Directorate of
Intelligence

~~Secret~~

25X1

South America: Struggling With Debt

25X1

An Intelligence Assessment

~~Secret~~

ALA 84-10036
GI 84-10065
April 1984

Copy 316

Declassified in Part - Sanitized Copy Approved for Release 2012/02/09 : CIA-RDP85S00317R000100040001-5

Page Denied

Declassified in Part - Sanitized Copy Approved for Release 2012/02/09 : CIA-RDP85S00317R000100040001-5

 25X1

Directorate of Intelligence

Secret [redacted]

South America: Struggling With Debt [redacted]

25X1

An Intelligence Assessment

This paper was prepared by [redacted] 25X1
Office of African and Latin American Analysis, with contributions by [redacted] 25X1
[redacted] 25X1
of ALA; and by [redacted] of the Office of Global Issues. It was coordinated with the Directorate of Operations. Comments and queries are welcome and may be directed to the Chief, South America Division, ALA, [redacted] 25X1

Secret
ALA 84-10036
GI 84-10065
April 1984

25X1

South America: Struggling With Debt

25X1

Key Judgments

Information available as of 30 March 1984 was used in this report.

South American countries face major challenges in obtaining the $62 billion we consider necessary to meet foreign financing obligations this year. Unless a high degree of international financial cooperation continues, the temporary payments suspensions that are already occurring could grow into an outright debt repudiation.

In our judgment, the major contentious issues affecting the cooperation of debtors and creditors will be:

- *Political resistance to IMF conditionality,* which is already intensifying in several key countries, including Argentina, Brazil, and Peru.
- *Debtor demands to ease the repayment burden,* which will be better coordinated and reinforce tougher bargaining by individual countries, especially by the Argentines and Ecuadoreans.
- *Bank lending,* which will be suspended if, as we expect, debtors backslide on IMF programs.

The current Argentine bank negotiations are bringing these issues into focus, but the same issues will have to be dealt with in Brazilian and Peruvian talks later this year.

Our estimates indicate that debtors will be able to manage the liquidity strains we expect to persist in 1984. Lenders are now moving to provide loans and refinance debts, although the disbursements of credit will most likely fall short of South America's new money requirements. Only about half of what we estimated to be a $13 billion regional requirement for financing to cover the current account deficit has been met. The greatest unmet gaps are now in Argentina, Colombia, and Peru.

With limited reserves and heightened resistance to making additional import cutbacks, we foresee most borrowers again resorting to temporary payments suspensions to cope with cash strains. The Argentines and Venezuelans are from one to three months behind in their payments, while the Brazilians will probably again resort to arrears if cut off from bank funds. These payments delays will most likely be grudgingly tolerated by international creditors, although they will create frictions with bankers. Overall, we believe the region's debtors will remain committed to honoring external obligations and sustaining necessary adjustments, progress will be made in refinancing old credits, and liquidity strains will ease. In that event, we believe headway will have been made toward easing the debt crisis.

25X1

Argentina will probably provide the clearest near-term indicator of whether our moderately optimistic scenario will hold. The Alfonsin government is facing substantial domestic resistance to austerity and has become increasingly tough in negotiations with bankers. Although most bankers now believe the Argentines will compromise, continued intransigence by Buenos Aires in negotiating its debt would cause a financial impasse, heightening prospects that Argentina might cease all payments, in essence, a debt repudiation.

In our judgment, Brazil would also probably resort to radical actions later this year if bankers ceased cooperating with its rescue program. Any unilateral moves by these two regional leaders would be likely to tempt Chile, Peru, and Venezuela—all encountering strong domestic pressure to engineer recovery—to follow, probably causing the rescue programs to collapse.

The rescue programs could also unravel from external shocks. The immediate danger is a major jolt to confidence caused by an unanticipated action on the part of creditors or debtors such as Argentina or Brazil. Even a modest increase in world interest rates, a slowdown in OECD recovery, or growing protectionism would pose major dangers. A less likely possibility is that another sharp cutback in foreign lending—such as occurred in late 1982—would undermine South American political leaders' willingness to honor their debts. At a minimum, we believe the IMF programs would be derailed, leading to a cessation of foreign exchange payments from the region and serious financial losses for US banks. At worst, South American leaders would repudiate their debts. In any case, the region's problems would probably spill over to other Third World borrowers, such as Mexico and Nigeria.

South America's progress, albeit uneven, in resolving its financial plight will continue to hurt US commercial interests. US banks have some $55 billion in outstanding loans to the region, while US exporters ship some $15 billion in products annually. As the debtors continue their export drive and the use of foreign exchange controls, Washington is likely to be involved in increasingly contentious commercial disputes. For the longer run, US commercial and political interests would be damaged if South America turns to a new round of import substitution or puts in place trade, finance, and investment policies that depart substantially from the free market.

25X1

25X1

Contents

South America: Struggling With Debt [redacted] 25X1

Introduction

After a year and a half of international efforts to battle South American debt problems, controversy still surrounds the efficacy of the "weapons" used so far. Most financial analysts acknowledge that the rescue programs have smoothed initial financial shocks and prevented the default of any South American debtor in 1983. Others, however, believe that the present case-by-case approach for treating these debt-troubled countries is not a solution to the debt crisis and impinges on longer term issues of concern to US bankers and businesses. [redacted]

This assessment examines the progress made by South American countries in managing their payments deficits in 1983 and the role of the new lending and debt reschedulings by the IMF and commercial banks.[1] It discusses debtors' plans for improving external accounts in 1984 and creditor support for these adjustments. It also assesses the likely results of the rescue programs and the factors that could undermine orderly adjustment. Finally, this assessment identifies the difficulties in resolving the Latin debt crisis and the risks to the United States if the rescue programs falter. [redacted]

Table 1
South America:
Debt Held by US Banks, 1983 [a]

	External Debt (*billion US $*)	US Bank Share (*percent*)
Total	**220**	**26**
Argentina	43	19
Bolivia	4	10
Brazil	93	24
Chile	18	33
Colombia	10	35
Ecuador	7	29
Peru	12	25
Venezuela	33	33

[a] Estimated.

[redacted] 25X1

25X1

Financial Adjustments in 1983

The rescue programs put in place since the debt crisis hit in 1982 have smoothed initial financial shocks, reduced payments deficits, and enabled economic adjustments in the debtor countries to take hold. While the debtors made impressive current account progress, the improvements were not enough to bring deficits in line with new lending and left the region grappling with tough payments problems. [redacted]

Payments Improvements. Economic retrenchment, the gathering momentum of world recovery, and the application of tight foreign exchange controls enabled the region, according to our estimates, to reduce its current account deficit nearly 60 percent to $12.4 billion last year. Despite a 1-percent decline in South America's exports, the region's trade surplus quadrupled to $17 billion. The trade improvements resulted from a 25-percent cut in imports as a consequence of the regional economic slowdown, cutbacks in import financing, and the use of import restraints. Moreover, the reduction in the six-month London Interbank Offer Rate (LIBOR), which generally determines the interest on loans, from an average 13.5 percent in 1982 to 10 percent last year was responsible for a large share of the nearly $4.6 billion decline in the service deficit to $29.5 billion. The region's foreign borrowing requirements, however, declined only 10 percent to $41 billion as the improvements in the current account were largely offset by increases in scheduled principal repayments. [redacted] 25X1 25X1

The payments performance on a country-by-country basis was uneven (appendix A). Although the major debtors improved their payments accounts, the smaller countries suffered setbacks:

- Among the key debtors, Brazil posted one of the best performances, slashing its current account deficit 60 percent to $6.9 billion. Argentina managed only a 20-percent reduction to $2 billion.

[1] This assessment excludes Guyana, Paraguay, Suriname, and Uruguay because of their relatively smaller debt problems and their inability to affect the international financial system. [redacted]

25X1

Averting a Default

In 1982, South American countries encountered severe difficulty in servicing their combined $220 billion foreign debt. Reduced export earnings, high world interest rates, and an abrupt cutback in bank lending caused severe financial strains for the region's largest borrowers. Major debt defaults were avoided, however, with a set of financial rescue packages coordinated by the IMF.

25X1

The Fund thus took the lead in preventing an international financial collapse in late 1982. With creditors demanding that debtor countries submit to IMF stabilization programs for financial assistance, the Fund conducted negotiations with Argentina, Brazil, Chile, Peru, and Ecuador. The IMF became the focal point for securing cooperation between private banks and foreign governments and pushed commercial banks to extend new medium-term loans and reschedule maturing debts. The Fund also was instrumental in arranging cash transfusions from the Bank For International Settlements and from the US Government for some of South America's debtors. All the essential elements came into place to complete the rescue packages.

Under IMF auspices, most South American debtors aimed at reducing external deficits and foreign borrowing requirements. By March 1983, Argentina, Brazil, and Chile joined Peru in making IMF adjustments. In June, Ecuador resolved its differences with the Fund and qualified for assistance. Some borrowers, however, refused to submit to IMF-backed programs. The Bolivian Government appears to have judged itself too weak politically to negotiate an agreement while Venezuela refused to submit to IMF discipline in an election year. Colombia did not seek Fund assistance in 1983, relying instead on tightened exchange controls to cope with foreign exchange stringencies.

Table 2
South America: Foreign Financing Requirements

Billion US $

	1982	1983 [a]	1984 [b]
Trade balance	4.2	17.1	18.6
Exports	57.5	56.9	61.0
Oil	20.0	17.9	18.0
Nonoil	37.5	39.0	43.0
Imports	53.3	39.8	42.4
Oil	11.8	9.3	8.5
Nonoil	41.5	30.5	33.9
Net services	−34.1	−29.5	−31.6
Interest payments [c]	25.2	21.0	23.5
Other	−8.9	−8.5	−8.1
Current account balance	−29.9	−12.4	−13.0
Arrearages	0	3.3	6.8
Scheduled principal repayments	14.9	24.9	41.7
Foreign financing requirements [d]	44.8	40.6	61.5

[a] Estimated.
[b] Projected.
[c] Scheduled interest payments minus arrears.
[d] Foreign financing requirements equals current account balance plus scheduled principal repayments on medium- and long-term debt plus previous year's arrearages.

25X1

25X1

- South America's largest oil exporters posted striking gains. Venezuela's current account swung from a $3.5 billion deficit in 1982 to nearly a $3 billion surplus last year; Ecuador reduced its payments deficit 60 percent to $570 million.

- Despite depressed minerals prices, Chile cut its payments deficit 40 percent to $1.4 billion while Peru's declined nearly half to $0.9 billion because of sharp import cuts.

Moving against the trend, Bolivia's current account deficit widened 20 percent to $375 million and Colombia's jumped 30 percent to a record $3 billion. Both countries were only partially able to offset sharp declines in exports by import retrenchments 25X1

25X1

Lending Arrangements. While commercial banks rescheduled and refinanced old debts, they remained reluctant to resume large-scale new lending in 1983, a factor that kept the financial rescue programs on a

South American Financing Arrangements in 1983

Argentina's *creditor banks agreed to a three-part financing package that included a $1.1 billion bridge loan, a $1.5 billion medium-term loan, and the rescheduling of principal falling due in 1983. The bridging loan and the first tranche of the medium-term loan were disbursed, but the rescheduling of maturing public-sector debt has not been completed. In addition, the IMF and foreign banks have postponed the disbursement of $1 billion each, leading to the current difficulties in financial negotiations.* [redacted]

Brazil *initiated discussions with international banks in late 1982 to request a four-part package. In February 1983, Brazil's creditor banks agreed to provide $4.4 billion in new medium-term loans and to refinance about $4.8 billion of 1983 maturities. Moreover, Brazil requested the rollover of $8.8 billion in trade-related debt and the reestablishment of about $10.8 billion in interbank lines. Short-term financing fell below these proposed levels, however, causing Brazil's foreign exchange situation to remain difficult for most of 1983.* [redacted] 25X1

Chile *obtained a $1.3 billion medium-term loan from commercial banks and refinanced about $1.3 billion in short-term debt in July 1983. Creditor banks also agreed to reschedule over $2 billion of public and private debt due in 1983 and 1984. Bank disbursements had been held up as rescheduling negotiations dragged.* [redacted] 25X1

Peru *signed an agreement in June 1983 with foreign banks for an $830 million financial rescue package, which included $380 million to pay off debt maturing between March 1983 and March 1984 and $450 million in new money to balance its foreign accounts. Two bank disbursements of $100 million each were not released because of Peru's noncompliance with its IMF program.* [redacted] 25X1

knife edge. Because voluntary lending was negligible and export recovery slower than expected, South American debtors were plagued by cash strains throughout 1983. [redacted]

Nearly all of the South American borrowers that raised new loans did so only in connection with IMF packages. Although foreign banks committed over $8 billion under these programs, the funds were disbursed unevenly during the year because they were tied to compliance with quarterly IMF performance reviews. Noncompliance with Fund programs resulted in a cutoff of disbursements for Brazil in May 1983, Argentina in August and November, and Peru last September and December. With scant foreign exchange reserves, these debtors had little choice but to make even deeper economic and import retrenchments and delay payments on a selective basis. [redacted]

Arrearages—in effect a type of forced lending from banks—were used to defer immediate cash needs. Consequently, South American countries are now nearly $7 billion behind in payments, according to estimates developed from press and US Embassy reporting. Press reports indicate the Argentines owe nearly $3 billion in public- and private-sector debt payments, [redacted] the Brazilians 25X1
are more than $2 billion behind in debt servicing and 25X1
import payments. Embassy [redacted] sources indi- 25X1
cate Venezuela's private sector has nearly $1 billion outstanding to creditors while Ecuador and Bolivia together have another $1 billion past due. [redacted] 25X1

The Costs. The external improvements exacted high political and social costs. Import retrenchments and tough exchange controls have contributed to recession everywhere in the region except Colombia and Argentina. According to Embassy and press sources, the decline in economic activity—measured by trends in real gross national product—in 1983 ranged from 1 percent in Chile to 12 percent in Peru and Bolivia. 25X1
Moreover, economic adjustments—such as devaluations and removal of subsidies—caused more inflation than Latin leaders expected. The consequent decline

in real wages accompanied by growing unemployment squeezed living standards, intensifying social strains throughout much of the region. Growing popular discontent, manifested by protests against austerity in Brazil, Chile, Peru, and Argentina, created further political problems in implementing adjustment programs. [redacted]

The Challenge

This year, the IMF must delicately try to maintain the cooperation of both debtors and creditors when both sides apparently feel they are reaching the limits of flexibility. The financial rescue strategy continues to rely on the case-by-case approach for treating the debt-troubled countries (appendix B), and bankers are again looking to the Fund to oversee the needed reforms in return for financial assistance. Although less restrictive adjustment programs would meet the political needs of the debtors, they could fall short of what lenders view as minimally acceptable, causing another credit contraction. [redacted]

South American political leaders are intensifying pressure on creditors to ease the adjustment burden. For example, the participants at the conference of the Economic Commission for Latin America in Quito in January called on the IMF to soften conditionality. According to recent Embassy reports, the Venezuelans and Colombians have joined the Argentines in issuing joint communiques urging lenders to demonstrate flexibility in the adjustment programs. [redacted]

An increasing number of South American debtors are also voicing opposition to the high interest rates and front-end fees charged by banks for new and restructured loans. We calculate that interest payments alone will claim nearly 40 percent of the region's exports earnings for the second consecutive year. At the Quito conference, according to an Embassy report, the participants proposed longer grace periods and reduced interest rates that would be compatible with economic recovery. [redacted] the Ecuadorean Government has complained to its creditors that it has paid too much for its recent reschedulings and expects a lower interest spread in 1984 debt renegotiations. [redacted]

Hurdles. The financial position of most South American debtors remains precarious, according to [redacted] Embassy reports. We estimate South America will probably require nearly $62 billion to meet foreign financing requirements in 1984. The Argentines are getting tougher with bankers to get them to release embargoed loans necessary to repay arrears and to obtain better terms. Venezuela is at an impasse in its debt reschedulings, while Ecuador is having difficulty convincing bankers to make new credits available. Continuing the trend of last year, Colombia is encountering growing resistance this year to its borrowing requests that are likely to result in some debt servicing disruptions in the months ahead. [redacted]

Embassy, [redacted] sources anticipate tough problems for financial negotiations. In our opinion, the major financial hurdles are:

- Meeting past-due interest payments and negotiating a revised IMF agreement for Argentina; these are essential to progress in rescheduling loans, obtaining new money, and defusing the tensions surrounding the current talks with bankers.
- Negotiating new money for Ecuador and Peru.
- Working around Bolivian, Colombian, and Venezuelan unwillingness to submit to adjustment programs because of domestic political problems. [redacted]

Incentives. Bankers are negotiating agreements to reschedule debts and provide new funds to South America. [redacted] open sources indicate that international lenders agree that they must continue financial support to:

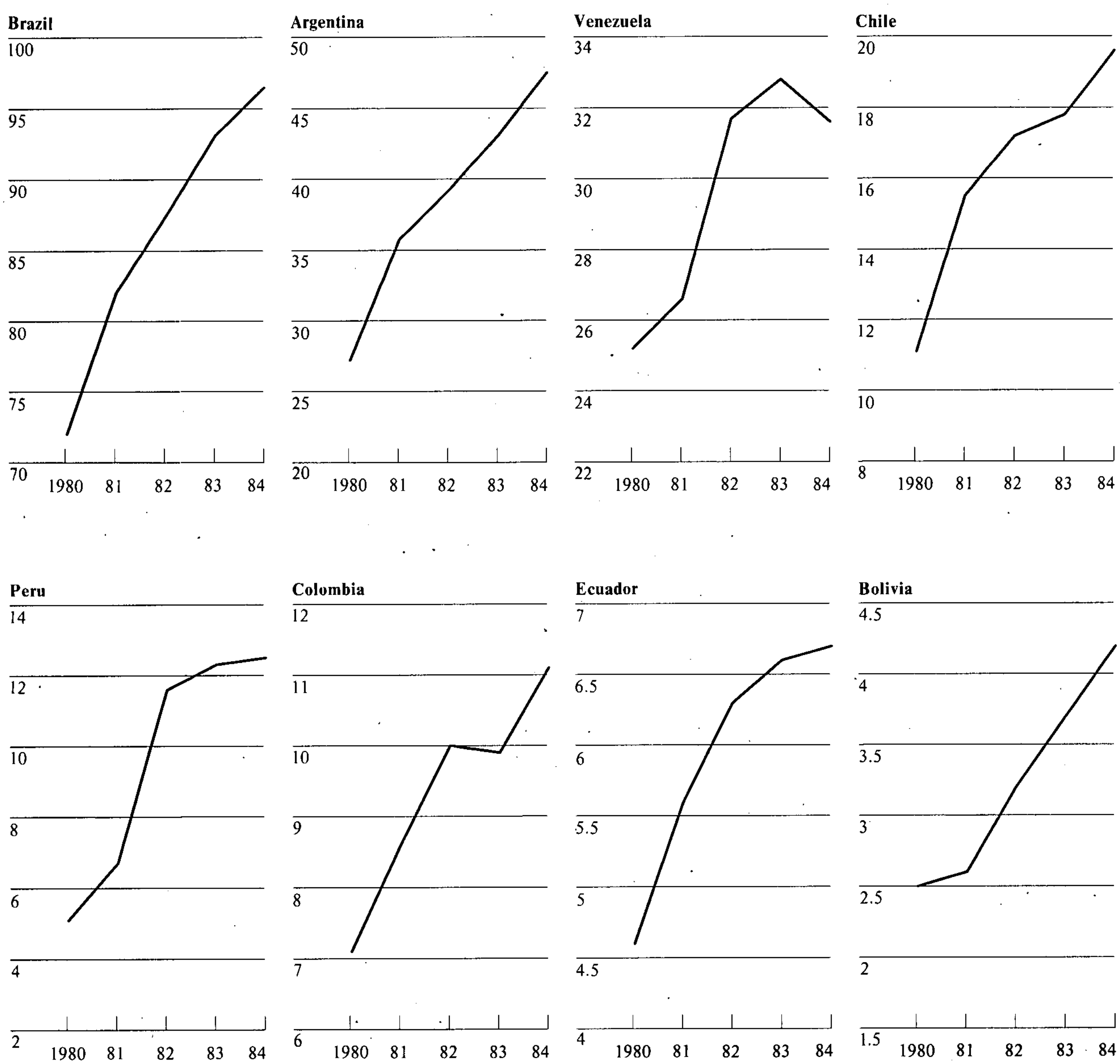
- Enhance the ability of the borrowers to repay debt by rescheduling and providing new money.
- Maintain the willingness of South American political leaders to honor debt obligations by easing the external constraints to domestic recovery.
- Encourage the debtors to continue the stabilization programs necessary to restore a healthy economy and reduce future borrowing requirements.

Indicative of this mood is banker willingness to lower interest spreads and extend repayment periods for

25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1 25X1

South America: Outstanding Debt[a]

Billion US $



[a] Medium- and long-term debt held by the public and private sectors.

25X1

302557 4-84

Brazil and Ecuador in rescheduling agreements concluded earlier this year. Despite Argentina's hardline rhetoric, bankers continue to seek compromises to keep the financial negotiations on track. Moreover, Chile's creditors, [redacted] have agreed in principle to provide some $800 million in fresh credits this year. [redacted] 25X1 25X1

The leaders of the large debtor countries generally support the overall objectives of the financial rescue programs. [redacted] most leaders recognize the need to retain access to world capital markets to secure necessary trade credits and future development loans, and to pay for technology transfers. Beyond this, the rescheduling of maturing debts is reducing immediate repayments obligations. Moreover, the economic adjustments, albeit painful, appear to be improving fiscal and monetary discipline and rooting out distortions in price and resource allocations—steps that are necessary to lay the foundations for economic improvements throughout the region. [redacted] 25X1 25X1 25X1

Pressure Points. These incentives to cooperate are partly offset by political resistance to austerity in most of South America, making some backsliding on IMF commitments likely. [redacted] Brasilia is willing to push key economic reforms mandated by the IMF, but not to the point of jeopardizing an orderly transfer of power to a civilian government in early 1985. Embassy reports indicate that Peruvian President Belaunde will have difficulty complying with IMF adjustments with elections scheduled for 1985 and his political position substantially eroded. Argentina's newly elected government is also under pressure to drive a hard bargain—lower interest rates and longer repayment terms—to demonstrate it is able to handle the debt problem more effectively than the predecessor military regime. [redacted] 25X1 25X1 25X1

We believe that difficulties in complying with the IMF accords will make new loans by commercial bankers harder to contract than in 1984. In the past, according to research by the Federal Reserve Bank of New York, new bank lending to Third World countries has depended on the debtors' implementation of economic adjustment programs. Moreover, some 30 IMF-endorsed financial rescue programs now under way will cause difficulties in completing new loan syndications and disbursing the credits to the South American borrowers in 1984. [redacted] 25X1

Financing Needs in 1984

South American governments have little choice but to continue foreign borrowing to meet their payments obligations. According to our estimates, the region's import requirements and interest payments will exceed earnings by nearly 10 percent in 1984. After a year of severe cutbacks in foreign purchases, most South American countries have little room—and appear unwilling—to cut imports further to avoid causing domestic economic disruptions. Moreover, the region's limited reserve cushion precludes a substantial drawdown in foreign exchange reserves to close the balance-of-payments gap in 1984. [redacted] 25X1

Our research indicates that the South American debtors will require some $13 billion in new loans this year to finance the current account deficit. Even though we believe real growth will rise to 3.7 percent in the OECD, thus raising the demand for LDC exports, and oil prices will remain at $29 per barrel, the region's trade surplus is likely to increase only 9 percent to $18.6 billion. In our judgment, imports will begin to rise moderately in 1984 to support plans for domestic economic recovery, thereby offsetting most of the 7-percent projected increase in export earnings. Additionally, the service deficit will rise nearly 7 percent to $31.6 billion. Although we believe that the LIBOR interest rate will remain at about 9 percent, the region's larger amount of outstanding debt will drive interest payments higher. Moreover, our estimate assumes that, because of the persistence of tough exchange controls, there will be no large-scale, short-term capital flows into or from South America that affect these borrowing requirements. [redacted] 25X1

Private bankers and official creditors have already started negotiations with South American countries to meet their financial requirements (appendix C). Bankers have already committed $6.5 billion in new credit

Table 3
South America: Lender Commitments Versus Foreign Financing Requirements, 1984

Billion US $

	Foreign Exchange Requirements	Lender Programs	Firm Commitments [a]	Current Foreign Exchange Gap [b]	Foreign Financing Under Negotiation [c]	Exchange Gap or Surplus end of 1984 [d]
Brazil						
Current account deficit [e]	7.0	New money	6.5	0.5	4.1	3.6
Principal repayments	7.9	Reschedulings	7.9	0	0	0
Argentina						
Current account deficit [f]	2.2	New money	0	2.2	2.5	0.3
Principal repayments [g]	12.0 [d]	Reschedulings	0	12.0	12.0	0
Venezuela						
Current account surplus [e]	1.8	New money	0	1.8	0	1.8
Principal repayments [g]	16.4 [d]	Reschedulings	0	16.4	16.4	0
Ecuador						
Current account deficit [f]	0.5	New money	0	0.5	0.5	0
Principal repayments	1.1	Reschedulings	0.6	0.5	0.5	0
Chile						
Current account deficit [e]	1.4	New money	0	1.4	1.5	0.1
Principal repayments	2.1	Reschedulings	2.1	0	0	0
Peru						
Current account deficit [h]	0.9	New money	0	0.7	0.6	−0.1
Principal repayments	1.1	Reschedulings	1.5	0.8	0.8	0
Bolivia						
Current account deficit [e]	0.4	New money	0	0.4	0	−0.4
Principal repayments	1.0	Reschedulings	0	1.0	1.0	0
Colombia						
Current account deficit [f]	2.4	New money	0	2.4	0	−2.4
Principal repayments	0.6	Reschedulings	0	0.6	0.6	0
South America						
Current account deficit	13.0	New money	6.7	6.3	9.2	2.9
Principal repayments	42.2	Reschedulings	13.7	28.5	28.5	0

[a] As of January 1984.
[b] Column (1) "minus" column (2).
[c] Includes IMF credits.
[d] Assumes that all financing under negotiations is disbursed by the end of December.
[e] Analyst estimate.
[f] Embassy estimate.
[g] Includes 1983 and 1984 principal repayments.
[h] Central Bank estimate.

25X1

to Brazil, promised $800 million to Chile, and released $200 million in frozen funds to Peru—about 60 percent of the region's current account requirements. They have also refinanced about one-fourth of the $42 billion in principal payment due. Despite these early indications of progress, it seems most likely to us that lender financial support will fall short of borrowing requirements. Because of last year's experience, we believe that loans will be disbursed unevenly throughout the remainder of 1984 while rescheduling agreements will be difficult to conclude. As a result, we foresee South American borrowers facing persistent cash-flow difficulties this year. We also expect three possible outcomes—persistent liquidity strains, an unraveling of rescue programs, or real financial progress—depending on creditor willingness to cooperate with the debtor adjustment programs [redacted]

Liquidity Strains Persist. In the most likely outcome, we foresee—about a 7 in 10 probability—lender financial assistance falling short of South America's current requirements. Such difficulties will most likely result from two factors:

- Temporary suspension of IMF and commercial bank loan disbursements because South American governments backslide on their IMF commitments.
- Continued difficulty in syndicating new credits, especially if the debtors step up pressure for easier terms.

We believe that the debtors are unwilling to bridge the current foreign exchange gap by new import cuts or large reserve drawdowns. Instead, we believe they will move to alleviate cash strains by running large arrears and delaying payments. [redacted]

In this scenario, the region continues to grapple with cash-flow difficulties throughout 1984. Because of last year's precedent and a variety of sources, we believe that several debtors will be temporarily cut off from foreign funds because of difficulties in meeting IMF commitments:

- Brazil will probably backslide in implementing its IMF program, especially as the January 1985 presidential election gets nearer, and again face a cutoff of credit and difficulty in syndicating new loans.
- The Belaunde government in Peru will be unable to comply with its ambitious IMF program because of political discontent, thereby causing bankers to freeze promised credits.
- The lameduck government in Ecuador will be likely to ease up on its stabilization program, causing difficulties in negotiating a $500 million credit.

Such events will create stumblingblocks, but probably not insurmountable obstacles, to the financial rescue programs. Based on precedent, we believe the IMF will react flexibly and renegotiate these agreements, enabling the borrowers to regain access to commercial credits. [redacted]

The most serious financial strains, in this scenario, would be caused by delays in obtaining new money. We believe that difficulties in implementing IMF-backed stabilization programs will probably result in delays in syndicating credits for several of the region's borrowers:

- Loan negotiations with the Argentines will remain in abeyance until interest arrears are cleared and a new IMF agreement is in place, according to reliable banker reporting. Because formal IMF approval of a new program is not expected before late May, Buenos Aires is not likely to make progress on new bank loans until June. 25X1
- Bolivia's request for new loans will be rejected, [redacted] until it submits to an IMF adjustment program. 25X1 25X1
- Colombia, based on Embassy [redacted] reports, is now being advised to begin negotiations with the IMF to counter resistance to its request for new funds. [redacted] 25X1

Because of last year's experience, we foresee some South American borrowers resorting to payments suspensions to cope with such cash strains. Some debtors, notably the Argentines, are even likely to implement long delays, in part to pressure banks to make funds available on better terms. As long as they are willing to continue steps necessary to avoid having regulators classify their loans, such suspensions probably would be grudgingly tolerated by international bankers.[2] [redacted] 25X1

The occasional resurgence of cash problems is likely to be headline catching and partly obscure the international cooperation that will continue to move the

[2] Suspensions greater than 90 days would force loans into "nonperforming" categories under US law and require banks to deduct past due interest from earnings and set aside loan loss reserves. Regulators do have discretion in classifying loans and probably will avoid this action if there is a reasonable prospect the debtor will pay past-due interest and become current in their payments to creditors. [redacted] 25X1

25X1

financial system toward adjustment. In this scenario, payments delays enable the debtors to bridge cash shortages until the influx of new credits eases liquidity strains. Moreover, the continued extensions of past due principal repayments will provide enough time to conclude rescheduling agreements. Under these conditions, the debtors remain willing to honor their external obligations, and their economic adjustment programs lay a foundation for progress in resolving the debt crisis in 1985.

The Programs Unravel. Although we think it unlikely—less than 2 chances in 10—the financial rescue programs could begin to unravel if bankers refused to supply new loans beyond those already obtained. For example, Brazil recently struggled to obtain commitments for the $6.5 billion jumbo loan, as many Arab banks refused to participate in the syndication because they believed there was little prospect for repayment. The more immediate danger is a South American debtor—notably Argentina—adopting hardline bargaining tactics with bankers that cause the creditors to take retaliatory measures, such as freezing all credits. Inability to obtain promised funds probably would result in the debtors becoming intransigent in refusing to honor traditional repayment norms, implementing their IMF programs, and more willing to resort to radical actions.

A cutoff in new lending would also cause unmanageable liquidity strains. In this scenario, foreign credit could fall as much as 40 percent short of covering South America's estimated $13 billion current account deficit. Under these conditions, we see South American debtors putting a prolonged moratorium on principal repayments and curtailing interest payments. Without new loans:

- Bolivia, Chile, Colombia, Ecuador, and Peru would probably suspend debt repayments for lengthy periods.
- Argentina would remain in a de facto moratorium and refuse to make any payments.
- Brazil would resort to prolonged delays on trade and debt repayments to cope with financial strains.

In the end, regional action to force bankers to provide debt relief—perhaps by threatening a collective repudiation—would become more likely. The breakdown of international cooperation would ultimately lead to the near cessation of foreign exchange payments by South American governments. Moreover, unwillingness to cooperate would increase the probability of an outright repudiation by one of the debtors, especially the Argentines.

Table 4
South America: The Impact of External Shocks

Million US $

	Sensitivity of Current Account to:		
	A 1-Percentage-Point Change in LIBOR	A 1-Percentage-Point Change in OECD Growth	A $1 Change in Crude Oil Prices
Key debtors			
Brazil	800	700	250
Argentina	300	400	NEGL
Chile	150	200	20
Peru	100	125	20
Venezuela	250	50	500

25X1

25X1

25X1

Financial Progress. If lenders made every effort to provide promised financial assistance—and the interplay of forces, as we see it, makes this only a faint chance—liquidity strains would ease dramatically. In this scenario, the lenders might disburse some $16 billion in new loans—about 25 percent more than necessary to meet 1984 current account requirements—in support of sustained adjustment efforts and the need to replenish reserves by debtors. Moreover, bankers would reschedule all outstanding obligations.

25X1

25X1

Even under these best conditions, however, the financial rescue programs would have little margin for error. Brazil, Chile, and Venezuela would be able to replenish reserves slightly, but probably would still have trouble obtaining additional credits to fund new development projects. Bolivia and Colombia probably would grapple with cash-flow difficulties unless they submitted to IMF-backed rescue programs.

25X1

Vulnerability to External Shocks. New external shocks would heighten the odds for a worst case outcome and substantially change the probabilities we assigned to the above scenarios. A major jolt to confidence caused by an unanticipated action by debtor or creditor will remain a continuing danger. We cannot preclude a debtor, especially the Argentines, taking unilateral actions against bankers in a fit of pique. Moreover, bankers may move to attach debtor assets to pressure a debtor to become current on past due payments. Such unpredictable actions probably would harden positions on both sides, leading to a collapse in negotiations.[redacted]

A runup in world interest rates and oil prices, or an aborted OECD recovery, would be likely to exceed the creditors' ability to make new money available quickly to cover larger deficits. With only a thin reserve cushion, most debtors would face unmanageable cash strains. According to the estimates of a respected financial journal, a 1-percentage-point increase in world interest rates—a growing concern in financial markets—would add $1.6 billion to South America's annual debt servicing requirements in 1984. Moreover, a 1-percentage-point slowdown in OECD recovery adds an additional $1.5 billion to the region's annual payments deficit from lower exports while a $1 rise in oil prices would cause the region's trade surplus to worsen by some nearly $800 million.[redacted]

In these cases, Brazil is the most severely affected and would require at least $1.8 billion in new loans beyond our present estimates because it has little room to cut imports or draw down reserves.[redacted] Brasilia would probably encounter serious difficulties in obtaining new funds of such magnitude, setting the stage for a confrontation with its creditors.[redacted]

The danger in such a confrontation is that Brasilia—facing widespread domestic opposition to austerity—would declare a payments moratorium. Instead of a decision to halt temporarily loan repayments, numerous bankers foresee that Brasilia would suspend all debt payments and freeze foreign exchange deposits for a lengthy period. They and we fear that such a move would be followed by other South American debtors, thereby causing creditors to halt trade financing and withdraw interbank deposits. Under such conditions, the various rescue programs would collapse, and South America's difficulties would probably spill over to other Third World borrowers.

[redacted] 25X1

Signs To Watch

The ability and willingness of South American borrowers to repay their debts as well as support by lenders for the IMF-backed rescue programs are dependent on a number of important variables.[redacted] 25X1 25X1

Ability To Export. Any abrupt change in South America's export prospects would affect the rescue programs. [redacted] 25X1 [redacted] 25X1 sustained export recovery, major improvements in the terms of trade, and sound exchange rate policies would enable the Latin debtors to resume regular debt servicing payments by 1986. We will continue to monitor growth in foreign markets; the behavior of metal, mineral, and agricultural export prices; and the pace of devaluations in tracking South America's export recovery. Moreover, we are concerned about the willingness of industrial countries to absorb the region's exports. Growing protectionism—manifest in increasing numbers of countervailing duties, import restrictions, and voluntary export restraints—would be likely partially to offset the benefits of world recovery this year and heighten the prospects for debt difficulties.[redacted] 25X1 25X1

Political and Regional Trends. A shift in South American political leaders' support for the current financial rescue strategy remains a danger. Embassy [redacted] reporting reveals support for a tougher posture against creditors—such as a payments moratorium—gaining political popularity in Argentina, Brazil, Ecuador, and Peru. It is likely to be manifest in: 25X1 25X1 25X1 25X1

- An emerging consensus among Latin financial officials that bankers are unresponsive to requests for improved debt repayments terms.

A Dangerous Financial Issue

International creditors and South American debtors seem to be talking past each other about financial reforms to ease debt servicing. Bankers are willing to ease repayment terms as seen in new lending to Brazil and Mexico at lower spreads and bearing somewhat longer grace and repayment periods. [redacted] *Ecuador and Peru are benefiting from easier terms in their lastest reschedulings.* [redacted]

The debtors, however, are beginning to press for bolder actions. The Declaration of Quito, for example, appeals to creditors to place a ceiling on debt servicing payments as determined by export earnings. The issue could polarize financial negotiations because it would severely depress bank profits. [redacted]

Similarly, some influential Latins are proposing new financial reforms. Carlos Langoni, the former head of Brazil's Central Bank, is calling on bankers to extend repayments over much longer terms, sharply reduce interest rates, and capitalize some interest payments. Although bankers are likely to resist such proposals, Langoni claims that the major debtors may take concerted action to force such changes. [redacted]

Table 5 *Billion US $*
United States: International Transactions With South America [a]

25X1

	1980	1982	Percent Change
Trade balance	2.2	0	−100
Exports	17.3	15.1	−13
Imports	15.1	15.1	0
Net services	2.7	+2.3	−15
Of which:			
Travel	−0.1	0.2	
Earnings on direct investment	1.5	1.6	7
Other receipts	1.3	0.5	−62
Current account	5.2	2.3	−53

[a] Estimated.

25X1 25X1 25X1 25X1

[redacted]

- The increased influence of nationalists and the willingness of influential policymaking groups—Brazil's National Security Council, Argentina's Economy Ministry, and Venezuela's Finance Ministry—to recommend more confrontational tactics in dealing with bankers.

- Rhetorical stridency at Latin debt conferences and growing support for a collective approach to the debt crisis. Argentina is likely to be a bellwether for such sentiment. [redacted]

Banker Cohesiveness. A split among bankers in supporting the adjustment programs is another vulnerability. The key sign to watch is the ability of bank advisory committees to assemble and complete loan syndications. Inability to assemble new loans for Chile, Argentina, Ecuador, and Peru or renewed disruptions in the interbank market would probably doom the rescue programs unless alternative funding—such as from the US Government or the Bank for International Settlements—was found. [redacted] 25X1

Implications for the United States 25X1
South America's financial difficulties will probably continue to hurt US commercial interests in 1984. According to our estimates, the US current account surplus with the region had already been reduced by more than half to $2.3 billion in 1982 and probably moved into a deficit last year. This shift into red ink reflects the sharp decline in US exports—merchandise sales to the region plunged 35 percent through September 1983—in the wake of import controls retrenchments; a sharp increase in US purchases—up 18 percent through three quarters—from the debtors as US recovery got under way; and the reduction in interest income as the region delayed repayments. 25X1 [redacted]

25X1

South America's financial difficulties will also draw the United States into acrimonious commercial disputes. We believe Washington officials will be caught between US interest groups seeking relief from trade

Table 6
South America: Decline in US Exports

	Peak Year	Exports at Peak Year *(billion US $)*	Decline From Peak Year to 1983 [a] *(percent)*
Argentina	1980	2.6	81
Bolivia	1981	0.2	60
Brazil	1980	4.4	71
Chile	1981	1.5	77
Colombia	1982	1.9	55
Ecuador	1980	0.9	70
Paraguay	1982	0.1	36
Peru	1982	1.5	73
Uruguay	1981	0.2	42
Venezuela	1981	5.4	68

[a] Estimated.

[redacted] 25X1

competition versus South American debtors' requests for trade concessions. According to press reports, US businessmen are increasingly critical of South America's restrictive commercial policies. Tight import controls and exchange restrictions are causing difficulties for US exporters and direct investors desiring to repatriate funds from their subsidiaries, [redacted] 25X1 25X1

US financial institutions will continue to be vulnerable to debt servicing disruptions. This year, we expect selective delays in repayments by South American debtors. [redacted] such delays are likely to exert a drag on US bank profitability, by forcing some writeoffs and increased loan loss reserves. These financial setbacks, by heightening bankers' perception of risk, would have an adverse impact on the continuation of new lending to the region. In our opinion, commercial banks will be less attracted by lending to South America especially as the demand for funds rises in the United States to sustain recovery. [redacted] 25X1

For the longer run, we are concerned about the damage that US commercial and political interests could suffer so long as South America's external finances are precarious. These would include:

- The increased exposure of US banks in the region to keep rescue programs on track.
- The attractiveness of import substitution policies that would permanently restrict US sales and investments to the region.
- The rise of economic nationalism in South America translating into even tougher current restrictions on US exporters and businesses.
- The potential for economic discontent to translate into political instability and much greater hostility toward the United States. [redacted] 25X1

Appendix A

South America's Current Account Adjustments in 1983 and Plans for 1984

Argentina

Buenos Aires began 1983 under an IMF program that projected a 60-percent reduction in the current account deficit to $800 million. The Fund program expected a $3.5 billion trade surplus based on $9.5 billion in export earnings against only $6 billion of imports. Reductions in interest payments were expected to reduce the services deficit by nearly 20 percent to $4 billion. The Fund agreement also stipulated that the $2.9 billion in external payments arrears be eliminated by June. [redacted]

The Argentines did manage to improve their current account some 20 percent to $2 billion. Although export earnings only moved up slightly to $7.7 billion in spite of a bumper grain crop, the lack of foreign exchange and weak domestic demand contributed to a 20-percent fall in imports and enabled Buenos Aires to record a $3.5 billion trade surplus. The deficit on the services account, however, rose 15 percent to $5.5 billion; although world interest rates declined, the Argentines' increased use of expensive short-term credit forced interest charges higher. [redacted]

Despite banker pledges of $3.5 billion in new financing, the Argentines received only $2.2 billion in disbursements during 1983. This forced Buenos Aires to resort to arrearages to cope with foreign exchange stringencies; press reports indicate they were probably left with $2.5 billion in interest arrears at the end of 1983. Argentina entered into a de facto payments moratorium late in the year, able to make interest payments only upon receipt of foreign exchange from lenders. [redacted]

To improve the current account in 1984, the newly elected civilian regime of Raul Alfonsin intends, according to press reports, to stimulate exports. The government is planning to boost agricultural exports by lowering the tax on foreign commodity sales and providing farm exporters easier access to imported inputs such as fertilizer. Moreover, the government claims it will continue to devalue the exchange rate daily at the pace of domestic inflation in order to encourage nonagricultural exports and restrain imports. [redacted] 25X1

Simultaneously, Buenos Aires is also tightening restrictions for imports of nonessential products and military goods. Taken together, Economy Minister Grinspun expects at least a $3.3 billion trade surplus this year. Grinspun will use some $3 billion of the trade surplus plus new commercial bank loans to cover the current account deficit and settle past due interest payments. [redacted] 25X1 25X1

Bolivia

President Siles's tenuous political position caused him to shy away from implementing the unpopular reforms necessary to resolve the country's payments problems in 1983. Although he enacted some tougher measures in November, Bolivia has yet to reconcile with the IMF and has had growing difficulty meeting foreign obligations. [redacted] 25X1 25X1

Bolivia's current account deficit widened 21 percent to $375 million in 1983. The trade accounts swung from a $110 million surplus in 1982 to a $30 million deficit last year. Exports sank 14 percent to $620 million because of low tin prices, labor unrest and lack of spare parts in the mines, an overvalued peso, and a falloff in sales of nonmineral exports to Bolivia's cash-strapped neighbors. Imports rose 7 percent to $650 million as La Paz had to double food purchases to cover weather-induced crop shortfalls and increase oil purchases because of declining domestic production. 25X1 Despite the trade setbacks, debt renegotiations enabled Bolivia to reduce the service deficit by 18 percent to $345 million, mainly by stretching interest expenses. As the year ended, however, delays in

Argentine payments for natural gas restricted La Paz's ability to meet scheduled interest payments and forced it into arrears.

Siles decreed new economic policies last November to improve the payments account and qualify for IMF assistance. The government devalued the peso by 60 percent to 500 pesos per US dollar and reduced food and gasoline subsidies. Although La Paz is counting on some strengthening of minerals prices, the peso devaluation should help the trade account mainly by reducing imports. Moreover, increases in food and gasoline prices are aimed at reducing contraband exports to neighboring countries. The service deficit should improve slightly as negotiations resume with creditors for additional relief on interest payments. Argentina has also promised to resume payments for natural gas shipped last year.

Brazil

Brazil's efforts to strengthen its external accounts under an IMF stabilization program ran into obstacles in early 1983. Much of Brazil's troubles resulted from unrealistic adjustment goals and the unwillingness of banks to fulfill financial pledges in support of the IMF program. Against the assumption of a strong world recovery, Brazil's export performance in the first two months of 1983 fell short of expectations. To improve its trade position, the government in late February undertook a large devaluation. Meanwhile, a number of European and US regional banks refused to restore short-term trade credits, causing a buildup of arrears. By May, Brazil also fell out of compliance with its IMF agreement and more than $3 billion in scheduled loans were suspended. Brasilia was forced to implement tougher exchange controls to husband its reserves.

Eventually, however, the combination of the devaluation, the pickup in the US economy, and the foreign exchange controls enabled the government to cut its current account deficit for the year by 60 percent to an estimated $6.9 billion. Brazil achieved a record $6.5 billion trade surplus on a 9-percent rise in exports and a 20-percent reduction in imports, surpassing the IMF target by a comfortable margin. Brazil's services deficit fell some 22 percent to $13.4 billion mainly on the basis of reductions in world interest rates. The trade improvements coupled with the resumption of lending in December following a revised IMF agreement allowed Brasilia to cut arrear- 25X1 ages to about $2 billion from a peak of $3.5 billion in November. 25X1

In keeping with the revised IMF agreement, Brasilia aims to reduce the current account deficit to $6 billion in 1984 and reach a trade surplus target of $9.0 billion. Its adjustment program calls for exports to rise to $25 billion as a result of competitive exchange rate policies; higher prices for soybeans and other export crops; a major rebound in agricultural production, weather permitting; and rising sales of manufactured products in response to economic recovery. On the import side, Brasilia wants to hold imports again to $16 billion. Depressed oil demand, increased national production, and stable oil import prices are 25X1 expected to trim more than $1 billion from its oil bill. The government expects some deterioration in the service accounts because the growing foreign debt is driving interest payments higher. 25X1

Chile

In January 1983, Chile's cash position—already weakened by declining exports, capital flight, and a slowdown in lending—became critical when bankers ceased lending because of a financial dispute with the government. This abrupt confrontation also caused Santiago to miss its domestic monetary and foreign reserve targets under its IMF program. For the rest of 1983, Chile moved to get the rescue program back on track, and strengthen its external accounts. 25X1

Chile's current account deficit improved by 40 percent to $1.4 billion in 1983. Although the decline in copper prices reduced exports 2 percent, the trade 25X1 surplus nearly quintupled to $1 billion as a result of a 25-percent drop in imports caused by reduced domestic demand, devaluations of the peso, and a doubling of the tariff rate to 20 percent. Although interest payments increased 19 percent to $1.6 billion in 1983, net services and transfers were nearly even with the previous year as Chileans reduced transportation and foreign travel expenses. The current account shortfall was covered by $1.3 billion in loans from international bankers. [redacted]

The Chilean Central Bank expects the current account deficit to stay about the same. According to government studies, the trade surplus is likely to decline 10 percent to $900 million in 1984. The government expects that a rise in public-sector demand as well as increased purchases by the private sector to spur imports by 24 percent to $3.3 billion. Exports should rise only 14 percent to $4.2 billion; although international demand for Chilean agricultural products is likely to strengthen, minerals exports will be held back by depressed prices. Interest payments are slated to rise 12.5 percent to $1.8 billion but purchase of foreign services should continue to decline, leaving the services deficit at the $2.3 billion level. [redacted]

Colombia

Bogota counted on a strong world recovery to improve external accounts in 1983. Instead, exports headed lower and foreign financing became harder to obtain, forcing the Colombians to move to improve the trade accounts. The Betancur administration hiked tariffs, accelerated the depreciation of the peso, and increased export subsidies. Bogota also halved the travel allowance for citizens abroad and declared illegal private transfers abroad to halt capital flight. [redacted]

Despite these moves, Colombia's current account deficit increased 31 percent to a record $3 billion. Bogota was only able to reduce its trade deficit by 7 percent to $1.8 billion because import retrenchments were partially offset by declining exports. Sales were off 11 percent to $2.9 billion as coffee revenues—half of total export earnings—declined because of lower prices and demand in developed countries. Moreover, protectionism and import cutbacks in Colombia's Andean Pact neighbors hurt nonagricultural export sales. Bogota's services deficit more than tripled to $1.2 billion because of falling tourism, interest earnings, and remittances from Colombians working abroad. [redacted]

Bogota drew down foreign exchange reserves to cover the widening payments gap. From the end of 1982 through the end of September 1983, foreign exchange reserves fell from $3.9 billion to $1.6 billion. Bankers also became increasingly reluctant to provide new credits to Colombia. Bogota had difficulty raising an 25X1 $80 million balance-of-payments loan in April, and, [redacted] it took four months to 25X1 syndicate a $210 million loan at the end of 1983. Despite World Bank cofinancing guarantees, bankers would not commit new loans for Colombia's ambitious 1983-86 investment program at the October Consultative Group meeting in Paris. [redacted] 25X1

Embassy reports indicate the Betancur government is counting on a strong export recovery and continued import restraints to generate a large trade surplus in 1984. We doubt that Colombian exports will post the strong rebound to achieve the sizable trade surplus required to eliminate its current account deficit. We also believe that international bankers will resist financing another large payments deficit and that 25X1 Bogota will have to undertake unpopular economic 25X1 adjustments under IMF guidance. [redacted] 25X1

Ecuador

President Hurtado implemented policies last year to end the financial crisis. Under the IMF's guidance, Quito devalued the sucre to restore price competitiveness and eliminated export taxes to spur nonoil exports. Simultaneously, interest rates were raised to slow capital flight. To stave off cash strains, import 25X1 controls were tightened while efforts were intensified to secure foreign financing. [redacted] 25X1

These moves paid handsome dividends. Quito reduced the payments deficit to $566 million, down 60 percent compared with 1982. According to the US Embassy, the trade surplus more than tripled to $750 million largely because imports were cut one-third to $1.4 billion. In contrast, export earnings dropped 4 percent to $2.1 billion because of soft prices for oil and coffee, weather-induced export shortfalls, and depressed demand for Ecuador's products in the Andean region. The successful 1983 debt renegotiation package allowed Quito to reduce the service deficit by 20 percent to $1.3 billion. Drawings from the IMF and commercial banks covered the deficit and enabled the Hurtado administration to clear some arrearages. [redacted] 25X1

With economic reforms in place and a return to normal weather, Quito expects additional improvement this year. According to government estimates, the deficit will shrink another 8 percent to the $520 million level. The Ecuadoreans are counting on a hefty rise in exports to increase the trade surplus. To spur oil sales, Quito has recently lowered its crude prices for contract sales; improved weather conditions will increase exports of tropical products. Continued currency devaluations and a slow domestic recovery should hold down import demand. Quito is negotiating with its bank advisory committee for a new $500 million loan to cover its external deficit.

Peru

The 1983 IMF program expected that a strong recovery in minerals prices would increase exports, thereby halving the current account deficit to $900 million. Peru, however, fell victim to floods and drought that disrupted minerals production and exports, while mineral prices remained depressed. As a result, the government was forced to slash imports to improve its external accounts.

According to recent Embassy reporting, Lima met its target for reducing the current account deficit, despite declining exports. Depressed copper and silver prices plus weather-induced disruptions caused a 10-percent reduction in export earnings to $3 billion. Cutbacks in import financing and the plunge in domestic economic activity, however, pushed imports down 29 percent to $2.7 billion. Lima's inability to reduce its public deficit as promised under the IMF program, however, resulted in the delay of some $350 million in scheduled loan disbursements. Lima was forced to draw down reserves heavily to cover the payments gap.

According to its recent projections, Peru's Central Bank expects the current account deficit to remain unchanged this year. The Central Bank foresees world economic recovery and a return of normal weather bolstering export earnings a slight 3 percent to $3.1 billion. With export earnings depressed, they recognize that imports must still be pared to prevent cash strains. This will result in further improvement in the trade acounts, which should record a $600 million surplus. The Central Bank expects a deterioration in the services accounts, which will offset the trade gains. Lima has no additional plans to bolster the current account, but some moves are likely if Peru encounters trade setbacks. The new IMF agreement—which calls for a cut in the public-sector deficit from 10 to 4 percent of GDP, no loss of foreign reserves, a limit on the current account deficit to 5 percent of GDP, and a reduction in inflation from 125 percent to 70 percent—will be difficult to comply with given domestic political pressures against further belt tightening. 25X1

25X1

Venezuela

Caracas faced unmanagable financial strains early in 1983. Against $7.5 billion in foreign exchange reserves, Venezuela faced potential demands for the repayment of $16 billion in maturing debt and the need to fund a projected $2 billion current account deficit. Venezuela's access to new credit, however, virtually ceased in January because bankers ceased lending in the face of continuing capital flight, delays in meeting scheduled debt repayments, and fears that 25X1 a drastic decline in oil prices would weaken debt servicing capabilities. The government resorted to tough import and exchange controls and suspended principal repayments in March to avert a cash crisis.

25X1

These measures improved Venezuela's external accounts in 1983. According to the Embassy, the current account swung from a $3.5 billion deficit in 1982 to nearly an estimated $3 billion surplus. Despite a 10-percent decline in oil exports, Venezuela posted a $7 billion trade surplus by slashing imports with higher tariffs, direct import controls, and a de facto devaluation of the bolivar. Moreover, tough exchange 25X1 controls and delays in meeting scheduled interest payments—Caracas now has some $900 million in interest arrears—reduced the service deficit by one-third to $4.2 billion. As a result, Caracas was able to rebuild reserves from $7.5 billion in January to $11 billion currently, providing the new Lusinchi administration with some flexibility in negotiations with its creditors. 25X1

Embassy reporting [redacted] believe Caracas will work to maintain a current account surplus this year to avoid the need for new borrowing. [redacted] oil export earnings probably will be flat at $14.0 billion because oil prices are depressed, averaging $25 to $27 per barrel. [redacted] the government plans to unify exchange rates by gradually devaluing, in part to boost nonoil exports. Despite a modest nonoil export recovery, the trade surplus will probably decline 11 percent to $6.2 billion because of government plans to stimulate the sluggish economy. Such pump-priming will require a rise in total imports, mainly producer goods, from $8 to $9 billion. Tough foreign exchange controls are likely to remain to prevent a resurgence of capital flight and restrain the import of services. [redacted]

25X1 25X1 25X1 25X1 25X1

Appendix B

Financial Rescue Programs in 1984

International bankers and South American debtors are already moving to resolve debt problems in 1984. The rescue strategy continues to rely on the case-by-case approach for treating the debt-troubled countries. In this appendix, we review the new lending and rescheduling programs being assembled by the creditors against the best available estimates—analyst, Embassy, or Central Bank—of South America's ability to reduce foreign borrowing requirements by improving their current account position.

Banker Commitments
Private bankers and official creditors have already started negotiations with South American countries in support of their financial rescue programs. This second wave consists of rescheduling 1984 maturities and raising new money.

The Major Debtors. Financial negotiations for the Brazilians are going well but the Argentines have yet to implement their program:

- *Brazil* has obtained agreements from creditors to help meet its financing needs for 1984. Its bank advisory committee is assembling an $11.8 billion package consisting of a $6.5 billion new money facility and a rescheduling of about $5.3 billion in 1984 debt maturities. Western governments agreed to reschedule $3.8 billion through the Paris Club and several industrial countries have committed about $2.5 billion in official export credits. Additionally, Brazil will be able to draw $1.5 billion from the IMF if it complies with program requirements.

- *Argentina*—currently out of compliance with the IMF—is having difficult negotiations with creditors for 1984 financing. According to press reports, Buenos Aires is seeking some $12 billion in debt reschedulings, $2.5 billion to clear arrears, and $3.2 billion in new money. The government has recently resorted to hardline rhetoric to pressure banks to extend credits, but is also working to resolve outstanding issues with the creditors. 25X1

  bankers believe Argentina will require approximately $1 billion in new money from commercial banks in 1984 in addition to the $1 billion in undisbursed funds. Buenos Aires is negotiating with the IMF for a new program that could allow up to $1.5 billion in new lending and reopen private financial support. 25X1 25X1

The Oil Exporters. Bankers have suspended negotiations with the Venezuelans until the new government gets organized; Ecuador is encountering resistance to its requests for new money: 25X1

- *Venezuela* continues to extend the debt moratorium on all public-sector principal repayments that was started in March 1983. President Jamie Lusinchi has stated that his first priority after taking office would be to reschedule his country's foreign debt. Negotiations with the bank advisory committee concern the rescheduling of some $16.5 billion of debt due in 1983 and 1984. To break the financial impasse, Caracas will need to impose enough economic discipline to appease the bankers and eliminate all debt arrearages. As long as Venezuela does not request any new money for 1984 and has a workable economic program, an IMF facility may not be viewed as necessary for the reschedulings. 25X1

- *Ecuador's* bank steering committee has agreed in principle to refinance the public and private sector debt falling due in the first six months of 1984—about $300 million. They have postponed a decision on the second half 1984 refinancing package until Ecuador reaches a new agreement with the IMF (it still remains eligible to draw $85 million under the current agreement) and the new government takes office in August 1984. Ecuador has requested a new $500 million medium-term loan for 1984 but the bankers are resisting. 25X1

The Copper Producers. Chile's compliance with the IMF and Peru's recent reconciliation with the Fund have smoothed negotiations with bankers:

- *Chile's* creditor banks agreed in principle in July 1983 to restructure over $1.6 billion of public and private debt due in 1983 and 1984. Individual debt reschedulings—modeled on the Central Bank agreement—began in December 1983. Santiago has requested a medium-term bank loan of $780 million for 1984 financing needs, while continued compliance with its IMF program will result in $230 million in new credits from the Fund.

- *Peru's* successful conclusion of its IMF negotiations will probably cause bankers to disburse $200 million in frozen loans. We expect Peru's new agreement with the IMF will result in $170 million in new credits if Lima complies with the program targets. We also expect the Peruvians to ask for $400 million in new money. We believe at least $300 million in medium-term maturities falling due in 1984 are likely to be rescheduled. Lima will also need to extend $2 billion of short-term debt falling due in 1984. [redacted]

Payments Prospects

South American debtors are again aiming to reduce their current account deficits and borrowing requirements. Most countries expect an export rebound, tight import controls, and stable oil prices and world interest rates to result in improvements. [redacted]

The Major Debtors. The Brazilians are unlikely to record improvement again in 1984 while the Argentines expect some worsening:

- *Brazil's* current account deficit, in the most likely scenario, increases slightly to $7 billion. We believe the Brazilians will realize a $8 billion trade surplus as exports jump to $24.5 billion but imports increase to $16.5 billion. Despite steady interest rates, a 20-percent increase in interest payments underlies a growing service deficit.

- We and the US Embassy expect *Argentina's* current account deficit to deepen slightly to $2.3 billion. We project that improved prices for corn and oilseeds will boost agricultural earnings by $300 million to the $6 billion level but sales of manufactures and petroleum products will remain constant. Embassy projections of a 12-percent rise in imports this year are based on estimates of purchases abroad required to support modest economic growth. Interest payments will range between $5 and 5.5 billion. [redacted] 25X1

The Oil Exporters. Depressed world oil prices will limit the external improvements managed by Venezuela and Ecuador:

- We estimate *Venezuela's* current account surplus will decline by one-third to $1.8 billion in 1984. Imports can be expected to rise about 12 percent to $9 billion to support domestic recovery, causing the decline in the trade surplus. We projected a $6 billion surplus because oil exports remain flat despite more aggressive marketing of oil products. We expect exchange controls will again hold down the service deficit. Interest arrears, however, will rise to $1.1 billion as private companies find it difficult to obtain foreign exchange for debt repayments. [redacted] 25X1

- *Ecuador's* current account deficit will shrink 8 percent to $520 million. We and the US Embassy project a 4-percent increase in the trade surplus to $780 million. Export revenues will rise 14 percent to $2.4 billion, benefiting from increasing oil sales, the impact of improved weather conditions on agricultural production and fisheries catch, and continued currency adjustments. We expect imports to rise 20 percent to $1.6 billion as restrictions for capital goods and industrial inputs are eased after July when the current agreement with the IMF expires. [redacted] 25X1 25X1 25X1

The Copper Producers. Despite a rebound in exports, Chile and Peru will witness slight deterioration in the external accounts:

- *Chile's* current account deficit, according to our estimates, is likely to rise 3 percent to about $1.4 billion. Although exports probably will increase 14 percent to $4.2 billion, stimulative monetary and fiscal policies will stimulate depressed demand for industrial and consumer goods imports. As a result, the trade surplus will decline 10 percent to $900 million. We expect the service deficit to decline to $2.3 billion as Santiago cuts trade-related services to offset higher interest payments.

- We concur with Central Bank projections that *Peru's* current account deficit will remain at $900 million this year. Oil exports are expected to recover most of the volume lost last year and contribute to a 40-percent jump in foreign sales. The trade surplus will rise to $600 million as a result of increased oil sales and further import cuts, but an expected expansion of the net services deficit as activity increases will wipe out the trade gains keeping the need for foreign financial assistance high again this year. 25X1

Primary Product Exporters. Export recovery enables Bolivia and Colombia to improve their external accounts. In our view:

- The new economic policies decreed by *Bolivian* President Siles last November will probably produce some improvement in the payments account. The current account deficit is likely to contract by 5 percent to $355 million. The trade deficit probably will be slashed in half to $15 million as mineral prices strengthen and the peso devaluation holds down imports. The service deficit is likely to shrink by 1.4 percent to $340 million.

- *Colombia's* current account will decline nearly 20 percent to $2.4 billion on the strength of trade improvements. Lower coffee prices and slow growth in its Andean trading partners will keep export growth to 4 percent to $3 billion. Imports, however, will decline 10 percent as Bogota takes economic adjustments under IMF guidance to obtain foreign financing. 25X1

Appendix C

South America's Detailed Current Account Statistics

Table 7
Argentina

	1982	1983	1984 [a]
	Billion US $		
Trade balance	2.3	3.5	3.3
Exports (f.o.b.)	7.6	7.7	8.0
Oil	0.5	0.4	0.4
Nonoil	7.1	7.3	7.6
Imports (f.o.b.)	5.3	4.2	4.7
Oil	0.8	0.5	0.5
Nonoil	4.5	3.7	4.2
Net services and transfers	−4.8	−5.5	−5.5
Interest payments [b]	−5.3	5.5	5.5
Other	0.5	−0	0
Current account balance	−2.5	−2.0	−2.2
Arrearages	2.9	2.5	0
Principal repayments	2.7	0	12.0
Foreign financing requirements [c]	5.2	4.9	16.7
	1982	1983	1984 [a]
	Percent		
Ratio of:			
Debt servicing to exports [d]	105	71	69
Interest payments to exports	70	71	69
Interest payments and arrears to exports	108	104	69
Current account deficit to GDP	4	[e]	[e]

[a] Embassy estimates.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments.
[e] These ratios are probably not meaningful given the sharp inflation and exchange rate movements as they would heavily reflect monetary changes.

Table 8
Bolivia

	1982	1983	1984 [a]
	Million US $		
Trade balance	110	−30	−15
Exports (f.o.b.)	720	620	625
Oil	30	20	10
Nonoil	690	600	615
Natural gas	338	382	300
Imports (f.o.b.)	610	650	640
Oil	5	10	15
Nonoil	605	640	625
Net services and transfers	−420	−345	−340
Interest payments [b]	30	50	45
Other	−390	−295	−295
Current account balance	−310	−375	−355
Arrearages	250	455	300
Principal repayments	264	503	1,000
Foreign financing requirements [c]	574	1,128	1,810
	Percent		
Ratio of:			
Debt servicing to exports [d]	41	89	167
Interest payments to exports	4	8	7
Interest payments and arrears to exports	39	82	55
Current account deficit to GDP	5	6.7	7

[a] Analyst estimate.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus scheduled principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments.

25X1
25X1

Table 9
Brazil

	1982	1983	1984 [a]
	Billion US $		
Trade balance	0.8	6.5	8.0
Exports (f.o.b.)	20.2	22.0	24.5
Oil	1.4	1.2	1.0
Nonoil	18.8	20.8	23.5
Imports (f.o.b.)	19.4	15.5	16.5
Oil	9.3	7.8	7.0
Nonoil	10.1	7.7	9.5
Net services and transfers	−17.1	−13.4	−15.0
Interest payments [b]	12.6	9.5	11.4
Other	−4.5	−3.9	−3.6
Current account balance	−16.3	−6.9	−7.0
Arrearages	0	2.3	2.0
Principal repayments	8.2	7.2	7.9
Foreign financing requirements [c]	24.5	14.1	17.2
	Percent		
Ratio of:			
Debt servicing to exports [d]	103	76	79
Interest payments to exports	62	43	47
Interest payments and arrears to exports	62	54	55
Current account deficit to GDP	6	3	2.5

[a] Analyst estimate.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus scheduled principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments.

Table 10
Chile

	1982	1983	1984 [a]
	Million US $		
Trade balance	218	1,001	900
Exports (f.o.b.)	3,798	3,672	4,200
Oil	0	0	0
Nonoil	3,798	3,672	4,200
Imports (f.o.b.)	3,580	2,671	3,300
Oil	282	461	475
Nonoil	3,298	2,210	2,825
Net services and transfers	−2,522	−2,363	−2,300
Interest payments [b]	1,350	1,600	1,800
Other	−1,172	−763	−500
Current account balance	−2,304	−1,362	−1,400
Arrearages	0	0	0
Principal repayments	1,300	1,800	1,550
Foreign financing requirements [c]	3,604	3,162	2,950
	Percent		
Ratio of:			
Debt servicing to exports [d]	70	93	80
Interest payments to exports	36	44	43
Interest payments and arrears to exports	36	44	43
Current account deficit to GDP	14	7	7

[a] Analyst estimate.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus scheduled principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments.

25X1

25X1

Table 11
Colombia

	1982	1983	1984 [a]
	Million US $		
Trade balance	−1,946	−1,805	−1,200
Exports (f.o.b.)	3,230	2,875	3,000
Oil	290	260	280
Nonoil	2,940	2,615	2,720
Imports (f.o.b.)	5,176	4,680	4,200
Oil	592	490	455
Nonoil	4,584	4,190	3,745
Net services and transfers	−346	−1,195	−1,235
Interest payments [b]	1,045	995	950
Other	699	−200	−285
Current account balance	−2,292	−3,000	−2,435
Arrearages	0	0	0
Principal repayments	670	746	550
Foreign financing requirements [c]	2,962	3,746	2,985
	Percent		
Ratio of:			
Debt servicing to exports [d]	53	61	50
Interest payments to exports	32	35	32
Interest payments and arrears to exports	32	35	32
Current account deficit to GDP	6	7	6

[a] Analyst estimate.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus scheduled principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments

Table 12
Ecuador

	1982	1983	1984 [a]
	Million US $		
Trade balance	201	750	780
Exports (f.o.b.)	2,189	2,100	2,400
Oil	1,341	1,484	1,732
Imports (f.o.b.)	1,988	1,350	1,620
Oil	0	0	0
Nonoil	1,988	1,350	1,620
Net services and transfers	−1,641	−1,316	−1,300
Interest payments [b]	710	215	500
Other	−931	−1,101	−800
Current account balance	−1,440	−566	−520
Arrearages	125	600	200
Principal repayments	598	691	1,100 [c]
Foreign financing requirements [d]	1,998	1,382	2,220
	Percent		
Ratio of:			
Debt servicing to exports [e]	60	72	75
Interest payments to exports	32	10	21
Interest payments and arrears to exports	38	39	29
Current account deficit to GDP	12	14	3

[a] Embassy estimate.
[b] Scheduled interest payments minus arrears.
[c] Includes payment of 10 percent on 1983 refinancing.
[d] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus scheduled principal repayments on medium- and long-term debt.
[e] Interest payments and principal repayments.

25X1

25X1

Table 13
Peru

	1982	1983	1984 [a]
	Billion US $		
Trade balance	−0.5	0.3	0.6
Exports (f.o.b.)	3.3	3.0	3.1
Oil	0.7	0.5	0.7
Nonoil	2.6	2.5	2.4
Imports (f.o.b.)	3.8	2.7	2.5
Oil	0	0	0
Nonoil	3.8	2.7	2.5
Net services and transfers	−1.2	−1.2	−1.5
Interest payments [b]	1.0	1.0	0.9
Other	−0.2	−0.2	−0.6
Current account balance	−1.7	−0.9	−0.9
Arrearages	0	0	0
Principal repayments	1.2	1.0	1.1
Foreign financing requirements [c]	2.9	1.9	2.0
	1982	1983	1984 [a]
	Percent		
Ratio of:			
Debt servicing to exports [d]	67	67	65
Interest payments to exports	30	33	29
Interest payments and arrears to exports	30	33	29
Current account deficit to GDP	8.8	5.9	6.3

[a] Central Bank estimate.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments.

Table 14
Venezuela

	1982	1983	1984 [a]
	Billion US $		
Trade balance	3.1	7.0	6.2
Exports (f.o.b.)	16.3	15.0	15.2
Oil	15.5	14.0	14.0
Nonoil	.8	1.0	1.2
Imports (f.o.b.)	13.2	8.0	9.0
Oil	0	0	0
Nonoil	13.2	8.0	9.0
Net services and transfers	−6.6	−4.2	−4.4
Interest paid [b]	4.0	2.2	2.2
Other	−2.6	−2.0	−2.2
Current account balance	−3.5	2.8	1.8
Arrearages	0	0.9	1.1
Principal repayments	0	0	16.4
Foreign financing requirements [c]	3.5	1.9	15.5
	1982	1983	1984 [a]
	Percent		
Ratio of:			
Debt servicing to exports [d]	25	15	122
Interest payments to exports	25	15	15
Interest payments and arrears to exports	25	21	22
Current account deficit to GDP	5.0	0	0

[a] Analyst estimate.
[b] Scheduled interest payments minus arrears.
[c] Foreign financing requirements equals current account balance plus the previous year's interest arrearages plus scheduled principal repayments on medium- and long-term debt.
[d] Interest payments and principal repayments.

25X1

25X1

Secret