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50-52 EXTRAS/CB

Latin America's Prospects for Managing Its International Debt

25X1

National Intelligence Estimate

Key Judgments

These Key Judgments represent the views of the Director of Central Intelligence with the advice and assistance of the US Intelligence Community.

~~**Secret**~~

NIE 80/90/3-89W
April 1989
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The following intelligence organizations participated in the preparation of these Key Judgments:

The Central Intelligence Agency

The Defense Intelligence Agency

The National Security Agency

The Bureau of Intelligence and Research, Department of State

The Office of Intelligence Support, Department of Treasury

also participating:

The Deputy Chief of Staff for Intelligence, Department of the Army

The Director of Naval Intelligence, Department of the Navy

The National Foreign Intelligence Board concurs, except as noted in the text.

The full text of this National Intelligence Estimate is being published separately with regular distribution.

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Key Judgments

This Estimate assesses the prospects over the next two years for managing the debt of Latin America's largest borrowers. Since the Intelligence Community last addressed the debt issue in NIE 80/90/3-85, economic and social conditions have worsened in most Latin American countries. Growth in the region has been insufficient to absorb new workers and meet debt-servicing obligations. Living standards have deteriorated significantly, and investment is too low for healthy economic development. 25X1

Efforts to link financing to economic reform have had only limited success, mainly because the political commitment to reform in debtor countries has been lacking. Latin leaders have acknowledged the need for change but have been unwilling to challenge the entrenched interest groups that have benefited from past policies. The stronger governments—Chile and Mexico—have posted the best records. Some of the more recently restored civilian governments—including Argentina and Peru—are less able to form the consensus required to undertake tough reforms. 25X1

Throughout much of the region the ascendancy of populist leaders signals significant economic policy shifts and increases the possibility for radical action on the debt. Front-runners in coming Latin American elections are a particular cause for concern. Some leaders, increasingly using the debt issue as a scapegoat for economic mismanagement, unrealistically raise public expectations at home by promising to restore economic health through debt reduction—ignoring the long delays involved and, more important, the fact that tough reforms are also needed for lasting economic improvement. Others who have managed their economies more responsibly have been unhappy with the lack of rewards from commercial creditors. 25X1

Debtors see the new initiative on international debt launched by US Treasury Secretary Brady as a major step, but private creditors so far are less enthusiastic. We expect difficult negotiations as creditors and debtors seek to mold the Brady initiative into a working plan. From the Latin American perspective, even if debt reduction occurs, a key element of the plan will be the willingness of commercial banks to provide new funds to support economic reform and to allow for improved economic conditions. 25X1

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We are concerned by the wide gap between the expectations of Latin countries for debt reduction and new money and the willingness of commercial banks to provide them. For countries such as Argentina, Brazil, Ecuador, and Peru, where there is political uncertainty and an unwillingness or an inability to undertake economic reform, commercial banks will probably resist funding the Brady initiative.[1] In any case, we believe neither commercial lending nor the pace of reform will be sufficient to improve social conditions significantly in these countries over the two-year time frame of this Estimate. 25X1

Despite the general populist shift among Latin governments, most leaders still recognize that economic reform is necessary. We believe the pace of reform will be dictated more by the strength and commitment of individual governments than by the promise of new money or debt reduction and external pressures such as IMF programs. We expect the current leaders of Mexico, Colombia, and Chile will remain strongly committed to reforms and they will most likely stay the course. Venezuela has undertaken impressive reform in the few months that Perez has been in power, but financial assistance and popular support for these efforts in the short term probably will be needed for Caracas to stay on this path. Argentina, Brazil, and Ecuador, in contrast, lack the political stability and consensus necessary to undertake significant reforms, although their leaders would like to move in that direction. The Government in Peru will probably have to change before there is a credible commitment to reform. Because of uncertain economic and political conditions, we expect capital flight to remain a serious problem for most of the region. 25X1

Over the next several months, it remains unlikely that the Latin American countries will collude to obtain more favorable terms. Nevertheless, if a few countries such as Mexico obtain significant debt reduction, but others do not, we foresee a sharp increase in the risk of a simultaneous—if not coordinated—debt payment suspension by other debtors, notably Argentina and Brazil. Argentina may well expand its payments suspension to include official creditors, and Brazil may again declare a moratorium. In countries that fail to qualify for debt reduction the consequent economic hardship will add to internal political turmoil. Debt will be only a contributing factor to the political problems within the Latin debtor countries, however, and debt reduction will not be a panacea for their economic problems. Reducing even large portions of the debt cannot ensure democracy or stability. 25X1

[1] *The Department of the Treasury disputes the grouping of Argentina, Brazil, Ecuador, and Peru. It is too early to conclude that these countries will be unwilling or unable to undertake economic reforms sufficient to attract new commercial bank lending.* 25X1

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