FUNDING OF LATIN AMERICAN DEVELOPMENT

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I. INTRODUCTION

There is broad consensus[1] that one of the key pre-conditions for restoring GDP growth in Latin America in the nineties to levels around 5 per cent annually is to increase total current savings by some 7 per cent to 8 per cent of GDP. This represents around $75 and $85 billion per year. Clearly resources of this magnitude cannot come from a single source; they require, amongst other efforts an increase in both domestic and external savings.

A significant increase in external savings can best be achieved if both significant debt service reduction and increased new capital flows can be achieved, as now seems increasingly feasible, at least in some countries.

As regards external savings, it is extremely encouraging that there is now some evidence (though it is still preliminary) that in 1990 there actually was a reversal of the negative net transfer of resources (NTR) from Latin America and the Caribbean to the creditor countries. A 1991 OECD study[2] estimates that during 1990, NTR were positive, at $10 billion for the first time since 1983. The main reason for this reversal was the significant increase in private flows to the region, estimated to have grown by over US $8 billion, between 1989 and 1990, to reach $24 billion in the latter year (see Table 1). These large increases are reported to have benefited only a small number of countries (essentially Mexico, Chile, Colombia and Venezuela).

Should this trend continue and be spread far more widely throughout the countries of the region, net external savings could again play a positive role in contributing to the region's growth, as they did in decades previous to that of the eighties.

TABLE 1

NET RESOURCE FLOWS TO WESTERN HEMISPHERE

(In current billion of dollars)

	1982	1983	1984	1985	1986	1987	1988	1989	1990 1/
I.OFFICIAL DEVELOPMENT FINANCE (ODF)	7.8	6.8	9.9	10.8	11.4	13.1	11.4	12.4	14.6
1.Official Development Assistance (ODA)	4.2	4.7	4.9	5.4	5.8	7.1	7.3	7.9	
of which: Bilateral disbursements	3.3	3.7	3.9	4.4	4.8	6.1	6.1	6.7	
Multilateral disbursements	0.9	1.0	1.0	1.0	1.0	1.0	1.2	1.2	
2.Other ODF	3.6	2.1	5.0	5.4	5.6	6.0	4.1	4.5	
of which: Bilateral disbursements	1.3	-0.5	1.3	2.1	1.6	3.4	1.3	2.1	
Multilateral disbursements	2.3	2.6	3.7	3.3	4.0	2.6	2.8	2.4	
II.TOTAL EXPORT CREDITS	2.6	2.4	1.4	1.3	0.9	0.7	1.3	2.1	1.8
1.DAC Countries	2.3	2.2	1.0	1.3	0.9	0.6	1.3	2.1	
of which: Short Term	0.6	x	0.1	1.4	1.6	1.5	1.0	0.8	
2.Other Countries	0.3	0.2	0.4	x	x	x	x	x	
III.PRIVATE FLOWS	39.0	18.5	18.6	10.6	6.2	8.1	11.0	15.3	23.7
1.Direct Investment (DAC)	5.9	3.8	5.8	5.1	3.9	6.4	9.4	9.8	
2.International Bank Lending 2/ 3/	28.3	15.3	13.7	6.2	1.6	3.7	1.5	6.0	
3.Total Bond Lending 3/	4.0	-0.8	-1.0	-0.8	-1.4	-2.1	-1.4	-1.1	
4.Other private	0.5	-0.1	-0.3	-0.3	1.6	-0.4	0.8	-0.1	
5.Grants by non-governmental organizations	0.3	0.3	0.4	0.4	0.5	0.5	0.7	0.7	
IV.TOTAL NET RESOURCE FLOWS (I+II+III)	49.4	27.7	29.9	22.7	18.5	21.9	23.7	29.8	40.1
V.TOTAL NET TRANSFER (IV+3)	8.7	-9.6	-7.7	-17	-15.2	-3.7	-12.5	-1.6	10.1
Memorandum items									
1.Total net credits from IMF	1.9	6.9	3.9	1.5	0.2	-0.8	-0.5	-0.2	1.2
2.Recorded asset transactions, net 4/	-8.0	-5.4	-7.2	-1.6	0.4	-7.1	-5.1	-2.1	-6.0
3.Interests and dividends paid by LDCs, gross	-40.7	-37.3	-37.6	-39.7	-33.7	-25.6	-36.2	-31.4	-30.0
4.Total official grants	2.2	2.4	2.7	3.2	3.5	4.1	4.4	4.7	5.6

SOURCE: OECD, Financing and External Debt of Developing Countries, 1990 Survey, Paris 1991.

1/ Preliminar

2/ Includes changes in interest arrears and long and short term transactions

3/ Excludes entries related to bonds for bank debt exchanges under the Mexican debt restructuring of February 1990 are not reflected in this table.

4/ Excludes offshore centres and, as regards transactions, changes in official reserves.

However, it should be stressed that even if there is a positive net resource transfer from abroad, important efforts need to be made to increase domestic savings. This is due to several reasons. Firstly, increased foreign savings of the magnitude estimated for 1990 (even if sustained) would not be sufficient to restore growth to desirable levels of around 5 per cent per annum. Secondly, higher foreign savings cannot be relied to be sustained, as the experience of the eighties so clearly demonstrated; this is partly because new flows can dry up or diminish, for circumstances outside the control of Latin American and Caribbean countries; partly the net contribution of foreign savings is cyclical because large increases in new flows are followed by increases in interest and dividend payments. Thirdly, often measures taken to increase domestic savings (e.g. such as reduction in the fiscal deficit, via increased revenue and/or cuts in current consumption) may also encourage external savings to come into the country.

More generally, there is growing evidence[3] that fiscal, monetary and exchange rate measures designed to create stable domestic economic and financial market conditions should encourage both domestic savings in developing countries, return of capital flight, as well as renewed access to international capital markets and encourage foreign direct investment.

In what follows (Section II), we will first examine the prospects that net resource transfers from abroad to the LAC region will remain meaningfully positive in the 1990s (both because new capital flows flow in and because debt servicing continues to decline). We will look in more detail at prospects for new private capital flows as this is a new phenomena, which is not yet fully understood. Then we will look briefly at the likely role that domestic savings can play in the 1990s, and the role that economic policy can have in encouraging them.

Conclusions are presented in Section III.

II. EXTERNAL FINANCIAL FLOWS

As is well known (and as can be seen in Table 1) in the eighties, net resource transfers to LAC were strongly negative; one of the key reasons for this was a sharp fall in private flows to the region, caused by a large decline in private bank lending, that had reached such high levels till 1982. Indeed, the total amount of voluntary loan and bond financing flows to Latin American countries during the whole 1983-88 period was considerable smaller than that for 1982 alone.[4]

Since 1989, but particularly since 1990, there has been an important increase in new private flows to the Latin American and Caribbean region, but this has not mainly been due to a return of bank lending, but due to the region's re-entry to capital markets (especially bonds) and due to increased foreign direct investment into the region. Although still relatively limited in terms of magnitude and spread of countries, the process of market re-entry seems to be gaining momentum and is affecting a wide range of financing instruments.

Amongst the instruments of recent greatest importance for the LAC region are: international bonds, (mainly Mexico and Venezuela), financial instruments backed by assets and other customised financial instruments (Mexico), and portfolio investment (Mexico and Chile).

As regards international bonds, there had been practically no issues of Latin American countries between 1983 and 1987; this situation was modified when in 1988, Venezuela made three bond issues for a total of approximately $260 million.[5] The re-entry was then followed on a larger scale by Mexican public and private sector corporations. El Erian, op cit. estimates that in the 18-month period ended December 1990, Mexico and Venezuela issued some $3 billion of bonds. Issues by Mexican public and private sector companies exceeded US $1.5 billion in the first five months of 1991. The majority of these bonds were placed in the US and German market; they mobilised both institutional investors (pension and insurance funds) and residents' capital held abroad. The latter would indicate that partly the bonds have become a mechanism for returning capital flight. However, given growing globalisation of international capital markets, the precise origin of the funds is not as important as in the past.

Not only has access to bond markets improved recently, but also the initially very high costs have declined. Thus, the first unsecured voluntary bond issue by a Mexican public enterprise since 1982 (Bancomext in June 1989) carried an initial yield of 17 per cent, implying a "risk premium" of 820 points over US government bonds; by the third quarter of 1990, the spread or "risk premium" has fallen to 320 points over US government bonds[6] (see Chart 1). Even if individual Mexican borrowers are tracked (to assure comparability) a similar, sharp decline in spreads is reflected for the June 1989 - February 1991 period.

An interesting very recent development is that Brazilian and Argentinian borrowers have also re-entered the capital markets, albeit on a smaller scale and at somewhat less favourable terms than those received by Mexican and Venezuelan borrowers.[7] The fact that the Brazilian government has begun to allow certain major companies to make debt payments directly, rather than through the central bank (thus somewhat de-linking company risk from country risk) has reportedly enhanced credit-worthy companies' ability to raise funds in international capital markets, even though the government has not yet reached agreement with its commercial bank creditors. Indeed, it was particularly interesting that the August 1991 Petrobras Eurobond issue was oversubscribed; this was reportedly one of the first times that a country technically in arrears and without agreement with its creditors raised funds so successfully on the world capital markets.[8]

Equity portfolio flows is another source of foreign capital, that has acquired increased importance in recent years for Latin America and the Caribbean, and which potentially may continue to increase its significance for the region.

Equity portfolio flows to Latin American countries take different forms, including foreign purchases of shares in a Latin American corporation, directly in the stock market; corporate equity issues in developed (especially the US) stock market; and - very significantly for Latin America - via indirect foreign purchases of shares in LAC corporations, through for example "country funds" that specialise in investing in emerging developing country stock markets.

It has been estimated[9] that in the case of Mexico, inflows of capital via these mechanisms have in recent years reached at least $3 billion. The Telmex privatisation alone, completed in May 1991, involved the issuance of some $2.3 billion of equities in several capital markets, including in Canada, France, Germany, Japan, Switzerland, the US and UK. The equity offering is reportedly the sixth largest placement in the world and the largest for any Latin American country.

In the case of Chile, there have been important inflows of equity portfolio, mainly via country funds. In 1990, the total inflows via this mechanism was reported to have reached 43 per cent of total foreign investment which entered that country. Though this high proportion is probably unlikely to be repeated in the future, it highlights the significance of the contribution which such funds can have in countries' external fundings.

As regards foreign direct investment itself, inflows into some Latin American countries have also increased significantly. In Mexico, for example, registered foreign direct investment inflows in 1989-90 were twice the level recorded in 1987-88, with the "pipeline" of new registrations growing to over $5 billion.[10] Similar developments were recorded in Chile.

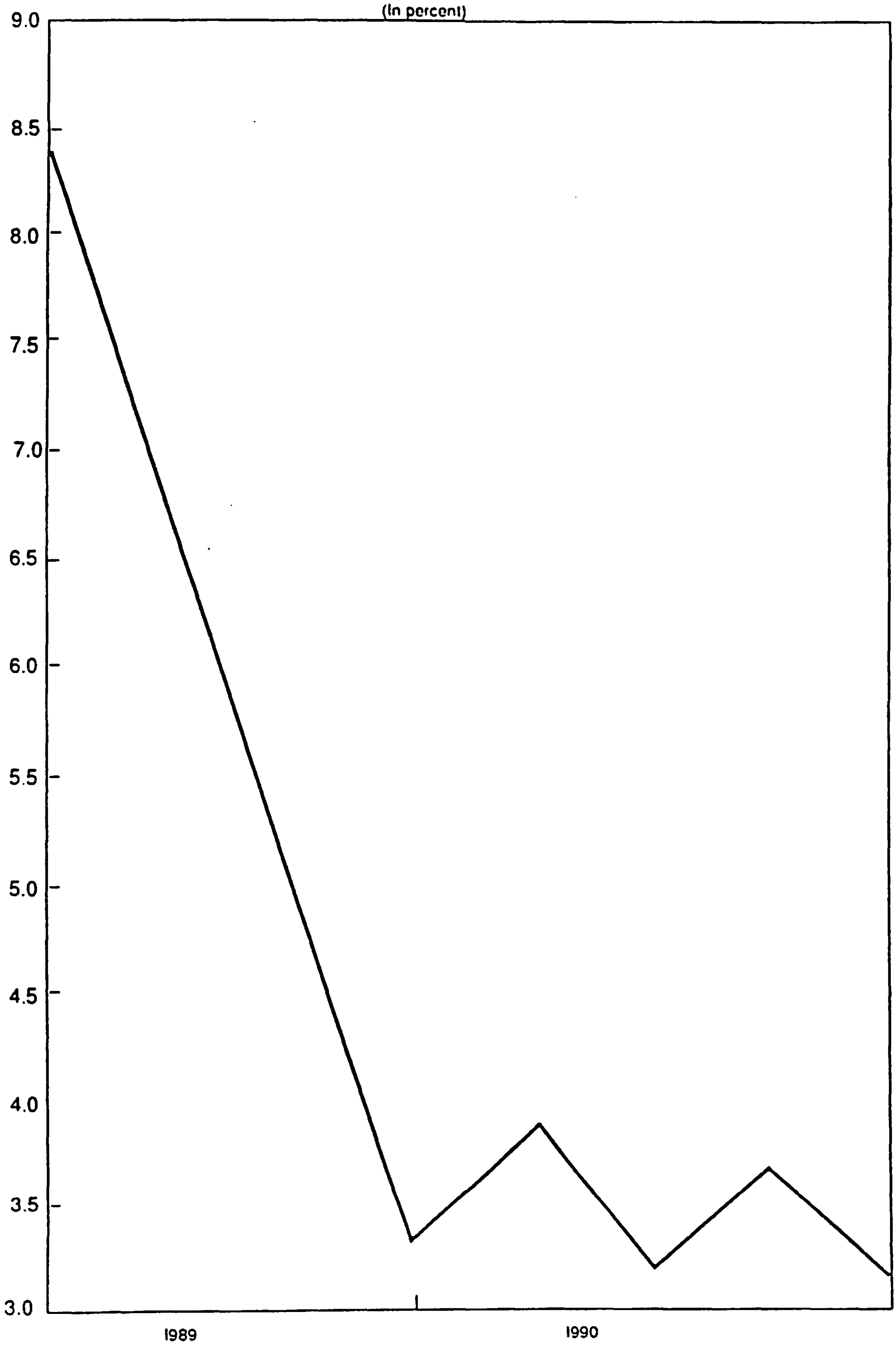
According to the International Finance Corporation (IFC), foreign direct investment in Latin America and the Caribbean reached $7.2 billion in 1990, level that was at pre-debt crisis levels.[11] According to IFC, foreign investors preferred Latin America over other destinations in the developing world; this latter perception is confirmed by the fact that, according to a recent Inter-American Development Bank report,[12] Latin America currently receives 80 per cent of all foreign direct investment in the developing countries, (the figure given by IADB for FDI is slightly higher, at 9 billion, than the IFC figure).

CHART 1

MEXICO

INDICATOR OF RISK PREMIA ON MARKET BORROWING

(In percent)



Source: IMF, Latin Finance and International Financing Review

The IADB Report referred to above also quotes forecasts[13] suggesting that foreign direct investment in the region could increase to as much as $22 billion at the end of the century. The feasibility of such a dynamic increase will be influenced by the recovery of the industrialised economies and by a possible shortage of capital world wide. For this and other reasons, institutions like the World Bank forecast lower levels of FDI to LAC for the nineties than the projections quoted above.

Another important and positive trend emerging since 1989 is the return of capital previously fled. According to Chartered West LB estimates,[14] for five major Latin American countries (Mexico, Chile, Venezuela, Brazil and Argentina), there was a total net capital repatriation for 1989-90, of $10.5 billion, which is in sharp contrast with the 1987-88 period, when there was a capital flight of -$8.0 billion, implying a turnaround of $18.5 billion in a short period.

As can be seen in Table 2, the situation is quite heterogeneous across these five countries. Some countries (Mexico, Venezuela and Chile) are seeing important levels of repatriation, while other (Brazil and Argentina) are seeing capital flight; indeed, Brazil once held as an example of a country to have avoided capital flight, has been consistently loosing capital since 1983. On the contrary, Mexico - a country which traditionally had large capital flight - has had a massive return (estimated at $10 billion) in the 1989-90 period. Of the five, the only country that has had a significant net repatriation of capital for the whole 1983-90 period is Chile. This seems to have been due both to so-called economic fundamental factors (strength of macro-economic policy, good relations with external creditors, private sector orientation, low inflation, positive real interest rates and a welcoming attitude to foreign direct investment) and institutional factors (debt conversions and dollar-swap mechanism); it is noteworthy that the apparently more sustainable stability given by a successful democratic government (in 1990) implied in that year the highest capital repatriation of the period for Chile (see, again Table 2). It is important to stress that, at least in the Chilean case, a return to democracy has had a favourable effect both on capital repatriation and foreign direct investment.

The questions that arise from these new and broadly positive trends in private capital markets are the following. What are the causes of these renewed flows? Are the levels of net private flows likely to be sustained throughout the decade of the nineties? What measures should be taken to encourage them? Will they also benefit other Latin American and Caribbean countries? If these inflows are sustained, should measures be taken to control their level and their effects?

Table 2

Estimated Capital Flight (-) Repatriation (+), 1983-90
(US $ billion)

	Argentina	Brazil	Chile	Mexico	Venezuela	Total
83	-1.7	-4.3	+0.2	-1.8	-4.5	-12.1
84	+0.9	-6.4	+1.2	-3.1	-1.6	- 9.0
85	+0.4	-1.3	+1.0	-4.1	+0.4	- 3.6
86	+1.6	-0.4	+0.6	-2.1	+1.2	+ 1.0
87	-1.8	-1.0	+0.2	-1.6	+0.9	- 3.2
88	+0.8	-1.5	-0.6	-5.3	+1.8	- 4.7
89	-1.3	-1.7	0.0	+5.2	+1.2	+ 3.4
90	+0.3	-1.0	+1.4	+5.5	+0.7	+ 7.0
1983-90	-0.7	-17.6	+4.1	-7.3	+0.2	-21.3

Source: Chartered West LB, op cit; figures have been rounded to one decimal.

To understand the causes of large inflows in the two recent years to Latin America, a valuable clue to the causes can be provided by the countries in which they have been concentrated (Mexico, Chile, Venezuela and Colombia).

a) Domestic Policies

There is consensus that one of the key-preconditions for access to foreign flows (as well as encouragement of return capital by nationals) is the reduction of domestic financial imbalances - where these existed - due to improved budgetary performance and prudent monetary policies. Amongst the relevant factors are reinforcement of fiscal revenue effort and positive real interest rates. Secondly, policies that enhance the supply response of the economy are clearly important, including that of production of tradeables. As, for example, the Chilean experience in the '80s clearly shows, a competitive exchange rate plays a key role in promoting both production of tradeables and growth. A third area where domestic policies seem important is improving economic efficiency through structural reforms, such as trade liberalisation, tax reform, rationalisation of legal and other procedures ruling foreign investment, etc. There is consensus on the need to carry out such reforms, though still some debate on timing and sequencing. The recent literature also emphasises the importance that structural reforms are made in such a way that they do not undermine (and if possible strengthen) prudent macro-economic equilibria. There are two areas not so frequently stressed in the literature which however seem important factors to explain both foreign capital inflows and return of flight capital. One is economic growth or the prospect of increased growth (the former illustrated by the Chilean case and the latter illustrated by the Mexican case, where prospects of growth are not only bolstered by recent figures but also by the prospects of the FTA with the US and Canada). A second additional factor is political stability, preferably in the context of a relatively consensual and democratic political process. The <u>increase</u> in capital inflows into Chile during the first year of democratic government provides evidence for the importance of this factor. There is also here an important distinction between most countries in the region and Eastern Europe as well as especially the former USSR, where both political stability <u>and</u> democracy are <u>extremely</u> fragile, and in some cases non-existent. In this sense it seems worthwhile that representatives of the region stress its relative political stability and more established democracy in comparison to other areas, especially but not only, the ex-USSR and Eastern Europe.

b) Restructuring of Existing Debt

There is now also agreement in the economic literature[15] that for many countries it is a pre-condition for renewed capital flows that the "old debt overhang" be eliminated or significantly reduced. There is now strong evidence (for example from Mexico) that at least for some countries there can be a strong <u>complementarity</u> between some debt reduction (as in Mexico via its Brady deal) <u>and</u> increased capital inflows. As had been hoped by the Mexican government,[16] the positive indirect effects of Mexico's Brady deal became more important than the direct effects. The multi-annual Mexican Brady deal, which not only reduced debt service but also shifted amortisations forward for an important number of years, reduced uncertainty and provided confidence, contributing to indirect benefits (including significantly increased capital flows and return of capital flight), which are estimated - at least in short-term - to have been more important than the cash flow effects of the Brady package.[17]

In the case of Venezuela, there is preliminary evidence that also its Brady deal has contributed to increased capital flows. The case of Chile is somewhat different, as its debt overhang was dealt with through pure market-based techniques (mainly via debt-equity swap) and - in 1990 - a more conventional rescheduling of commercial debt. However, also in this case, the reduction of the debt overhang (together with rapidly growing exports) was an important factor in encouraging new private flows.

It should, however, be mentioned here that countries - like Brazil and Argentina - which have not reached an agreement with the commercial banks, (and which are still partially in arrears), and (especially in the case of Brazil) which have not yet put "their macro-economic house in order" have had since 1991 some access to new capital flows (though less than the countries discussed above, and at less attractive financial terms). These flows seem to have come partly on the expectation that Brazil and Argentina will follow the same positive path of Chile, Mexico and Venezuela (a sort of positive regionalisation of expectations) and partly is linked to the fact that it is highly credit-worthy companies (allowed unrestricted access to foreign exchange and with a good payment record in the past) which have been attracting these flows. However, in the medium-term, for companies in those countries to borrow significant amounts, it seems an important pre-requisite that their macro-economic situation improves and that the debt overhang has some kind of definite settlement. At the time of writing, the prospects that Argentina and Brazil reach a relatively satisfactory (for their economies' growth) settlement with commercial banks are relatively favourable, though not certain.

However, it is important to stress that the "quality" of the company attracting the flows (whether public or private, or - as often occurred recently - in the context of privatisation), is a very significant element in attracting new flows. Large, well-known credit-worthy companies, especially if they are exporters, will find this task much easier. It seems to be that the size, and reputation, of the companies rather than particular sectors is what attracts foreign flows; indeed, foreign flows have been attracted by companies in sectors as diverse as oil, paper, tourism, banks, telephone companies and copper mines (see Appendix 1); perhaps the main common feature is their ability to generate foreign exchange income via their sales. It is unclear and perhaps doubtful whether small countries in the region (with fewer and less well known companies in that category) will be equally able to attract the type of new private inflows that are now coming into Mexico, Chile, Venezuela, Colombia and may continue to enter Argentina and Brazil. Their task is made even more difficult if they still have an unresolved debt overhang, as several (e.g. Ecuador) do. In this sense, it seems important if that is the case: i) that they get - where necessary - relatively more debt reduction than those countries which can attract new flows; ii) they get strong support from the IFI's in reaching soon a favourable debt settlement (as commercial banks may be less keen in those cases to do so, and as they may require more debt reduction); iii) they continue to have significant access to official flows, and iv) that special efforts are made by IFI's and industrial governments to help those countries try to attract private flows.

c) Reduced Transaction Cost

Though perhaps somewhat less important, but also of significance, is the fact that there has been a reduction in transaction costs for developing countries to access international capital markets, and especially that of the USA. The 1990 approval of "Regulation S" and "Rule 144A" has reduced transaction costs and liquidity problems for LAC countries tapping US markets.[18] Regulation S exempts securities from registration and disclosure requirements (with costs for first time LDC issues estimated formerly in the order of US $500.000 to US $700.000); simultaneously, the adoption of rule 144A reduced the loss of liquidity associated with "private placements" (in the past buyers of securities through private placements had to hold them for at least two years after the initial offering). Since 1990, "qualified institutional buyers" (e.g. entities managing and owning at least $100 million in securities) have had the 2 year holding requirement relaxed.

These changes have also reportedly reinforced the possibilities offered by the American Depository Receipts (ADS) program without meeting the full costs of offerings/listings. This has helped LAC countries (e.g. Chile, Mexico, as described above) to place shares in the US market.

Also, access to bond markets for LAC countries has lead to and been helped by established market-credible credit ratings, thus reducing investors' costs, with Mexico receiving its first credit rating by Moody's Investors in December 1990.

These improvements in access to US capital markets should also be accompanied by similar (or equivalent) changes, if necessary, in European and/or Japanese markets. LAC governments and institutions like the IADB as well as the private sector itself could play an important role in identifying any problems with access, and suggesting changes to facilitate and/or make cheaper such access. Furthermore, technical assistance may be required for smaller LAC countries about already existing possibilities of access.

d) Possibility of Customising Financial Instruments

One option for improving access to capital markets, especially by countries at a stage when they are re-establishing (or establishing) fully their reputation in those markets is to provide explicit credit enhancements, via collateralisation (e.g. on the basis of existing assets, such as deposits abroad), or expected stream of receivables, (such as Telmex's granting investors by providing them a claim on payments due to it by the US company AT and T on account of international communications).

Such mechanisms have been innovatively used in recent year by Mexican, Venezuelan and other LAC companies; their use could be broadened, if necessary, to companies and countries that need to offer this type of "comfort", to investors still somewhat worried about credit and transfer risk. However, possible costs of extensive use of this mechanism need to be carefully evaluated. These costs include the reduction of flexibility for the country and the company on use of its future income, as well as costs associated with legal and technical problems. These would be compared with the advantage of initially helping restore market access and of possibly obtaining funds cheaper than would have been otherwise possible (the latter illustrated by the Telmex issue described above).

It needs to be stressed that net private capital flows to the Latin American region will not just depend on conditions and policies in those countries, but on the savings and investment balances in the rest of the world (and especially in the developed countries) and on the efficiency and stability of international financial and capital markets (for a detailed discussion see previous section of this report, on Development of the International Financial System[19]). There are some international elements which may make it more difficult for LAC countries to attract private capital flows. One is the likely continued net savings deficiency of industrialised economies (at levels at least similar to those that occurred in the 1980s); this problem could be accentuated by increased demand for private (and especially public) industrialised countries' funds to finance Eastern Europe and the ex-USSR (if the sums demanded become higher than had been assumed in existing projections). The international financial system itself has some important weaknesses and sources of fragility, though these are more prevalent in the international banking sector, which in any case would not be likely to provide significant new funding to LAC countries.

Though these types of international uncertainties should lead LAC governments to even more prudence in not relying exclusively or even excessively on foreign savings to increase total savings, they should not detract governments from carrying out policies which attract foreign flows. Indeed, in this sense it is very encouraging that certain LAC countries (e.g. Mexico, Chile) have regained international capital market access at a time (1990/91) when a number of international factors (declining German current account surplus, increased demands from EE and ex-USSR, fragility of some international banks) were either problematic and/or highly uncertain. The rapid improvement in those countries' performance (and the international perception of such improvement), combined with the relatively small magnitude (on a world scale) of flows to the region would seem to allow for this not only promising but rather surprising trend. Though its continuation and diffusion to other countries in the region cannot be taken for granted, there are fairly strong reasons to assume certain optimism in this matter; the risk of continued recession in the US and slow-down of European and Japanese growth for 1992 does however cast an additional shadow over this fairly optimistic assessment.

Mobilisation of domestic resources

As pointed out in the Introduction, even though there may be a positive net resource transfer from abroad, in the 1990s (and this is not certain) the LAC needs to make an important effort to increase domestic savings. Fortunately, some of the measures required to attract foreign savings are also helpful for increasing national savings, and for encouraging it to stay in the country.

A good example of this relates to measures which are geared to increase public savings. There is growing consensus in the relevant economic literature[20] that "the most direct tool at the government's disposal for altering the national saving rate is changes in the level of public saving or dissaving". Indeed, in Latin America, in the 1984-87 period, the recovery of the Latin American savings rate (from its low 1982-83 level) was almost entirely caused by an increase in public savings (while private saving remained constant during that period); furthermore, as Corbo and Schmidt-Hebbel, op. cit. seem to show conclusively with econometric evidence for Latin America, in the short-to-medium run, raising public savings is the most effective and sure way to increase national savings; it is important to stress that the increase in public savings will not in Latin America lead to major declines in private savings, particularly if the increase in public savings is achieved via a reduction of non-essential government spending; however, in cases where traditional tax revenue is low, (as occurs in many LAC countries) the most efficient way to increase public savings is to increase taxes and improve tax compliance. It should also be stressed that increasing public savings, by reducing budget deficits helps lower inflation, improve the current account deficit and provide a more stable and predictable macro-economic environment; this will tend to provide an incentive to increase national private savings and attract foreign savings.

Indeed, there seems to be a close link between low levels of inflation and higher national savings. The IMF Occasional Paper quoted above shows that after 1982, developing countries that managed to keep annual inflation rates below 10%, displayed on average higher savings rates than those countries that did not - by as much as 9-10 percentage points of GDP. The same IMF study provides clear evidence that since 1982, developing countries which had serious debt servicing difficulties had their national savings rates decline substantially (from 27% in 1976-81, to 22½% in 1982-88), while countries without debt servicing problems were able to maintain savings rates at about 26% in both periods. Therefore, it can be concluded that prudent macro-economic policies (as well as other policies) which avoid both high inflation and debt-servicing difficulties, are a very important factor for encouraging higher national savings rates.

Also of importance for encouraging national savings is the existence of exchange rate and interest rate policies which give competitive yields nationally so as to generate saving within the country and keep those savings there. However, there seems to be agreement in the literature that private saving is not very responsive to increases of interest rates; therefore, other mechanisms (such as having an appropriately designed social security system) need to complement interest rate policy, for the promotion of personal savings.

Finally, a factor which can contribute to greater mobilisation of national savings - and their channelling to productive investment - is development of the financial sector (or financial deepening). However, there is growing agreement in the literature (see, for example, CEPAL and IMF documents quoted above) that the timing, phasing, design and modality of such deepening is crucial for it to have a positive effect on increasing and not decreasing saving mobilisation and improving investment efficiency. The processes of financial liberalisation carried out in countries such as South Korea and Taiwan (which implied a gradual interest rate liberalisation, and thus a measured programme of removing financial distortions, while maintaining macro-economic stability <u>and</u> boosting bank supervision) lead to a significant rise in private saving as well as substantial gains in efficiency; however when financial liberalisation is carried out abruptly, in a context of high and variable inflation, as well as poor supervision of financial institutions, and especially if it is combined with stringent monetary policies aimed at correcting macro-economic imbalances (as occurred in Argentina and Chile), this process may lead to excessively high and variable real rates of interest or extreme credit rationing; the resulting declines of output may indirectly result in a fall in savings. Furthermore, if there is a severe crisis in the financial sector (as occurred in the early eighties in countries such as Chile and Argentina), the required rescue operations will absorb substantial public resources, (e.g. in Chile, the Central Bank had losses due to these causes which reached almost 40% of the country's 1989 GDP) which will restrict the public sector's future ability to save.

Therefore, financial liberalisation must be carried out prudently and in a fairly balanced macro-economic context, so as to generate additional national savings; it must be accompanied by appropriate supervision of financial institutions. Development of financial institutions for savings mobilisation should not just be restricted to the banking sector, but should also include the development of competitive and transparent Stock Exchanges and appropriately designed and supervised institutions such as pension funds and insurance companies. Special measures also need to be taken to encourage mechanisms for mobilising savings from (and channelling resources for investment to) small and medium enterprises and relatively lower income group families.

III. CONCLUSIONS

Since 1990, there is cause for some optimism for LAC on international mobilisation of resources to help fund its investment needs, due to the fact that reportedly negative net resource transfers have been reversed for the first time since 1983 and were positive, and the region as a whole (as well as some of the major countries) have regained access to international capital markets on a voluntary basis.

Though it is still too soon to reach definite conclusions, there seems to be a good chance that (unless there are major and unexpected changes in the international environment, and/or in domestic policies) countries like Chile and Mexico will continue for the next few years to have important market access, though possibly at a lower level and/or at worse financial conditions than at present. For those countries, the challenge will be not just to maintain market access, but also to regulate inflows so that distortions are not caused by them on economic policy (e.g. over-valued exchange rate, monetisation leading to inflationary pressures); the need to avoid excessive (in relation to future servicing capacity) indebtedness or obligations in foreign exchange must also be carefully considered. In this respect, both the volume and the financial conditions of all types of inflows needs to be carefully monitored, and - if necessary - policy measures be taken to regulate them. Preference would seem desirable for capital flows with greater likelihood of remaining in the country for longer periods (e.g. foreign direct investment). Complementary efforts at domestic savings generation and mobilisation remains a central challenge, even when foreign savings are increasing, as the South Korean experience so clearly shows!

For countries, without such access at present, efforts need to be made to gain such access, via an improvement in their policies, via reduction of their debt overhang and possibly via technical assistance. However, there may be countries which are either unable to achieve the above described pre-conditions and/or even if they achieve them, will not attract significant new private flows, either in the near future or ever. In these cases, special efforts need to be made to mobilise domestic savings, reduce debt overhang sufficiently and rapidly (with the need for bilateral official, Paris Club debt as particularly important, for certain countries in the region) and mobilisation of public international flows, especially via IFI's (and particularly through the IADB).

The role of the IADB in the region will not only be increased due to its important recent capital increase and the significant new initiatives it has taken, but also because it will be the only IFI lending to the region whose resources and efforts will not be distracted and/or diverted by lending/giving policy advice, etc. to Eastern Europe and/or the former USSR.

The problem of possible diversion of resources to Eastern Europe and/or the former USSR will probably be more significant in the near future for public flows (both bilateral and multilateral). It therefore will become more difficult to fund new public initiatives for the region, via official flows. However, as regards private flows, in the near future, (e.g. next 5 years), it seems unlikely that there will be any important diversion from the LAC region to EE and the ex-USSR; at present LAC offers an established market environment, (with clear property laws, availability of managers and entrepreneurs, established accounting practices, etc) not yet available in EE and the ex-USSR; furthermore, it offers in many cases, relatively better growth and political stability prospects, e.g. EE and the ex-USSR face difficult and complex economic and political challenges simultaneously in the next four years.

Particularly if EE and ex-USSR countries achieve political stability and sustained growth (as they may during the nineties), they may become competitors with LAC countries for foreign and other investment; this competition may be particularly for production to be exported into the rest of Europe (and especially into the EEC and EFTA, where clearly EE and perhaps the ex-USSR will have, and already is beginning to have, preferential market access for its products). LAC countries and companies can take actions, to try to counteract such trends, for example by themselves making foreign investments in Europe (including in EE). This again will be a task that will be easier for the larger, more successful and less foreign-exchange constrained countries in the region, and harder for the smaller, less successful and more foreign exchange constrained countries. The main diversion of resources would come from European (especially German) sources, in the private sector.

Returning to the role which IFI's will play in the region, because of the relative scarcity of there flows, there may be a need for greater selectivity. Preference may need to be given to funding high priority public sector projects (especially if they have relatively little access to international capital markets); more broadly, public funding may become somewhat more important for countries with less access to private capital markets. Finally, IFI's may need to expand their important catalysing role in promoting private capital flows to the region, especially for countries with still insufficient access.

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APPENDIX 1

Petroleos Mexicanos (Pemex)	Public sector oil company	7/90	ASch 500 mn	11.00	11.24	6	Vienna	
Nacional Financiera, SNC (Nafinsa)	Public sector development bank	7/90	$100 mn	11.75	12.10	5	Luxembourg	Put option
Barton Corp. (offshore sub. Corp. Industrial San Luis)	Private sector mining company	8/90	$92 mn	12.00	14.24	3	Luxembourg (and private placement—Rule 144A)	Collateral: deposits with Banca Serfin in London. Issue included $17 million private placement tranche.
Euro Novum (Novum SA de CV)	Private sector carbon black	9/90	$60 mn	12.00	14.25	3	Luxembourg	
Petroleos Mexicanos (Pemex)	Public sector oil company	10/90	$150 mn	11.63	11.75	3	Luxembourg	
		10/90	$100 mn	. . .	11.76	5	Private placement (Rule 144A)	
Sidek International Finance	Private sector	12/90	$50 mn	12.00	14.05	5	Private placement	
Venezuela								
Siderurgica Venezolana (Sivensa)	Private sector steel company	4/90	$40 mn	LIBOR + 1.25	16.03	5	Luxembourg	
Baproven Ltd. (offshore subsidiary of Pdvsa)	Public sector oil company	9/90	DM 200 mn	11.13	11.68	5	Frankfurt	
Corimon International Finance Ltd.	Private sector chemicals, etc.	9/90	$35 mn	10.25	15.00	5	Luxembourg	
Siderurgica del Turbio (Sidetur)	Private sector steel company	12/90	$60 mn	LIBOR + 1.375	10.60	5.5	Private placement	Collateral: receivables from supply contract

FOOTNOTES

1 See, for example, Massad, C. "External events, domestic policies and structural adjustment" CEPAL Review April 1991, No 41.

2 OECD, Financing and External Debt of Developing Countries, 1990 Survey, Paris 1991.

3 Aghlevi, Bijan and others, The Role of National Savings in the World Economy, IMF Occasional Paper No 67, Washington DC International Monetary Fund, March 1990.

4 M. El-Erian, "The Restoration of Latin America's Access to Voluntary Capital Market Financing, Developments and Prospects", IMF Working Paper, mimeo, Washington DC, August 1991.

5 CEPAL, "El regreso de Paises Latinoamericanos al Mercado Internacional de Capitales Privados: Una Nota Preliminar", April 1990.

6 El-Erian, "Mexico's External Debt and the Return to Voluntary Capital Market Financing", IMF Working Paper, mimeo, August 1991.

7 For details, see for example, World Bank, Debt and International Finance Division, Financial Flows to Developing Countries, Quarterly Review, September 1991.

8 "Brazil seeks to come in from the cold", Financial Times, September 4, 1991.

9 CEPAL, op cit.

10 Source, M. El-Erian, "The Restoration of Latin America's Access to Voluntary Capital Market Financing, Developments and Prospects", op cit.

11 Source: Latin American Economy and Business, October 1991.

12 IADB, Report of the Economic and Social Progress in Latin America, 1991, Washington DC, John Hopkins University Press.

13 N. Rey de Marulanda, "External financing requirements for Latin America in the Nineties: Alternative Scenarios", in L. Emmerij and E. Iglesias (ed.) Restoring Financial Flows to Latin America, OECD Development Centre, 1990, Paris.

14 Chartered West LB Limited, Developing Country Investment Review, London, March 1991.

15 Amongst those stressing the direct link between debt reduction and new capital flows, see M. Dooley, "Market valuation of external debt", in J. Frenkel, M. Dooley and P. Wickan (eds.), Analytical Issues in Debt, 1990, IMF Washington DC and S. van Wijnbergen (1991), "Mexico and the Brady Plan", Economic Policy, April, Sachs, Krugman and others have argued in the similar way.

16 See, P. Aspe, "The Renegotiation of Mexico's External Debt", in M. Faber and S. Griffith-Jones (eds.), Approaches to Third World Debt Reduction, IDS Bulletin, Vol 21, No 2, April 1990.

17 For a more detailed discussion, see S. Griffith-Jones (1991), Is there still a Latin American debt crisis? Paper prepared for CEPAL.

18 This section draws on M.A. El-Erian, "The Restoration of Latin America's Access to Voluntary Capital Market Financing, Developments and Prospects", op cit., where more details can be found.

[19] See also, for example, IMF "Determinants and Systemic Consequences of International Capital Flows" Occasional Paper 77. March 1991. Washington, DC.

[20] L. Summer (1985) "Issues in National Savings Policy" NBER Working Paper No. 1710, Cambridge, Massachussets; for Latin America, see IMF "The Role of National Savings in the World Economy" March 1990, Occasional paper 67; see V. Corbo and K. Schmidt-Hebbel (1990) Public Policies and Saving in Latin America, paper presented to CEPAL-PNUD seminar on Fiscal Policy and Stabilisation in Santiago, August 1990 and Ahorro y Formacion de Capital, October 1991, Proyecto CEPAL/PNUD "Politicas financieras para el desarrollo".