take this into account. Limiting debt service to growth performance would seem to best reflect this.

There are clear benefits at the macro-economic level to be had in the Latin American economies from overall debt reduction. This relates most crucially to improved credit worthiness and the urgent need for investment flows to the region. Falling real consumption and increases in absolute poverty levels, as mentioned, continue to worsen the conditions of the largest shares of the Latin American populations. This is not to ignore the fact that segments of these same populations which have shared in the rewards of foreign borrowing through the capital flight mechanism. Overall one must recognize though that the debt burden is bringing increasing fiscal, monetary and political problems to these countries as the situation is prolongued.

The costliness of provisionary reserve holdings to the Canadian banks has also been emphasized here and, as such, one can conclude from this discussion that there are mutual benefits to be had from debt reduction by both the debtors and creditors. It is not likely that either the Canadian commercial banks nor the federal government would be in a position to initiate or support any international debt relief mechanisms due to the relatively small size of funds involved and the middle power status of the country. For this reason the Big-6 must look toward the available debt reduction mechanisms at present and must take advantage of those venues open to the creative banker. The secondary market and the exit bond mechanisms have been emphasized here as a reflection of this. As was alluded to in Chapter 4, the commercial banks would be well advised to employ the recently deregulated financial environment to their advantage. This could be done in a variety of ways.

1) The debt for development swap has already come into existence and creates a situation whereby the commercial banks could recycle their outstanding Latin American assets through the official development agencies of Canada. This would require the cooperation of the federal government to facilitate the participation of CIDA (the Canadian International Development Agency) and the Export Development Corporation in the secondary market. By allowing these agencies to buy up the Big-6 commercial bank assets at the secondary market rates one could envision a variety of benefits for the agents involved. These include:

a) The commercial banks could reduce their non performing portfolios and escape the costs of provisionary reserve holdings. Though the loans would be sold at a loss, as discussed banks continue to earn interest on these assets and on top of that earn service fee for the secondary market transactions themselves. Arguably the banks have already conceded that they will never recover the principle on these loans. With balance sheets remodeled the banks could return to the crucial export financing role that they have historically fulfilled in relation to Canadian business interests with Latin American markets.

b) The development agencies could double and even triple their money through the conversion of commercial debts, which sell at much below face value, to Latin American currencies for use in their development activities in these countries. Also the participation by these official agents in the investment conversion schemes offered now by many countries could provide stimulus for renewed growth and demand for Canadian exports.

c) The Canadian federal government could validate their image as debt resolution supporters and strengthen links with Latin America. In an indirect way the government could essentially bail out the banks through the development finance mechanism without contravening those laws which prevent direct transfers to the commercial sectors in crisis. The government at the very least could redirect $2.6 bil of bank taxes into development support activities in the region. In the longer term the government will have increased worries as export markets continue to collapse in the case that no remedial action is taken.

d) The Latin American countries quite clearly would stand to benefit from debt reduction as the credit worthiness of both public and private agents would improve. Securing new financial flows to the region is crucial to support investment activities. If the liability of this debt was transferred to official sources as suggested here, the terms of servicing and renegotiation, based on past experience, would most likely 'soften'. From a purely humanitarian perspective, development activities aimed at improving the conditions of the poorest segments of society and supporting minimum consumption levels would likely be welcomed. This is especially true in countries which are increasingly being driven to rely on the ethos of the competitive market which very often does not have space for the poorest strata.

2) With the diversification of the banking industry, the Big-6 have entered the investment brokerage field. This allows a greater participation in the debt securitization market. Through the debt for equity swap the banks could essentially sell their own assets to their investment wings who could then exchange debt for equity in Latin American enterprises. Again the banks stand to earn transaction fees from this.

3) Debt exit bonds switch repayment to the longer term for the debtor and has the advantage for the banks to allow escape from involuntary lending obligations which are a feature of rescheduling agreements. As the benefits of the exit bond mechanism were elaborated upon at some length in section 5.3, they will not be restated here. From the banks' perspective, balance sheets are maintained in good order and again provisionary reserve requirements can be escaped.

In line with the arguments in support of mutual responsibility for a resolution to the debt crisis it has been suggested that the debtors should be forced only to service the debt at the current market value.[135] Critics of this approach claim that this vein of thought brings with it a moral hazard in that the responsibility associated with international transactions is undermined.[136] It is in fact changing the rules ex post facto and would threaten the whole nature of contractual responsibility upon which international interaction depend. The Cartagena Group argues that a country's debt servicing obligations should only be commensurate with its ability to pay.[137] In this sense as a middle point it would be reasonable to lend further support to the use of the conditionality clause in renegotiated debt arrangements. As was discussed in Chapter 3, adverse exogenous shocks can have extremely severe effects on the developing economy and, in terms of the debt situation, it must be recognized that beyond a certain point it becomes unreasonable to expect a poor country to finance repayment at unsustainable rates. Failure to reach consensus on this type of middle ground will likely push countries to consider default and will surely contribute to the collapse of export markets. The increased use of the conditionality clause by middle level debtors would support the theme of shared debt responsibility stressed here.

The last issue which has been raised is the weakness in the rescheduling procedure applied to the commercial debt. Lack of uniformity in treatment is one of the main points of contention to which the Cartagena Group has voiced its opposition.[138] The Canadian banks also have an interest in distancing themselves from the London Club process for the reasons discussed above. The debtors would stand to benefit from improved negotiating skill but institutional deficiencies in the process remain. First the process allows collective negotiation to be undertaken by the commercial creditors but strictly prevents a collective platform or forum for the debtors. Hence there tends to be large differences in the treatment received by the various creditors. Support is due to proposals to reorganize the debt renegotiation framework such as those that have suggested a multilateral debt restructuring facility. A more multilateral and consensual framework could actually work to reduce the overall level of debt as opposed to the present system which has not been successful in achieving this to date. Recent meetings of the IMF and World Bank in Berlin have continued to lend support to the case by case approach however, suggesting that there is not the degree of political will to move away from the current mechanism. In this sense, things may need to get worse for Latin America before there can be consensus that they must get better, and only a system of shared responsibility and economic cooperation will achieve this end. In the short term maybe the banks could muddle through and be no worse off but, in the longer term, they too will have increasing incentives to decrease the overall size of the debt as the assets become increasingly expensive to maintain.

Appendices

Table 1. Canadian Bank-6 Data

1987	Total loans	Total assets	Special Provision	General Provision	LA and Car as % loans	LA and Car as % assets
Royal Bank	69293.00	102170.00	800.00	2019.00	8.60	5.80
Bank of Montreal	52558.00	84228.00	765.00	2060.00	8.50	5.30
CIB Commerce	63589.00	88375.00	450.00	1275.00	6.50	4.60
Bank of Nova Scotia	48079.00	71430.00	693.00	1174.00	6.80	5.60
Toronto Dominion	40416.00	54525.00	475.00	1032.00	3.60	2.70
National Bank	21782.00	29978.00	298.00	846.00	6.10	4.40
TOTAL	295717.00	430706.00	3481.00	8406.00	6.68 average	4.73 average

Source: Complied from Annual Reports.

Primary Data

Royal Bank of Canada

LA and Car Exposure	1987 mil$	%	1986 mil$	%
Mexico	1479.00	2.20	1525.00	2.30
Brazil	1432.00	2.10	1362.00	2.10
Bahamas	574.00	0.80	511.00	0.80
Venezuela	667.00	1.00	720.00	1.10
Argentina	445.00	0.60	464.00	0.70
Other	1374.00	2.00	1584.00	2.40
TOTAL	5971.00	8.70	6166.00	9.40

Canadian Imperial Bank of Commerce

LA and Car Exposure	1987 mil$	%	1986 mil$	%
Mexico	985.00	1.10	1036.00	1.20
Brazil	1154.00	1.30	1203.00	1.40
Other LA	973.00	1.10	1057.00	1.30
Caribbean	1030.00	1.20	794.00	1.00
TOTAL	4142.00	4.70	4090.00	4.90

Bank of Nova Scotia

LA and Car Exposure	1987 mil$	%	1986 mil$	%
Mexico	838.00	1.30	1188.00	1.90
Brazil	627.00	0.90	921.00	1.50
Other LA	1185.00	1.80	1772.00	2.90
Caribbean	623.00	0.90	683.00	1.10
TOTAL	3273.00	4.90	4564.00	7.40

Toronto Dominion Bank

LA and Car Exposure	1987 mil$	%	1986 mil$	%
Mexico	552.00	1.10	937.00	1.90
Brazil	488.00	0.90	809.00	1.70
Other LA and Car	430.00	0.80	924.00	1.90
TOTAL	1470.00	2.80	2670.00	5.50
			1985 data	

National Bank of Canada

LA and Car Exposure	1987 mil$	%	1986 mil$	%
Brazil	353.00	1.20	525.00	2.00
Mexico	390.00	1.30	588.00	2.20
Argentina	139.00	0.50	187.00	0.70
Venezuela	154.00	0.50	174.00	0.60
Other	267.00	0.90	374.00	1.40
TOTAL	1303.00	4.40	1848.00	6.90

Bank of Montreal

LA and Car Exposure	1987 mil$	%	1986 mil$	%
Brazil	1729.00	2.10	1983.00	2.20
Mexico	1543.00	1.90	1810.00	2.00
Other LA and Car	1199.00	1.50	1609.00	1.80
TOTAL	4471.00	5.50	5402.00	6.00

Footnotes

1. For a discussion of the process of structural adjustment in Latin America linked to the external debt crises see R. Devlin "Economic Restructuring in Latin America in the Face of the Foreign Debt and the External Transfer Problem", CEPAL Review, No.32, August 1987. In this paper economic restructuring and continued large negative resource transfers are put forth as countervailing forces which, without economic relief from centre countries, will lead to increased instability in the Latin American region and heightened likelihood of debt moratoria.

2. This emphasis on insolvency is discussed by J. Dietz in "Debt and Development: The Future of Latin America", Journal of Economic Issues, Vol.20, No.4, 1986, pp.1029-1051. This approach is characteristic of later structuralist critiques of the debt issue and is also of the position adopted by the Cartagena Consensus.

3. R. Dornbusch, "On Muddling Through the Debt Crises", World Development, Vol.7, No.2, 1984, p.145.

4. Ibid. This is the main criticism of the muddling through process put forward by Dornbusch who also emphasizes the medium and long term negative effects of prolonged economic stagnation in Latin America.

5. World Debt Tables 1988/89, World Bank, Vol.2, p.18.

6. Ibid.

7. Op.cit., Vol.1, p.28.

8. By this term it is implied that politically a style of economic management has been adopted, by necessity, which entails decision making based on a type of receivership status of the national economy. Though a commercial bank cannot foreclose on a country as it can on a company, a type of prolonged receivership status can be imposed in an attempt to recoup as much of a bank's commercial assets as possible.

9. ECLAC, External Debt in Latin America, 1985, p.57.

10. Economic and Social Progress in Latin America-1987 Report, Inter-American Development Bank, ch.3, p.33.

11. E. Weisner, "Domestic and External Causes of the Latin American Debt Crises", Finance and Development, March 1985, p.24.

12. World Debt Tables 1987/88, World Bank, Vol.1, p.11.

13. Ibid.

14. This is most clearly emphasized by W. Cline in International Debt and the Stability of the World Economy, 1983 where a growth model is elaborated suggesting that with 3% annual growth in the OECD the debtor countries could successfully be supported in economic recovery.

15. P. Wellons, Passing the Buck: Banks, Governments and Third World Debt, 1987, p.230.

16. For a complete summary of Commercial Bank rescheduling, see World Debt Tables 1987/88, World Bank, Vol.1, Table IV-3, pp.36-42.

17. Though referred to as the London Club in most journalistic and academic work, officially the Commercial Bank Advisory Committee handles the rescheduling of the commercial debts. This 'group' does not have a regular membership such as that of the Paris Club, but is composed of a changing group of bank representatives based on the loan in question and the representation of the particular bank in the loan. Renegotiation of a debt is dependent on the acceptance of an IMF adjustment program by the country in question and normally only principal is rescheduled while arrears are expected to be paid when the restructuring agreement goes into effect. Meetings of the Commercial Bank Advisory Committee do not always take place in London. The rescheduling process and the London Club will be discussed in greater detail in Chapter 5.

18. The Latin American Debt Crises: Causes, Consequences, Prospects, North South Institute, 1985, p.6. Dollar ($) figures are Canadian dollars.

19. M. Pastor in "The Effects of IMF Programs in the Third World: Debate and Evidence from Latin America", World Development, Vol.15, No.2, 1987, p.249 points out that these were in effect an IMF 'seal of approval' which was a prerequisite to capital inflows.

20. W. Cline, op. cit, p.74.

21. This view is also emphasized by W. Cline, op. cit, 1983, pp.31-34, and is explained in terms of the very high gearing ratios of the commercial banks. In his terms loss of even a part of bank capital through debtor default could place "severe strains on the Western economies". This was a dominant theme in the early stages of the crisis.

22. P. Nunnenkamp, The International Debt Crises of the Third World: Causes and Consequences for the World Economy, 1986, Ch.8., pp.113-121 discusses the analogy with the debt situation of the 1930s.

23. G. Helleiner in "Policy Based Program Lending: A Look at the Bank's New Role", Between Two Worlds: The World Bank's Next Decade, (Feinberg ed), 1986, p.47 is highly critical of the IMF demand oriented approach to resolving economic difficulties in the case of problem which as he sees it are external in origin. For this reason he argues that they are often ineffective, bringing about net negative effects due especially to their short term focus.

24. M. Posner in Problems of International Money 1972-85, 1986, explains the concept and discusses the details of the MYRAs extended to Mexico and Venezuela, pp.126-7.

25. The Banker, January 1988, p.80.

26. A. Kaletsky "Debating Debt Default", Third World Affairs 1986, Gauhar ed., 1986. pp.1-3, argues that the reason Western creditors no longer consider the debt crises as a grave problem is exactly because the debtor countries continue to 'play by the rules.' In this way compliance by debtors to repayment and adjustment conditions has allowed the banks to strengthen their

belief in their own security while the objective reasons for considering the situation as a crises have not improved.

27. Primary Overview of the Latin American Economy During 1984, Economic Commission for Latin America and the Caribbean (ECLAC), 1984.

28. W. Cline, op.cit, p.30.

29. M. Posner op.cit., p.114, has also described this as the "contagion effect" of the Mexican default in 1982.

30. IADB, Inter-American Development Bank 1987 Annual Report, 1988, p.128.

31. Beyond Baker: The Maturing Debt Crises, North South Institute, 1987, p.3.

32. H. Lever and C. Huhne, Debt and Danger: the World Financial Crises, 1985, p.33.

33. The document resulting form this conference, the Cartagena Consensus is reproduced in Third World Affairs 1986. Here the specific conclusions and recommendations of the meeting are expressed.

34. H. Lever and C. Huhne, op.cit., p.1 state; " This reverse or negative flow is a perversion of economic sense and sound economics". This is based on the notion that capital from the rich countries should logically flow to the poorer ones where returns to investment are argued to be greater.

35. Economic and Social Progress in Latin America 1987 Report, IADB, p.33.

36. A. Kaletsky, op.cit. p.8, coined this expression by which it is meant that a debtor limits or slows debt service while publicly and officially declaring an intention to honour its debt but on the new terms.

37. Chapter Four will discuss in more detail the proposals of the Baker Plan and will analyze the successes and failures of the initiative to date.

38. World Debt Tables 1988/89, World Bank, Vol.2, p.21.

39. This view is explicitly stated in the Cartagena Consensus as well as the Santo Domingo Declaration also reproduced in Third World Affairs 1986.

40. See Chapter Five for a full discussion of the Brady initiative.

41. For and outline of the details of the Miyazawa Plan see G. Evans, "Japan Takes over the IMF", Euromoney, September 1988, pp.103.

42. M. Posner, op.cit., p.133 though supportive of the case by case approach in the short run, argues that in the longer term it can not be successful as exclusion from international capital markets is prolonged while debt servicing remains high. Similarly R. Dornbusch, Dollars, Debts and Deficits, 1986, p.138 is critical of the 'muddling through' strategy in the longer term due to the recessionary effect associated with negative capital transfers and adjustment.

43. M. Pastor, op.cit., p.259, strongly emphasizes this point arguing that as labour's share of national income decreases as a result of austerity measures, there is increased surplus available to the dominant classes leading to an increasingly class biased situation in which the poorest suffer most.

44. Latin American Economic Report, 29 February, 1988, p.1.

45. P. Kuczynski, "Latin American Debt: Act Two", Foreign Affairs, Vol.62, No.1, 1983, p.26 in an excellent review of the Latin American debt, warns of the threat of increased political turmoil and instability in the region resulting from the debt.

46. The four causal points put forward by W. Cline 1983, op.cit., have remained the cornerstones of virtually all subsequent analysis. These are; 1) the 1973 oil price increases, 2) the recession of 1980-82, 3) the sharp increase in interest rates 4) poor domestic policy in the debtor countries themselves. He also gives emphasis to the psychology of credit markets and sees the causes of the crises as largely external in origin.

47. For a most comprehensive review of the various approaches taken in analysing the debt crisis see the review article by J. Eaton and L. Taylor, "Developing Country Finance and Debt", Journal of Development Economics, No.22, 1986, pp.209-265. Sixteen approaches are discussed broken down into four catagories which include the three presented here as well as a fourth from the perspective of the industrial organization literature.

48. For an excellent detailed discussion of these three factors see Chs.3&4 of H. Lever and C. Huhne, op.cit.

49. O. Emminger, "International Debt Crises and the Banks", Intereconomics, Vol.20, No.3, p.107.

50. H. Lever and C. Huhne, op. cit. p.51.

51. For an excellent detailed discussion on the growth of the Euromarket and its relation to the debt crises see J. Loxley, ch.3 of Debt and Disorder, 1986.

52. E. Weisner, "Domestic and External Causes of the Latin American Debt Crises", Finance and Development, March 1985, p.24.

53. W. Cline, op. cit., p.22, records the average interest rate as -0.8% (LIBOR plus 1%) between 1971-1980.

54. World Bank, World Debt Tables 1987/88, Vol.1, p. 11.

55. G. Biggs, "Legal Aspects of the Latin American Public Debt: Relations with the Commercial Banks", CEPAL Review, No.25, 1985, pp.170-73 gives an excellent review of the development of the Euromarket and the legal regulations which govern it.

56. J. Loxley, op.cit., p.71.

57. The development of international commercial lending practices and mislaid assumptions concerning sovereign risk are discussed in Casino Capitalism, by S. Strange, 1986, Ch.2.

58. P. Wellons, op. cit., p.231, discusses the "fuzzy allocation of risk" associated with general obligation lending especially in relation to syndicated loans. This author sees the financial hysteria in the banking community in 1982 resulting from uncertainty over liability to be one of the causes of the crises itself.

59. See ECLAC, op.cit., 1985, pp.14-16, for a full discussion on state strategy regarding external borrowing.

60. P. Kuczynski, "Latin American Debt", Foreign Affairs, Vol.61, No.2, 1982/3. p.355 sees the massive expansion of the Latin American public sectors as a contributing factor in the development of the debt crises.

61. World Bank, World Debt Tables 1987-88, Vol.2, p.21.

62. E. Weisner, op. cit., p.24.

63. Ibid.

64. A. Krueger, "Origins of the Developing Countries' Debt Crises:1970-1982", Journal of Development Economics, Vol.27, 1987.

65. Quoted in A View From the South: Canadian/ Latin American Links, North South Institute, March 1988, p.8.

66. The Banker, September 1987, p.45.

67. World Bank, World Development Report 1985, p.64.

68. H. Lever and C. Huhne, op. cit. p.50. See Ch.3 for a more detailed discussion of capital flight with special reference to Mexico, Venezuela and Argentina. Dornbusch 1986, op. cit., Ch.4, also discusses this problem and finds it to be the most serious in the case of Argentina.

69. This is echoed by R. Dornbusch op. cit., 1986, p.93 where he argues that while it was the upper and middle classes who were responsible for borrowing funds, the poor now pay the adjustment burden.

70. W. Cline, op. cit. p.24.

71. P. Hartland-Thunberg and C. Ebinger in Banks, Petrodollars and Sovereign Debtors: Blood From a Stone, 1986, pp. 47-50, provide an excellent description of developments in US monetary policy in the 1970-80s which led to the recession.

72. World Bank, World Debt Tables 1987/88, Vol.1, p.15.

73. R. Dornbusch, op.cit., 1984, p.151, demonstrates the severe negative effects to the debtor economy of relatively small increases in real interest rates compared to the contraction of exports.

74. ECLAC, op. cit., 1985, p.10.

75. IADB, Economic and Social Progress in Latin America, 1985, p.5.

76. P. Kuczynski, op.cit., 1982, p.345. This term refers to the very rapid deterioration in ratios employed in indicating credit worthiness. This effect led to the 'cut off' of new credit and, in the author's view, was causal to the debt crises.

77. P. Hartland-Thunberg and C. Ebinger, op. cit., p.4, provide an excellent discussion of the severe negative effects of the second oil price increase, which in their view were greater than those of the first and which contributed to the 1980 recession.

78. The Economist, July 16, 1988, p.57.

79. Dollar ($) figures used throughout this paper will refer to Canadian dollars unless otherwise noted.

80. Summary of Canada's International Trade, Statistics Canada, 1987.

81. A View From the South: Canadian/ Latin American Links, North South Institute, March 1988.

82. Currently (1983-85) Canada absorbs only 2.1% of Latin America's exports according to the IADB, op.cit., 1988, p.117.

83. Collected data from the Annual Reports of the Big-6 banks.

84. Base capital as defined by the Superintendent of Financial Institutions consists of funds which are permanent, subordinate to depositors and creditors. Base capital includes common shares, preferred shares, retained earnings and appropriations for contingencies. Capital ratios relate base capital to a bank's gross assets and give a measure or indication of capital adequacy as required legally by the Superintendent. Capital ratios in excess of 100% to a single creditor are viewed as high risk. Speculation concerning default possibilities of Mexico and/or Brazil raised concerns over the value of post default bank shares.

85. The Mulroney Program and the Third World, North South Institute, 1985, p.6.

86. See K. Lissaker's "Bank Regulation and International Debt", Ch.2 in Uncertain Future: Commercial Banks and the Third World, R. Feinberg and V. Kallab eds. for and explanation of capital ratios and risk spreading by banks. Here it is explained that a cardinal rule of banking is that loan portfolios should be diversified and risks spread among many customers. US banks are subject to a legal lending limit of 15% of assets to capital to any one borrower (p.52). As discussed the existence of the Eurodollar market and the growth of offshore banking allowed commercial banks to ignore these limits and arguably led to the high degree of exposure through imprudence on the part of the bankers. H. Lever and C.Huhne, op.cit., pp.25-28, also discuss the relationship between capital ratios and risk.

87. Ibid.

88. Canadian Imperial Bank of Commerce Annual Report-1987, p.31.

89. Provisioning Against Country Risk, August 17, 1987.

90. The Banker, September 1987, p.31.

91. R. Dornbusch, "On the Consequences of Muddling Through the Debt Crises", The World Economy, Vol.7, No.2, June 1984, p.148.

92. Richard Evans, "Secondary Markets: Anomalous but Profitable", Euromoney supplement, Global Debt, January 1988, pp.26-27.

93. The Banker, October 1987, p.12.

94. P. Nunnenkamp, op.cit., p.144.

95. S. Griffith-Jones, and O. Sunkel, Debt and Development Crises, 1986, Ch.10, p.142.

96. For a comparison of the Paris Club and London Club see The Role of the Paris Club in Managing Debt Problems by A. Rieffel in the series Essays in International Finance, (Princeton University) No.162, December 1985, p.22.

97. M. Posner, op.cit., p.122, in fact points out the dominance of US legal practice employed in the rescheduling process.

98. See. Ch.9 by C. Evans in H. Mehran, External Debt Management, 1985, p.138. This chapter discusses the formalities of London Club reschedulings.

99. ECLAC, op.cit., 1985, p.81. Details of first and second round reschedulings are elaborated here.

100. D. Hojman, "Why the Latin American Countries will Never Form a Debtors' Cartel", KYKLOS, Vol.40, 1987, pp.215.

101. World Debt Tables 1987/88, World Bank, Vol.1, Table IV-3.

102. G. Biggs, op.cit., pp.177-9, gives details of commercial rescheduling conditions.

103. Annual Report 1987, Toronto Dominion Bank, p.28.

104. Jamaica is included in the discussion of the Latin American debt as it is in the same general region, faces similar economic conditions and is a country to which the Canadian banks are exposed. Strictly speaking, however, Jamaica is not part of Latin America but of the Caribbean region.

105. By interest capping it is understood that interest rates applied to debt repayment are not allowed to float above a certain maximum level, thereby insuring a ceiling on interest rates.

106. For a full discussion of these measures see World Debt Tables 1987/88, World Bank, Vol.1, Box 3: "Menus".

107. Ibid, p.30.

108. Martin Schubert in The Banker, February 1987 describes in more detail the debt for equity conversion process on p.19 of his short article "Trading Debt for Equity", pp.18-22.

109. R. Weinert, "Swapping Third World Debt", Foreign Affairs, Vol.65, Winter 1986-87, p.87.

110. See World Bank Debt Tables, 1988-89, Vol.1, p. 23 for a summary of the growth of the volume of commercial debt traded in the secondary market since 1984.

111. The Economist, July 2, 1988, p.68. This figure does include double counting as some debts are sold and resold.

112. Euromoney, special supplement, "Global Debt: the Equity Solution", January 1988, p.56 by Richard Evans.

113. Ibid, p.58.

114. Figures in columns 1 & 2 are taken from Euromoney, special supplement "Global Debt: The Equity Solution", January 1988, pp.26-7, and column 3 from the World Debt Tables 1988/89, Vol.1, p.24, 1988. World bank figures covering the earlier period are in line with those of Euromoney.

115. Annual Report 1987, Bank of Montreal, p.20.

116. Annual Report 1987, Toronto Dominion Bank, p.27.

117. For a full discussion on debt swapping see G. Bird "Debt Swapping in Developing Countries: A Preliminary Overview", The Journal of Development Studies, Vol.24, No.3, April 1988, pp.293-309.

118. The Economist, July 2, 1988, p.67.

119. As mentioned in Chapter 2, fifteen countries were designated to receive assistance through the Baker Plan, ten of which were the most heavily indebted countries in Latin America.

120. For a summary of the Baker Plan as seen by the World Bank refer to the World Debt Tables 1988-89, Vol.1, pp. 18-22.

121. The Banker, "Third World Debt beyond the Baker Plan", September 1987, written by Percy Mistry, a senior financial advisor to the World Bank.

122. R. Weinert, op.cit., p.97.

123. Beyond Baker; The Maturing Debt Crises, North South Institute, May 1987, p.1.

124. Latin American Economic Report, 29 February 1988.

125. See Box 5 in World Debt Tables 1987/88, World Bank, Vol.1, p.18, for details of these and other proposals.

126. See The Economist, March 18, p.110.

127. Financial Times, "IMF moves to ease Third World lending", April 10, 1989, p.1.

128. For details regarding the implications of such a waiver and the various legal mechanisms affecting commercial bank participation in debt reduction see Financial Times, "Bankers balk at call for debt clause waivers", April 6, 1989, p.4.

129. Financial Times, "Brady-bashers toe the line", April 4, 1989, p.7.

130. Financial Times, "Banks' reply to Brady", April 19, 1989, p.22.

131. The Economist, April 8, 1989, p.94.

132. This title was coined during IADB meetings this year in Amsterdam. See the Financial Times, "The plan that isn't", March 22, 1989, p.6.

133. S. Griffith Jones, "Debt Crises Management in the 1980s: Can Lessons be Learnt", EADI Conference paper, Amsterdam 1987. This now appears in 1988 Managing World Debt, yet to arrive at ISS library.

134. See G. Helleiner, op.cit, for a full discussion of the conflict in objectives among the Bretton Woods institutions.

135. F. Stewart in "The International Debt Situation and North-South Relations", World Development, Vol.13, No.2, p.191, stresses this theme of mutual interests or "identity of interests" (p.204) and argues that the level of debt must be kept tolerable to avoid default.

136. W. Cline, op.cit., p.119.

137. J. Loxley, op.cit., p.214.

138. F. Stewart, op.cit., p.200, has also stressed the need for more uniformity arguing that "a generalized solution is needed to extend the benefits to a country in a weak position to bargain individually".

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