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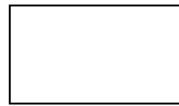
The Cartagena Group: Politicizing the Debt in Latin America



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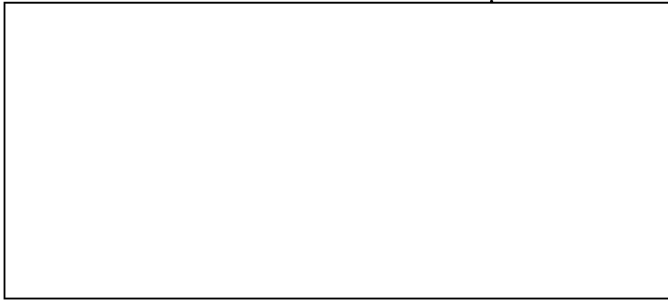

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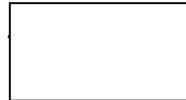
The Cartagena Group: Politicizing the Debt in Latin America



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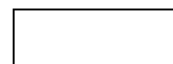


The Cartagena Group: Politicizing the Debt in Latin America

Key Judgments

Information available as of 1 December 1986 was used in this report.

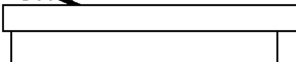
We believe that the Cartagena Group of 11 Latin American debtor countries[1] will work to keep alive the implicit threat of a debtors' cartel, but we expect a host of interacting factors to continue to hinder near-term collusion:

- The economic performances of the member countries almost certainly will continue to diverge, lessening the likelihood that a consensus will form around a single technical solution to the region's debt problems.
- Mexico City's recent success in enlisting US help to reach an innovative accord with the International Monetary Fund (IMF) and its commercial bankers will reconfirm the value of cooperation for other major debtors and will probably spur them to seek individual solutions to their debt problems.
- Regional rivalries, the lack of strong leadership within the group, and fear of the economic impact of alienating international creditors will hamper collective action.
- The Latin Americans have seen that lenders are extending more favorable terms to cooperative governments and inflicting hardship on maverick countries such as Peru.

The key factor inhibiting collective action, in our judgment, is the conviction of Brazil and Mexico—each accounts for more than one-fourth of the Latin debt—that collusion with other Latin American debtors would dilute Brasilia's and Mexico City's bargaining power.

Nevertheless, we believe that members of the Cartagena Group intend to preserve joint action as a weapon of last resort. we judge that the very existence of a debtors' club has strongly influenced debtor-creditor relationships. Since the group's first meeting, sources have reported on creditors' anxiety about pushing the debtors—especially Brazil, Mexico, Argentina, and Venezuela—too hard on financing terms, austerity programs, and economic restructuring for fear of provoking a debtors' rebellion. We note that the

[1] The Cartagena Group consists of Argentina, Bolivia, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Mexico, Peru, Uruguay, and Venezuela. (U)



Cartagena Group's calls for easier repayment terms and growth-oriented adjustment programs have been endorsed by creditors. Most recently, Mexico City's employment of harder line financial tactics—on its own and through the Cartagena Group—helped secure a ground-breaking financial assistance package. Although this new agreement provides incentives to cooperate with creditors for the near term, it also has encouraged some debtors to adopt new positions on ways to resolve debt difficulties. Brazilian Finance Minister Dilson Funaro, for example, told the press in July 1986 that his country needed to cut debt payments to 2.5 percent of GDP in 1987 in order to support a targeted 7-percent growth rate.

Although we judge that the formation of a debtors' cartel has a low probability, we believe that the Cartagena Group will continue to play a major role as a consultative mechanism on the region's debt problem. Mexico is attempting to gain support for a group meeting in early 1987. We believe that the group will use this occasion to continue to lobby creditors to accept a political solution to the region's debt problem. While Cartagena Group communiques almost certainly will continue to contain some unrealistic demands, they will also signal serious concerns. The return of a more hostile external economic environment—marked by increased protectionism, lower commodity prices, and rising interest rates—could again, in the view of group members, make the debt burden unsustainable.

Creditors remain—and probably will continue to be—sensitive to Latin American concerns, even while defending their own financial interests. Nonetheless, the almost constant cycle of debt reschedulings since 1982 has taken its toll, particularly—but not exclusively—on commercial bankers. As a result, creditors, inured to special pleading by the debtors, might ignore clear indications that Latin American countries can no longer bear the debt burden. Should creditors fail to heed these signals, a strong anticreditor reaction could rapidly spread among Cartagena Group members. Working under the aegis of the group, Latin debtors would then be in position to reach a quick political decision to confront creditors with a collective move that could threaten the financial stability of many US banks.

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The Cartagena Group: Politicizing the Debt in Latin America

Introduction

Although calls by Ecuador as early as 1983 for Latin American solidarity in addressing the debt service burden went unheeded, frustration among the debtor nations over their lack of bargaining power with international banks was mounting. By early 1984, political unrest resulting from austerity programs backed by the International Monetary Fund (IMF) prompted Latin governments to consider joint action to secure easier payment terms. Thus, in June 1984 foreign and finance ministers from 11 Latin American debtor countries met in Cartagena, Colombia, and agreed to establish a new forum, the Cartagena Group, to share news on debt issues and to coordinate negotiating positions (see figure 1).[2] Their strongly worded "Consensus of Cartagena" unnerved bankers, according to press reports, as financiers faced the prospect of a militant cartel of debtor states whose collective default or cessation of interest payments could threaten the stability of the international financial system.

Events since the first days of the group have generally dispelled such fears. The group has been dominated by the large, moderate nations and, moreover, has lacked cohesion (see appendix A). As improving world economic conditions and banker concessions have lightened the debt repayment load in the region, the impulse for collusion has weakened. Nevertheless, concern resurged among creditors in early 1986 when the group advocated the position that economic setbacks—in this case the plunge in oil prices—could justify radical actions by individual governments. This development again served notice, albeit briefly, that both Latin American governments and their creditors recognize the group's potential to destabilize international finance. Financial press reports indicate that sensitivity to this threat continues to affect the behavior of both sides.

This paper examines the factors that affect the organizational strength and weaknesses of the Cartagena Group, its ability to rally its membership for joint action, and its performance to date. Looking ahead, this paper assesses the probable role the group will play over the next few years and points to opportunities and pitfalls for international creditors in dealing with the group.

Strength Through Weakness

Despite the Cartagena Group's failure to develop as an organization and to act collectively, the very existence of a debtors' club has strongly influenced the debtor-creditor relationship, in our judgment. Since the group's first meeting, sources have reported on creditors' anxiety about pushing the debtors—particularly Brazil, Mexico, Argentina, and Venezuela—too hard on financing terms, austerity programs, and economic restructuring for fear of provoking a debtors' rebellion. Incidents such as the presence of Mexican officials, who were encountering resistance from lenders in early 1986 to requests for a financial assistance package, at the signing of the Venezuelan debt rescheduling accord in February 1986—just before Cartagena Group meetings began in Uruguay—serve to remind lenders of the potential for joint debtor action (see inset). We believe that the implicit threat of collective default has helped members obtain better repayment terms—such as lower interest spreads, reduced fees, and longer maturities—than they otherwise could have secured. We also note that the Cartagena Group's calls for growth-oriented IMF programs, multiyear

[2] The Cartagena Group consists of Argentina, Bolivia, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Mexico, Peru, Uruguay, and Venezuela. Although other Latin American organizations, such as the Latin American Economic System, discuss the debt problem, the Cartagena Group is the only regional body dedicated solely to finding a way to ease the debt burden.

The Cartagena Group's Declarations

The Cartagena Group's first statement, issued at the end of the founding meeting in June 1984, was generally moderate in tone but exposed clear disagreements with the US approach to resolving Latin America's debt difficulties. The ministers, for example, called for limiting total debt service to a "reasonable" share of export earnings and asked for interest capitalization where convenient for the debtor. In addition, they called for longer repayment and grace periods based on the debtor country's ability to repay, increased official and commercial lending to the debtors, immediate and drastic cuts in interest rates, and priority given to growth and employment creation in International Monetary Fund (IMF) programs.

The September 1984 followup meeting in Mar del Plata, Argentina, resulted in a moderately worded, 10-point communique expressing concern over the loss of the "sense of urgency" by the creditor countries. The committee also indicated that the group would invite the developed country governments to engage in direct talks in the first half of 1985.

The Cartagena Group met in Santo Domingo in February 1985 to prepare a joint position for the April 1985 meetings of the IMF/World Bank Interim and Development Committees. Issues addressed included extension of multiyear rescheduling agreements similar to the 1984 Mexican Accord to other countries, broadening debt negotiations to include creditor governments and international institutions, and hardships caused by stringent austerity programs and uncontrollable events in the world economy. The group also repeated its desire for a dialogue between debtor and creditor governments and warned of regional instability if the request were ignored.

The ministers next met in December 1985 in Montevideo, Uruguay, to respond to the Baker Initiative. The group issued counterproposals, identifying high real interest rates and falling commodity prices as the major obstacles to solving the debt problem. The group called for increased private and official lending, Paris Club debt reschedulings without IMF programs, and easier conditions in IMF programs.

Meeting in Punta del Este, Uruguay, in February 1986, the followup committee for the first time supported efforts to modify existing debt agreements, especially by renegotiating interest rates. The committee concluded that "the point has been reached at which significant modifications in existing agreements can no longer be delayed, particularly with regard to interest rates, in order that creditors and debtors share more equitably the burden of adjustment." The communique noted that high interest rates at a time of falling commodity prices made it necessary for some countries to take dramatic actions "in defense of their economies."

rescheduling agreements, and increased lending by multilateral banks have been endorsed by creditors.

Moderation Begets Accommodation

A host of interacting factors has served to keep the threat of debtor revolt dormant. Our review of events convinces us that divisions within the Cartagena Group—exploited with considerable success by the creditors—contributed to a diminishing of cartel fever as each government pondered its distinctive needs and interests (see appendix A). New formulas for dealing with the debt problem, generated largely by the Latin Americans, and creditors' responsiveness to these solutions also blunted moves toward radical action. Politicization of the issues, aided by close media attention to and dramatization of disaster scenarios, also kept both sides acutely conscious of the dangers of rigidity during negotiations.

the largest debtor nations—particularly Brazil, Venezuela, and Mexico, the group's most influential members, in our view—regularly weighed in on the side of moderation in Cartagena Group meetings from 1984 to late 1985. In some cases, these countries saw no benefit in particular formulations advocated by other members. Brazilians and Venezuelans, for example, judged as infeasible a complicated Argentine interest relending and capitalization scheme in late 1985 and offered no support for the proposal in group meetings. In other instances, financial self-interest shaped the positions of group members. For example, the Brazilian delegation at the group's Punta del Este meeting last February (Brazil was then trying to convince its creditors to reschedule its debts without an IMF program) insisted on weakening a recommendation that debt service be tied to export revenue.

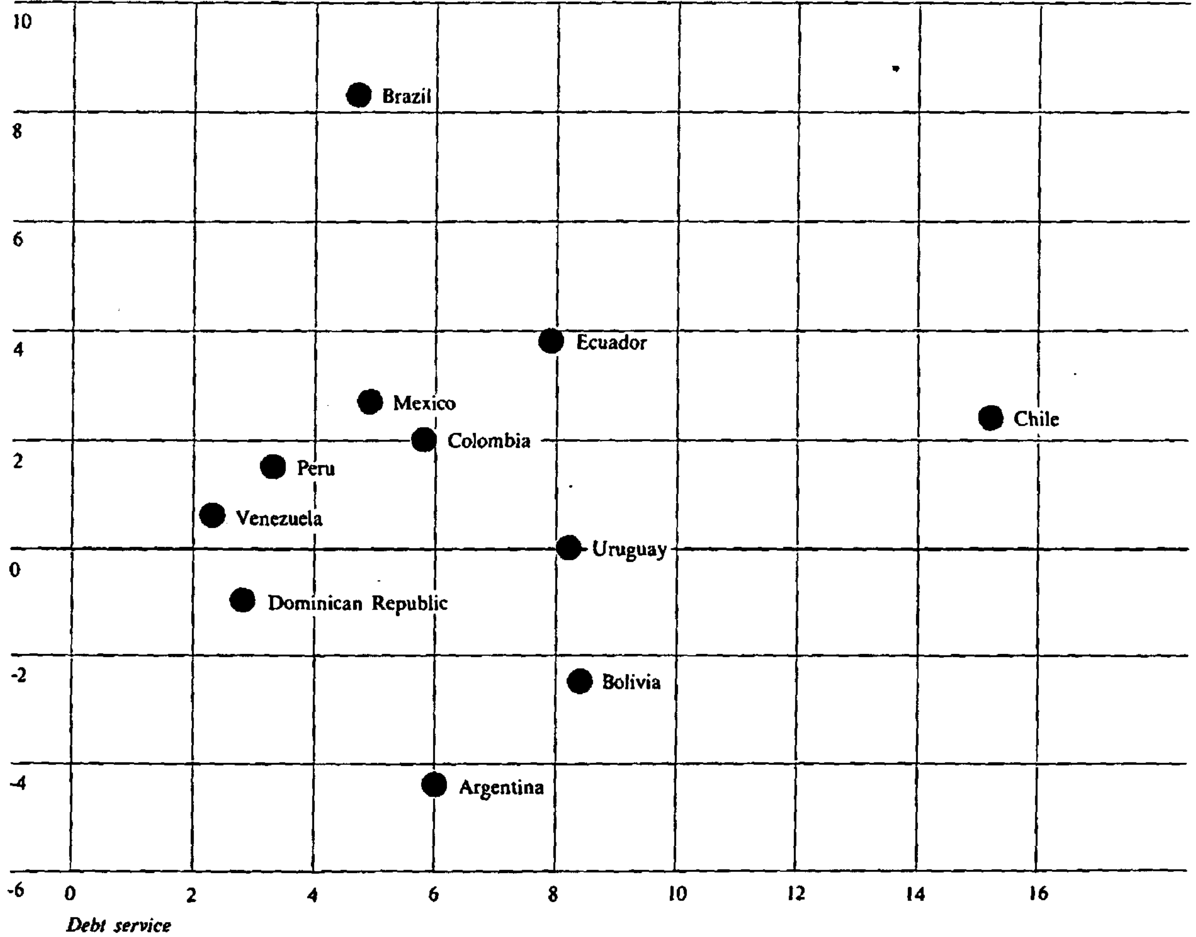
Table 1
Cartagena Group: Total Debt Service as a Share of Exports of Goods and Services
Percent

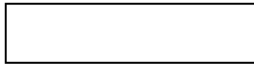
	1980	1981	1982	1983	1984	1985
Argentina	48	60	75	51	58	39
Bolivia	35	38	40	45	55	49
Brazil	64	70	84	51	43	44
Chile	44	70	73	57	62	56
Colombia	17	28	32	29	33	34
Dominican Republic	26	26	35	32	18	26
Ecuador	21	43	51	27	38	36
Mexico	48	54	59	50	54	44
Peru	41	62	53	37	33	23
Uruguay	18	18	35	27	37	40
Venezuela	26	25	32	28	26	30

For their part, bankers have worked to give clear signals that moderation pays and rebellion does not. Latin American governments have seen that lenders are extending more favorable terms to countries following adjustment programs. Mexico, praised for its cooperation, was granted the first multiyear rescheduling agreement in late 1984, with as much as a 1-percentage-point reduction in its spread over the London Interbank Offer Rate (LIBOR). This treatment has motivated Mexico City to stick to moderate stances in Cartagena Group sessions. Similarly, Ecuador's free-market-oriented President Leon Febres-Cordero negotiated a multiyear rescheduling in 1985 as well as a new bank loan of $220 million in 1986; Ecuador's success has led its delegates to argue forcefully within the group in support of adjustment programs instead of collective action. Peru, on the other hand, is receiving very different treatment because of its failure to meet all but a small part of its debt service obligations. Its unilateral debt service ceiling caused bankers in 1985 to cut access to long-term loans. Peru increasingly is being forced to accept higher fees and shorter repayment periods on trade financing, and many bankers refuse to honor its letters of credit because of growing concern that Lima might set unilateral limits on repayment of its short-term debt. Similarly, the immediate suspension of Venezuelan trade credits in July 1986 forced Caracas to modify its unilateral rescheduling of foreign loans to the private sector.

Sentiment favoring radical collective action has also been undercut by an improving economic environment that has made debt servicing less onerous. World interest rates, as measured by LIBOR, are about 5 percentage points lower than in 1984, reducing annual debt service by an estimated $12.5 billion for the region (see table 1). Strong economic growth in the United States has helped increase Latin American exports; the region's exports have grown an average 7.3 percent a year since the start of the debt crisis in 1982, with most of the rise linked to greater US import demand. Taken together, these developments have bolstered the payments positions of most group members while sparking domestic economic recovery, thereby fostering a spirit of accommodation (see figure 2). Brazil in particular probably will enjoy as

Figure 2
Cartagena Group: GDP Growth and Debt Service as a Share of GDP, 1985





Oil Prices Divide Debtors

The collapse in world oil prices this year has caused the economic performances of the Cartagena Group countries to diverge, precluding cooperation to find a single technical solution to the region's debt problems. According to various sources, cheaper oil has lessened inflation and spurred growth in Bolivia, Brazil, Chile, the Dominican Republic, and Uruguay, contributing to a spirit of cooperation with creditors. Argentina, Colombia, and Peru—self-sufficient or minor exporters—were only slightly affected by oil price declines, allowing each country to remain preoccupied with its own financial situation. Ecuador, Mexico, and Venezuela were seriously hurt by the plunge in oil prices, but these countries were unable to rally around a common approach. Ecuador, for example, continued implementing market-oriented reforms, in part to retain creditor good will. Although various sources rumored that Mexico and Venezuela made efforts to coordinate debt strategy earlier this year, conflicting financial imperatives apparently drove a wedge between these debtors. Venezuela, bolstered by a strong international reserve position, moved unilaterally to reduce its debt repayments but was rebuffed sharply by bankers. Mexico's dire financial straits ultimately caused the government to reach agreement with its creditors, but the negotiations were more contentious and confrontational than in the past.

much as 7-percent GNP growth and a $11.5 billion trade surplus in 1986; lower oil prices and interest rates meant that it needed no new funds this year. Consequently, Brazil's top priority was to reschedule its commercial debt without an IMF agreement. On the strength of its image with creditors, Brasilia was able to conclude such an agreement, giving it little incentive to press for radical action through the Cartagena Group (see inset).

Confrontation Still a Threat

Although sentiment among group members for confrontational approaches to resolving debt difficulties has waned, the threat can still strike a responsive chord among creditors and debtors. Unlike its performance in 1984 and 1985, Mexico used both carrots and sticks to garner financial assistance this year. Its willingness to accept IMF-backed adjustment programs and its cooperative approach in direct talks with its bankers have led to a tentative agreement for some $12 billion in new credits for 1986-87, contingency loans of more than $2 billion linked to economic performance, and rescheduling of more than $52 billion in debt over 20 years including a seven-year grace period. Mexico City's agreement with the IMF, however, obscures the fact that the government has also resorted to a harder line on its own and through the Cartagena Group since December 1985 (see inset). In our view, this combination of tactics helped it secure a favorable financial assistance package.

In our opinion, Mexico City's harder line on debt has already had some impact on other Cartagena Group countries. For example, Argentina, Venezuela, and Chile put their financial negotiations on hold in order to benefit from concessions obtained by the Mexicans. In October the ministerial conference of the Latin American Economic System, of which Mexico is a member, agreed in Lima to adopt a tougher stance on the debt. It recommended:

- A limit on debt repayments based on a country's ability to pay.
- The end of protectionist measures.
- An end to coercive economic measures by creditors, such as freezing funds or loan suspension.
- More credits from lenders at concessional rates.

Finally, Mexico is trying to line up support for a Latin American presidents' meeting on debt in early 1987, even though Brazil already has declined because it feels that such a meeting could sour the current spirit of international financial cooperation.

Mexico's Tougher Tactics

- *In Montevideo in December 1985, Mexico signed the Cartagena Group declaration that said debt service had to be linked to a country's capacity to pay. The declaration added that the group could seek to match improvement in debt terms obtained by any single country in bilateral negotiations with its creditors.*

- *Subsequently, President de la Madrid reiterated in his 21 February speech to the nation that Mexico's debt service has to be linked to its capacity to pay. Moreover, he warned that protectionist barriers in developed countries had to be lowered in order to help debtors improve their trade balances to meet interest payments.*

- [redacted] *the resignation of Finance Minister Silva Herzog in June was perceived by creditors as another signal that the President was serious in his intent not to lower Mexico's already low standard of living just to satisfy creditors' demands.*

- *Numerous calls for substantial concessions from creditors were issued in early 1986. At times, according to financial press reports, they were accompanied by threats to suspend interest payments. These tactics, however, were muted in July, as Mexico City was bringing to fruition negotiations with the International Monetary Fund.*

- *President de la Madrid reiterated during his speech at the UN General Assembly in September that there was a need for mutually acceptable "global solutions" in the areas of energy, trade, productivity, financing, and debt. He also called for restructuring the debt load as well as new credits and lower interest rates.* [redacted]

Keeping the Lid on Collective Action

In our view, maintaining the prevailing spirit of accommodation will require close monitoring of the economic circumstances and atmospherics surrounding Latin calls for debt meetings and summits. While present conditions make a debtors' revolt an unappealing option for most Latin American governments, all members of the Cartagena Group continue to consider the threat of collective action their ultimate weapon, [redacted]

Several possible developments could quickly provoke a downturn in debtor-creditor relations. We believe that Latin American governments are watching three key areas in which changes could alter their calculations about the costs and benefits of moving to more radical positions:

- *Export earnings.* Prices for Latin American exports, the degree of protectionism among trading partners, and economic growth in the key Organization for Economic Cooperation and Development (OECD) countries are prime factors that would weigh in debtors' decisionmaking.

- *Financial trends.* Latin governments would look at the level of interest rates, the willingness of international creditors to provide new money and easier terms on loans, and lenders' attitudes toward austerity programs versus growth-oriented solutions.

- *Political support.* Latin American government leaders would be more likely to adopt radical debt policies if they thought that their political base—either in the legislatures or among the public—was eroding. [redacted]

Stimuli to Debtor Collusion

Long-term export setbacks caused by events beyond the control of Latin American governments, in our opinion, carry the greatest potential for pushing the debtors toward collective action. If Latin leaders believe that enduring changes in the market for their exports have occurred that will harm their ability to earn the income needed to service the debt, they would be more likely to reexamine their debt policies and to exert the effort required to overcome obstacles to unity. For example, when the plunge in oil prices in

early 1986 severely weakened the financial position of the region's petroleum exporters, Venezuela and Mexico shifted from their previous conciliatory approaches and convoked a special Cartagena Group meeting to consider limits on debt service payments. The meeting resulted in the group's giving notice to creditors—for the first time—that it would support members' actions to modify agreements when economic conditions warranted.

According to Latin officials who addressed a recent *Euromoney* conference, their governments in particular fear:

- A recession in the developed economies.
- An increase in developed country protectionism.
- Lower world market prices for Latin commodity exports.

Almost all the group's members—including Brazil, the debtor with the region's strongest economy—would be hard hit by any of these developments (see appendix B). Without financing to offset the impact, the group probably would be motivated once again to join forces. Mexico, however, would be insulated from these developments by its new agreement with the IMF, and would be unlikely to ally with the others unless its debt package fell apart.

Latin America's inability to obtain affordable financing would be another key ingredient affecting debtor cohesion. For example, rising interest rates, which led to the first group meeting in 1984, could again galvanize the Cartagena Group—particularly if members could not obtain repayment concessions to sustain growth. The appeal of collusion on debt policies would be enhanced if the economic philosophies of creditors diverge further. For example, regional bankers are becoming less willing to accommodate Latin debtors. As one banker declared at an international meeting in October 1986, regional banks see "no reason why they should be compelled to put up fresh money simply to bail out Latin debtors or money center banks with large loan exposures and inadequate loan loss provisions." Without regional banks sharing the burden of debt relief, money center banks would be hard pressed to meet demands by individual group members and might balk at further concessions, thereby triggering Latin moves toward collective action (see inset).

Even if external shocks are avoided, international media speculation about changes in the rules of the game—particularly when debt negotiations break new ground—could influence the lender-creditor dialogue. One widely read journal reported in October 1986 that despite the debtors' inclination to behave responsibly, rising public frustration with four years of economic stagnation was prompting Latin American leaders to recognize an urgent need for new debt approaches to continue economic growth (see figure 3). We believe the media's coverage of Latin American needs—particularly sympathetic analyses—encourage the region's leaders to probe for creative propositions. Indeed, Latin leaders are already outlining the types of new accord they will be seeking. Argentine President Raul Alfonsin, for example, told the press that Buenos Aires will request a sizable reduction in interest payments from its creditors because of the price-depressing effect of US-subsidized wheat sales to the Soviet Union.

In his state-of-the-nation address in August, Ecuadorean President Febres-Cordero said that Quito would seek more favorable terms on its foreign debt if oil prices did not rebound soon. In late July, Brazil's Finance Minister Funaro told the press that Brazil needed to cut its net debt payments to 2.5 percent of GDP next year to support a planned 7-percent growth rate.

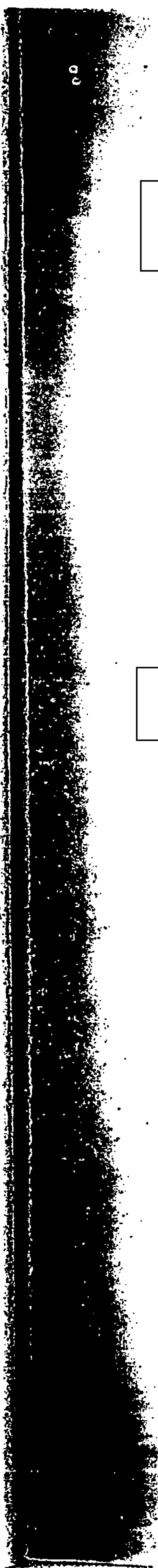
Another trigger for debtor revolt would be miscalculation in financial circles of the true level of—and tolerance for—economic pain in Latin American societies. The persistence of Cartagena Group members in seeking special favor might harden creditors against such pleas, thus preventing them from taking seriously clear warnings—perhaps issued in the form of communiques by the group—that the debt burden had become unsustainable. If Latin governments believe that the developed countries are ignoring their plight, support within the Cartagena Group for collective action could rapidly coalesce, in our judgment. A

Cartagena Group: Current Status of Individual Debt Negotiations

Argentina	Buenos Aires has started negotiations with the International Monetary Fund (IMF) for a new standby agreement. It also is requesting new money and a multiyear rescheduling of its debt.
Bolivia	After reaching an agreement with the IMF in June 1986, La Paz reached agreement with the Paris Club in July on the guidelines for rescheduling its debt to foreign governments.
Brazil	Brasilia recently completed the rescheduling of its 1985 commercial debt and rollover of 1986 debt without IMF involvement. Large arrearages and the lack of a Fund program, however, continue to prevent the Paris Club from rescheduling official credits. Brazil is expected to start talks for a new multiyear rescheduling of bank debt by early 1987.
Chile	The Pinochet government continues to be a model debtor, fully complying with its IMF program. [ ] Santiago is also working with its creditors on expediting debt-to-equity swaps, and its net foreign debt has declined by $800 million. Santiago has already begun talks for new loans from commercial banks.
Colombia	The two-year economic program that the IMF monitors is progressing smoothly; the Barco administration has drawn down $639 million of Colombia's $1 billion commercial loan—the so-called jumbo loan.
Dominican Republic	Ratification of Santo Domingo's Paris Club accord—a prerequisite for opening talks with the bank advisory committee—is stalled in the Chamber of Deputies.
Ecuador	Having cooperated fully with international creditors, President Febres-Cordero's government in July 1986 negotiated a new standby agreement with the IMF and successfully floated a $220 million commercial loan to compensate for the oil price drop.
Mexico	Mexico City reached agreement with the IMF for a standby facility in July 1986 and its bank advisory committee in September for rescheduling and obtaining new money.
Peru	President Garcia announced on 28 July 1986 that he was extending the unilateral ceiling—10 percent of exports—on public-sector debt service. He suspended payment on loans owed by the private sector for two years. He also indicated that Peru would make payments on its foreign debt only up to the amount of new money coming into the country. Peru made only a partial payment on its arrears to the IMF on 15 August, and the Fund declared Lima ineligible for new loans.
Uruguay	Both moderate in rhetoric and in compliance with its IMF program, President Sanguinetti's government in July rescheduled $1.7 billion in commercial loans out of its $4.9 billion total debt.
Venezuela	Caracas invoked a contingency clause in the public-sector rescheduling accord it reached with bankers in February 1986 before the agreement went into effect. The Congress passed a law in July unilaterally transforming short- and medium-term foreign loans to the private sector into 15-year, 5-percent bonds, which caused a furor among bankers. The government rescinded the law and is looking for other ways to relieve the private-sector debt burden.

move toward nonpayment on debt would catch many money center banks—despite recent maneuvers to lower their exposure—with Latin American loans still exceeding capital. US banks, holding 40 percent of the loans to Latin America, would be especially vulnerable. [ ]

The way Latin American governments react to changes in either the political or economic landscape, however, will not be easy to predict. The region's leaders typically will be responding to complex domestic forces, such as public mood, political exigencies, and the strength of their opposition (see figure 4). Their domestic policies are also influenced by changes in international opinion regarding debt issues, perceptions of fairness of treatment by financiers, and international spillovers of actions taken by individual



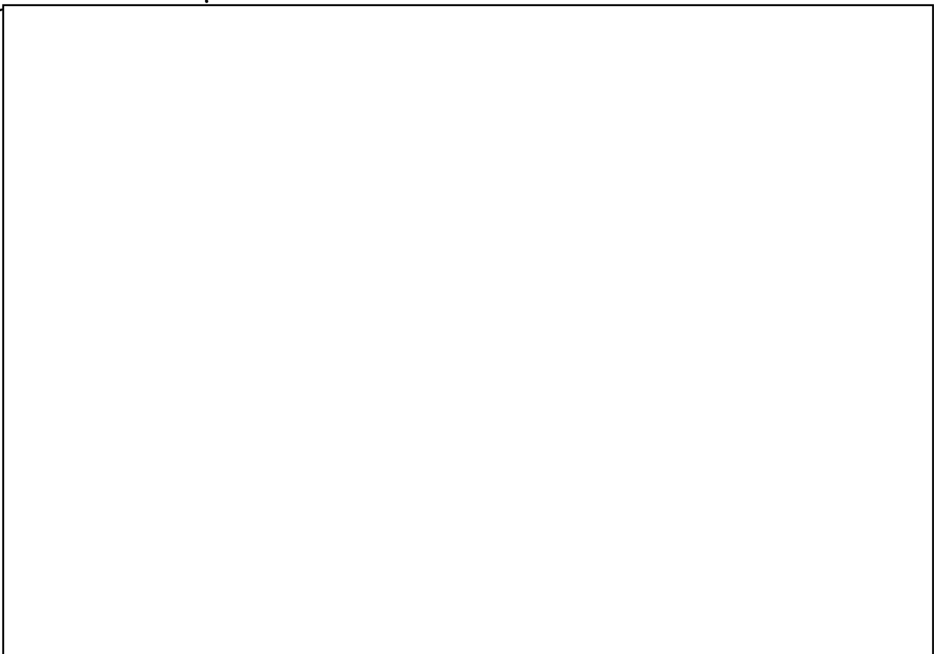


Table 2
Cartagena Group: Current Account Balances •

Billion US $

	1984	1985	1986	1987	1988	1989
Argentina	−2.5	−1.1	−1.8	−1.6	−1.7	−2.0
Brazil	NEGL	NEGL	−0.5	0.4	0.8	−0.5
Chile	−2.1	−1.3	−1.1	−0.9	−0.7	−0.8
Colombia	−1.2	−1.3	0.4	−1.2	−1.5	−1.8
Ecuador	−0.2	−0.2	−0.8	−0.3	−0.2	−0.2
Mexico	4.0	0.5	−2.6	−3.2	−4.2	−2.8
Peru	−0.3	−0.1	−0.5	−1.1	−0.8	−0.6
Uruguay	−0.1	−0.2	0.1	NEGL	NEGL	NEGL
Venezuela	4.5	3.1	−0.9	NEGL	NEGL	−0.1

nations. Thus far, Latin presidents remain willing to honor external obligations, but it has become clear that the debtor countries are constantly seeking new linkages in their efforts to lighten the debt burden. In their efforts to influence the industrialized nations, debtors have argued for "coresponsibility" for easing external restraints to renewed economic growth. At other times, the debtors have tried to exploit US interest in fostering democracy in the region, citing the threat to civilian rule from the parlous condition of Latin American economies.

Outlook and Implications

In our judgment, while all members of the Cartagena Group intend to preserve rebellion as a weapon of last resort, their diverse financial situations and their own sense of independence will probably lead Latin governments to continue individual negotiations with creditors:

- The economic performance of Latin American countries almost certainly will continue to diverge, making unity on action against creditors difficult to achieve (see table 2). According to several econometric forecasting services, Brazil and Colombia will continue to register significantly higher GNP growth than other Cartagena Group members, while the major oil exporters such as Mexico and Venezuela will manage only modest recoveries. Most group members will thus remain preoccupied with their domestic economic priorities.

- Mexico's success in securing US help in reaching an innovative, growth-oriented IMF agreement almost certainly will give hope to other debtors that creditors will remain flexible and responsive to providing future financial assistance.

- The lack of strong leadership within the group and fear of the cost of creditor retaliation will continue to inhibit the group's vitality.

- Creditor governments and banks probably will continue the case-by-case approach, which exploits diversity within the group, and will try to make well-timed concessions to key debtors to forestall collective action.

We believe that in the near term Latin American debt repayments will remain manageable, thereby reducing a major incentive for retaliatory moves. Prices for most Latin commodity exports seem to have reached their floor, although they are likely to recover at uneven rates. Recent cuts in the US Federal Reserve discount rate and continued low inflation in the OECD augur further declines in interest rates and Latin debt payments. Should stronger growth in Western Europe and Japan take hold and the dollar continue depreciating—most Latin American currencies are linked to the dollar—Latin exporters should improve price competitiveness and increase sales in these markets in the future.

Under these circumstances, we believe that the Cartagena Group's major function will be to provide a forum for member governments to discuss strategies for dealing with international bankers and creditor governments—on an individual basis, not collectively. We also expect that the Cartagena Group will periodically issue communiques to exert political pressure on

creditors to grant concessions on financing. Moreover, proposals in the group's communiques will still provide guidelines for the member governments to use in their individual negotiations. Although none of the member governments probably expects to receive all the concessions that the group's declarations call for, we believe the members will continue to see advantage in keeping alive the implied threat of collective action.

Opportunities and Pitfalls

Creditor governments, in our opinion, will continue to enjoy opportunities to keep the Cartagena Group from moving toward collusion. Tactically, achieving this goal will require creditors to keep the door open for dialogue with individual member governments. We believe that any sign of willingness to deal with the group as a legitimate regional organization would only encourage the idea that creditors accept the principle of a debtors' cartel.

We believe the key to blocking collective action by Latin debtors is the ability of Latin America's creditors to convince Brasilia and Mexico City that joint negotiations would dilute their superior bargaining power, lessening their chances for favored status. Without either of the two largest Latin debtors on board, any attempt at reaching a common debt strategy would be unlikely to gain the full participation of other group members necessary to threaten the solvency of international banks:

- The Brazilians are consistently pragmatic in dealing with issues affecting their national interests, and they are proud that their economy is stronger than any other in Latin America; a sympathetic hearing by creditors for Brazil's efforts to find growth-oriented answers to its debt problems would reinforce the government's propensity to seek accommodation. We also believe that Brazil—as a creditor of other debt-troubled countries in Latin America and Africa—is mindful of the potentially adverse effects of a debtor cartel on its own position.
- Mexico, on the other hand, probably wants to protect what it perceives as its unique relationship with the United States—a major advantage over other debtors. The preference of Mexico for being treated as a special case is underscored by its longtime resistance to joining such organizations as the Organization of Petroleum Exporting Countries and the General Agreement on Tariffs and Trade. We believe that Mexican policymakers would align the country's fate with that of other debtors only if relations with the United States suffered a major setback.

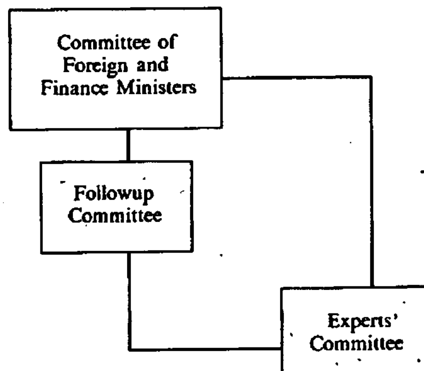
We believe, nevertheless, that the Latin American sense of victimization by the industrialized nations runs deep and that the debt issue can readily evoke an emotional political response. To preserve the present dialogue, creditors will need to remain sensitive to Latin American government interpretations of how new financial developments help or harm prospects for economic recovery and political stability. In our judgment, a miscalculation by the creditors could quickly galvanize the Latin American governments into a unified position.

Appendix A

Organization of the Cartagena Group

Despite the Cartagena Group's efforts to project the image of a strong, cohesive body, our examination of its structure reveals a loose, ad hoc organization. The power of the secretary general, currently Uruguayan Foreign Minister Enrique Iglesias (see inset), is limited to chairing ministerial meetings. The group has no permanent officers, staff, or headquarters. Instead of maintaining a regular meeting schedule, Iglesias canvasses members of the group periodically to determine their interest in convening; their mixed responses have often resulted in long periods between meetings. This approach also means that the activity and emotion generated at meetings are not sustained after adjournment.

Figure 5
Organization of the Cartagena Group



At the plenary sessions, member governments submit papers for discussion by the group's three committees (see figure 5):

- The committee of foreign and finance ministers of all 11 member countries, which sets policy for the group.

- The followup committee—made up of the foreign and finance ministers from Argentina, Brazil, Colombia, Mexico, and Venezuela—which monitors progress toward achieving the group's goals. Iglesias attends in his role as secretary general.

- The experts' committee, staffed by specialists on rotation from member countries, which drafts communiques for ministerial review.

The group's major debtors dominate decisionmaking, and they have repeatedly scuttled proposals by smaller countries, such as Peru, for group-sponsored negotiations with creditors.

Appendix B

Impact of a Developed Country Recession on Latin America

Economic forecasters are optimistic about the continuation of the current recovery among developed countries but are backing away from the projections for strong short-term growth that they made on the heels of the sharp drop in oil prices earlier this year. They believe their earlier forecasts were too optimistic about the effect of lower oil prices and the ability of developed countries to rectify the imbalances lurking behind the scenes of the recovery. Slow growth in the United States during the second quarter raised questions about the health of the current economic expansion. Most forecasters, nevertheless, believe that the factors hindering growth are temporary and that developed countries will enjoy an upturn in 1987. As a result, growth in the Organization of Economic Cooperation and Development (OECD) countries now is expected by most forecasters to weaken in 1986 to 2.6 percent—from 2.7 percent in 1985—and then rebound in 1987 to about 3 percent.

A series of simulations using CIA's Linked Policy Impact Model (LPIM) indicates that a recession in the developed countries would have a dramatic negative impact on the Latin American debt situation. The immediate impact would be a severe cutback in demand for Latin American exports. Dwindling export earnings, in turn, would damage the ability of Latin American countries to service their debt. Latin American countries would not suffer equally during the slowdown because of the pivotal role of oil. Nonetheless, a fall in oil prices, on balance, would aggravate the Latin debt crisis. Although interest rates would decline, our simulations show that reduced export earnings would overwhelm the benefits of lower interest payments.

To access the impact of a developed country slowdown on Latin American debtors, we first estimated the impact of the current outlook for developed countries (see table B-1) on the debt situation—the baseline case—and then ran two recession scenarios on our LPIM. Oil prices in the baseline are assumed to remain at $15 a barrel. In the baseline simulation, the aggregate Latin American current account would deteriorate in 1986 as exports fall more than imports but would recover in 1987 and 1988. Latin American countries would require $4 billion in new lending in both 1987 and 1988. The total debt figures drawn from our simulations represent the minimum total requirements of Latin debtors to cover current account deficits. Capital flight as well as a decision to build up reserves would make borrowing needs greater. We also assume a two-year grace period for repayment of principal and a 12-year principal repayment period on new loans, so that the debt service ratio (interest and principal payments divided by exports) would gradually decline in the baseline, since principal payments on the new debt would begin falling due in 1989.

The two recession scenarios assume a decline in interest rates. For debtor countries, lower interest rates would partially offset the negative impact of the downturn in export demand by reducing the servicing burden on the floating rate portion of their debt. The situation would worsen more quickly if tighter monetary policies in the developed countries triggered the recession, causing interest rates to rise. The scenarios assume that political contraints would keep Latin American governments from reducing import volumes by implementing contractionary policies as they have in the past.

Scenario 1

Scenario 1 assumes OECD growth rates 3 percentage points below the baseline during 1987 and 1988, with oil prices steady at $15 a barrel (see table B-2). The resulting lower demand for Latin exports, assuming imports hold steady, would cause the overall Latin American current account deficit to worsen in 1988. Latin American exports of nonfuel goods and services

Table B-1
Latin America: Baseline Forecast

	1985	1986	1987	1988
	Billion US $			
Current account balance	−4.2	−9.0	−5.7	−3.7
Trade balance	24.0	17.5	18.8	19.4
Exports (f.o.b.)	102.0	94.8	99.9	105.3
Imports (c.i.f.)	78.0	77.2	81.0	85.9
Exports of services	32.0	34.2	36.1	38.6
Imports of services	68.0	65.3	64.6	65.2
Oil trade balance	23.6	15.0	13.1	12.3
Exports of nonfuel goods and services to the OECD	110.9	105.6	111.4	117.8
Total debt [a]	393.9	402.9	408.6	412.3
Total interest payments	32.7	28.2	26.5	25.8
Debt service ratio	34.3	32.5	29.8	27.9
	US $ per barrel			
Oil prices	27.0	15.0	15.0	15.0
	Percent			
Latin American real GDP growth	3.8	1.6	3.5	2.6
OECD real GDP growth	2.7	2.6	3.0	3.2
London Interbank Offer Rate	8.2	6.5	6.0	6.0

[a] Implied total gross debt. Calculations for gross debt are based on estimated current account balances; capital flight would increase financing requirements.

to OECD countries would fall by about $7 billion in 1987 and $16 billion in 1988 compared to the baseline because of a drop in volume and export prices. The weaker export performance would easily outweigh the favorable effects of the accompanying 1- to 2-percentage-point drop in interest rates. Under this scenario, Latin debtors would need an additional $3 billion in 1987 and $7 billion in 1988 on top of the $4-6 billion that they would need in the baseline simulation. Lower interest rates and the rescheduling of old debt would allow the debt service ratio to decline slightly.

Scenario 2

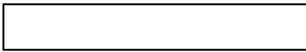
Scenario 2 assumes OECD growth rates 5 percentage points below the baseline, with oil prices declining to $10 a barrel. This would lead to a grave debt crisis, especially for the major oil exporters, Mexico and Venezuela. The predicament of Mexico probably would be alleviated somewhat by its agreement with the IMF that stipulates a contingency fund based on the price of oil. In this scenario, Latin America's current account deficit would worsen by $8 billion in

Table B-2
Latin America: Impact of a Developed Country Recession

Change from the baseline

	Scenario 1		Scenario 2	
	1987	1988	1987	1988
	Billion US $			
Current account balance	−2.9	−7.0	−8.2	−12.7
Of which:				
Trade balance	−3.3	−7.1	−9.7	−14.6
Exports (f.o.b.)	−5.2	−11.9	−17.2	−28.8
Imports (c.i.f.)	−1.8	−4.8	−7.5	−14.1
Exports of services	−2.9	−6.6	−5.2	−11.8
Imports of services	−3.3	−6.7	−6.8	−13.7
Oil trade balance	NEGL	NEGL	−4.4	−4.1
Exports of nonfuel goods and services to the OECD	−7.1	−16.1	−19.8	−35.2
Total debt [b]	2.9	9.9	8.2	20.8
Total interest payments	−2.8	−5.4	−5.7	−10.9
Debt service ratio	−0.4	−0.1	0.9	0.6
	US $ per barrel			
Oil prices	0	0	−5.0	−5.0
	Percentage point			
Latin American real GDP growth	−1.1	−0.2	−1.8	−0.3
OECD real GDP growth	−3.0	−3.0	−5.0	−5.0
London Interbank Offer Rate	−1.5	−2.0	−3.0	−4.0

[a] Components may not add to the totals shown because of rounding.
[b] Implied total gross debt. Calculations for gross debt are based on estimated current account balances; capital flight would increase financing requirements.



1987 and $13 billion in 1988, compared to the baseline projections. Nonoil exports to OECD countries would fall about $20 billion in 1987 and $35 billion in 1988. Total financing needs would reach $14-16 billion in both 1987 and 1988. The debt service ratio would rise in this scenario due to the steep drop in Latin exports.

The outcome for individual oil-exporting countries in Latin America would hinge on oil price trends. If oil prices remain at $15 a barrel, the Mexican current account, for example, would stay at the same level in the baseline projections in 1987 and would suffe only a slight deterioration in 1988—about $600 m lion—from baseline projections. Mexican growth probably would slow less than 1 percentage point. oil prices fall to $10 a barrel, on the other hand, Mexico's current account deficit would plunge an additional $2.4 billion in 1987 and $2.9 billion in

1988, and the outlook for growth would darken considerably. If the developed countries enter a recession with growth 3 percentage points below the baseline forecast, the Venezuelan current account deficit would remain the same in 1987 and increase about $100 million in 1988 over the baseline. If oil prices fall to $10 a barrel, the deficit would swell by $1.5-2 billion in 1987 and 1988.

Damage to such oil importers as Brazil and Chile would be reduced considerably if oil price declines accompany a developed country recession; oil prices do not play a pivotal role for Argentina because its oil exports and imports almost balance. With oil prices at $10 a barrel, Brazil's current account would deteriorate less than $1 billion in 1987, and growth would hardly falter. Brazil would suffer a setback if developed countries sank into a recession and oil prices held steady. Its current account would fall about $1.2 billion below the baseline projections in 1987. Brazilian growth, which has been buoyant the last two years, would slow by as much as 2 percentage points. Brazil, nevertheless, almost certainly is the Latin American debtor best able to cope with a developed country recession.

Longer Term Consequences

Our scenarios indicate that as a developed country recession drags on, its impact would become larger and more uniform on the Latin American economies. Compared with the baseline, Latin America's aggregate current account would deteriorate substantially more the second year of a slowdown than during the first. The borrowing needs of Latin debtors also would be greater in 1988 than in 1987. If a recession dragged on until 1989, the capacity of Latin American countries to meet their interest payments would deteriorate further. A prolonged slowdown would wipe out the advantages obtained by oil-importing countries from the decline in oil prices. Consequently, Latin debtors who had been in bad shape before would be far worse off after the second year of a recession, and those that had been making progress would be pushed back.