

FILE

Central Intelligence Agency

DATE 9/26/86 FILEDOC NO GI M 86-20082OIR 3P & PD 1

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

1 April 1986

The Cartagena Group: Politicizing the
Latin Debt Problem

25X1

Summary

The declarations issued by the Cartagena Group are part of the Latin debtor effort to gain concessions from their international creditors. The Group's pronouncements also are intended to appease growing domestic popular sentiment for a tougher stand with creditors. Moreover, Latin leaders want Washington to view their debt problem as at least as important as issues in Central America.

25X1

Despite the growing cohesiveness of the Group, the unique and diverse financial situations of each debtor country, the continuing disagreement over how to resolve their debt problems, and the fear of financial fallout will continue to undercut a hardline approach by the Group. Falling dollar interest rates and continued progress in debt negotiations also will moderate Latin debtor criticism. Nonetheless, should a major debtor succeed in negotiating significant concessions, Cartagena members will put strong pressure on creditors to obtain similar terms.

25X1

Dramatic changes in the global economy or in the Latin political environment could heighten the prospects for collective action by the Cartagena Group. Developments that would most likely alter the reluctance of Latin nations to reject the current approach on debt would be deterioration in conditions the debtors perceive the United States as having control over--such as sharply rising dollar interest rates, spreading OECD trade protectionism, and uncompromising creditors demands for substantial economic reforms as a condition for new money.

25X1

This memorandum was prepared by [redacted] the Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, Economics Division, OGI [redacted]

25X1

25X1

25X1

GI M 86-20082

25X1

The Cartagena Group: Politicizing the Latin Debt Problem

25X1

A key development relating to the Latin American debt situation during the three past years has been the rising outspokenness of Latin debtors. The process of politicizing the debt issue began in February 1983, when the President of Ecuador, Osvaldo Hurtado, sent a proposal to the Economic Commission for Latin America (ECLA), the Latin American Economic Systems (SELA), and all Latin American nations seeking a common response to the region's economic crisis. His initiative led to formation of the Cartagena Group¹, which has held four ministerial-level meetings on the debt issue.

25X1

Evolution of the Cartagena Group

At the end of the June 1984 ministerial-level meeting held in Cartagena, Colombia (see Appendix A), the Cartagena Group issued its first statement on the debt issue. Although the resulting statement generally was moderate in tone, the proposals for debt relief went further than previous Latin declarations and contradicted longstanding US policy. For example, the Latin ministers called for limiting total debt service to a "reasonable" percentage of export earnings and asked for interest capitalization where convenient to the debtor. Moreover, establishment of the Cartagena Group created a permanent forum to voice Latin concerns; this consultative system would enable

¹ The Cartagena Group consists of Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Peru, Uruguay, and Venezuela.

25X1

the debtors to coordinate their positions more effectively by sharing information on debt negotiations. []

25X1

The September 1984 follow-up meeting of the 11 Cartagena Group countries in Mar del Plata, Argentina resulted in a moderately worded, 10-point communique that expressed concern over the loss of the "sense of urgency" by the industrial countries regarding their debt repayment difficulties. They also indicated that they would invite the industrial governments to engage in a direct political dialogue in the first half of 1985. By late 1984, however, some of the complaints of the Group had been defused as dollar-denominated interest rates fell and Latin trade balances showed substantial improvement. []

25X1

The Cartagena Group met in the Dominican Republic in February 1985 to prepare the Group for the April 1985 IMF/IBRD Interim and Development committee meetings. Issues they addressed at this meeting included the extension of Mexican-like multiyear restructuring terms to other debtors, a broadening of debt negotiations beyond commercial banks to include creditor governments and institutions, and the recognition of hardships brought on Latin debtors by stringent adjustment programs and unfavorable external factors. The declaration simply reiterated the Cartagena Group's desire for a dialogue between debtor and creditor countries and warned of serious regional instability if their request was ignored. []

25X1

By August 1985, some Latin leaders--including Uruguayan Foreign Minister Iglesias--were seeking to strengthen the Cartagena Group because they viewed it as the best forum to

discuss the political aspects of Latin America's foreign debt problem, according to [] press reporting. They began to search for a way to reduce debt payments rather than merely postpone them through multiyear debt restructurings. They also were becoming increasingly disturbed by the transfer of resources from debt-troubled countries to creditors. Cartagena Group members began examining proposals for interest payment relief and they came out strongly advocating increased funding for the multilateral institutions. []

25X1

25X1

The Cartagena Group's foreign and economic ministers met for the fourth time in December 1985 in Montevideo, Uruguay mainly to respond to the US initiative on debt, which was announced by Secretary Baker in October. The 11 Latin American nations issued a set of "emergency" measures for negotiations on debt and growth that went beyond the US initiative (see Appendix B). The ministers presented counterproposals to the US approach and in a joint declaration cited structural problems in industrial countries--particularly high real interest rates--and falling terms of trade as the major obstacles to solving their debt problem. In addition to the nine Montevideo proposals, the Cartagena Steering Committee, which met on 27-28 February in Punta del Este, Uruguay to respond to the "emergency" situation created by the drop in oil prices, voiced full support for Cartagena members' efforts to modify existing debt agreements, especially by renegotiating interest rates. []

25X1

Present Objectives and Strategies

The declarations issued by the Cartagena Group are part of the Latin debtor effort to gain concessions from their international creditors, an objective that heretofore has been accomplished through bilateral negotiations. The Group's pronouncements also are intended to appease growing domestic popular sentiment--in countries like Argentina, Mexico, and Venezuela--for a tougher stand with creditors. Moreover, Latin leaders want Washington to view their debt problem as at least as important as issues in Central America. []

25X1

Tactically, the Cartagena Group is trying to shift debt negotiations from commercial banks and the IMF to policymaking levels in creditor governments. By trying to arrange a political dialogue between themselves and industrial country governments, the debtor nations are seeking "coresponsibility" for finding a solution. They are acutely aware that concessions, such as the ones they are pursuing on interest rates, might have to be facilitated by regulatory changes by creditor governments. [] [] we believe they envision a dialogue that would begin with a general exchange of impressions and ideas and would evolve toward the implementation of specific measures to relieve LDC debt burdens and to promote further financial flows to debtors. []

25X1

25X1

25X1

During the last two years the roles and positions of each Latin country at the Cartagena Group meetings have changed, primarily because of the evolving nature of their financial situations. One significant and disturbing trend has emerged;

the largest debtors--Mexico, Brazil, and Argentina--have recently acquired a greater say in the direction of the Group. The big debtors are now making an effort to communicate more often with each other on their financial troubles, and at the Montevideo meeting, a steering committee made up of Argentina, Brazil, Colombia, Mexico, and Venezuela was organized to follow the progress of Cartagena proposals. Given that Mexico, Brazil, and Argentina are working more closely together, the Group has now been injected with enhanced political clout.

25X1

Implications and Outlook

The Cartagena Group established a political forum to voice Latin concerns to industrial country governments through public declarations, but so far no consensus has been reached on radical alternative proposals such as a unilateral moratorium on interest payments. Indeed, by limiting itself to the lowest common denominator, the Cartagena process has reinforced a moderate position. Most Latin leaders continue to take a two-track approach to resolving their financial burden: servicing their debt to the best of their ability, while concurrently seeking more concessions. Nonetheless, the Cartagena process has encouraged the Latin debtors to share information on debt negotiations and to use that information to seek better terms from creditors--the so-called spillover effect. The creation of the consultative system also has heightened the level of participation on the part of Latin political leaders to press for changes in the policies and operations of official and private Western institutions.

25X1

The flavor and results of the Cartagena process suggest that Latin debtors will continue to meet as long as the Group's position does not threaten their ability to negotiate individually with commercial banks and creditor governments. We also expect members to continue to see merit in sharing information and presenting unified positions in multilateral institutions. The decisive roles in the Cartagena Group will be played by the finance and foreign ministers of the major debtor nations--especially Mexico and Brazil. Future meetings will continue to serve as rhetorical forums--expressing Latin solidarity--and to alert creditors to their growing frustrations.

25X1

Despite the growing cohesiveness of the Group, the unique and diverse financial situation of each debtor country, the lack of consensus on how to resolve their debt problems, and the fear of financial fallout will continue to undercut a hardline approach by the Group. Falling dollar-denominated interest rates and continued progress in debt negotiations also will moderate Latin debtor criticism. Nevertheless, should a major debtor succeed in negotiating significant concessions, Cartagena members will individually put strong pressure on creditors to obtain similar terms.

25X1

Dramatic changes in the global economy or in the Latin political environment could heighten the prospects for collective action by the Cartagena Group. In our view, developments that would most likely coalesce Latin nations and alter their unwillingness to buck the current approach to debt would be those

they view the United States as having some control over, such as: sharply rising interest rates, spreading OECD trade protectionism, or uncompromising creditor demands for economic austerity and far-reaching economic reforms. Other factors that could force a stronger collective stand would be: increasing domestic political pressures in key Latin countries resulting from a continuing inability for the nations to grow at politically acceptable levels or falls in export prices/earnings sufficient to make continued debt servicing nearly impossible.



25X1



25X1

Appendix A

Consensus of Cartagena Summary of Proposals

June 1984

1. Immediate and drastic reduction in nominal and real interest rates.
2. Shift in the reference interest rate to one that does not exceed banks' cost of funds and that is not based on an "administered" rate (e.g. the US prime rate).
3. Minimal spreads and elimination of bank commissions.
4. Temporary mechanisms to attenuate the impact of high interest rates, including a compensatory fund in the IMF, concessional official credits, and extension of repayment periods.
5. Improvement in repayment and grace periods based on the debtor's capacity for repayment and need for economic recovery, and multi-year reschedulings and capitalization of interest where convenient to the debtor.
6. Partial deferral of interest payments in the case of countries with extreme balance of payments problems (e.g. Bolivia).
7. Limitation of total debt service payments to a "reasonable" percentage of export earnings compatible with maintenance of domestic productive activity.
8. Elimination of the requirement for the public sector to assume private sector commercial risk.
9. Elimination of regulatory rigidities which impede new commercial bank loans.
10. Reactivation of capital flows, including renewal of short-term trade finance.
11. Increase in the financial resources of the IMF, World Bank, and IDB.
12. A new distribution of SDRs compatible with the liquidity needs of developing countries, longer terms for IMF adjustment programs, and increased access to IMF resources.

13. Revision of IMF conditionality to give priority to growth and employment creation and shield the borrower from increases in interest rates.
14. Accelerated use of World Bank and IDB resources through:
 - an increase in program loans and in the maximum allowable percentage of financing of project costs,
 - accelerated disbursement of credits already contracted,
 - a temporary but substantial reduction in local currency counterpart requirements, and
 - elimination of graduation.
15. Longer terms and lower interest rates for Paris Club reschedulings, accompanied by new lines of concessional credit sufficient to prevent the interruption of imports.
16. Immediate attention to the developing countries' appeals for the stabilization of commodity prices at remunerative levels.
17. Rapid elimination of industrial countries' tariff and non-tariff barriers for traditional and industrial products, including technology goods.

25X1

Appendix BDeclaration of Montevideo
Summary of the Nine Proposals

December 1985

1. Western action to return real interest rates to historic levels and examination of mechanisms to ease the debt service burden.
2. Increased capital flows to the region and a separation of old debt from new debt, with future credit flows getting lower rates.
3. Increases in commercial bank lending to at least match world inflation.
4. A limitation on debt payments, linked to either economic growth or to export earnings.
5. A 20-percent annual increase in multilateral development lending for the next three years.
6. Arrangement of multiyear restructuring and interest capitalization through the Paris Club without creditors requiring an IMF-supported adjustment program.
7. Enlarging and broadening the coverage of the IMF's compensatory financing facility to help offset the impact of deteriorating terms of trade, natural disasters, and increased interest rates.
8. An easing of conditionality required by creditors for new loans to allow for economic growth.
9. Elimination of industrial country protectionist measures.

25X1