Debt overhang: A review of the Latin American experiences of the eighties. The case of Chile.

Damill, M., R. Frenkel, D. Kampel y M. Rapetti

Introduction.

Five years after the implosion of the 2008/9 international financial crisis that hit the world economy, many advanced countries are still far from returning to a solid growth path. Some academics and informed observers fear that chances of avoiding a complete "lost decade" are gradually eroding for some of the involved cases[1]. On the one hand, the US has managed to resume growth though registering modest growth rates (It has averaged about 2 percent since June 2009). Such pace has nonetheless allowed for a reduction in the level of unemployment, from the two-digit figures registered in the midst of the crisis to a still high but more socially-acceptable level. On the other hand, the economy in most of the Eurozone area still recedes and unemployment remains very high. The youth segment of the working-age population in periphery countries are especially affected leading to profound social concern.

Policy responses to the crises on both sides of the Atlantic pivoted specially on non-traditional monetary measures. The FED, under the guidance of Ben Bernanke-Janet Yellen duet cut interest rates deep into the lower bound and adopted quantitative easing and other unconventional monetary policy measures programs aimed at mitigating the effects of the crisis. More reluctantly at the beginning, the ECB also ended up by pushing forward non-standard policy measures in response to the financial and sovereign debt crisis. Effectiveness of these measures were limited, as expected in a liquidity trap situation, as described in Keynes' General Theory . On the fiscal front, the policy response to the crisis has been insufficient in the US and rather inadequate in Europe. The American fiscal stimulus program was short of resources and not large enough to begin with, according to some analysts (see, for example, a series of articles by Paul Krugman[2] and those by the economists at the Levy Economics Institute[3]), and later counteracted by policies gathered under the headings of fiscal cliff and sequestration. In Europe, policymakers directly turned to austerity in the form of aggressive expense reductions, in the hope that regained confidence would smooth the behaviour of financial markets. Needless to say, the results of these pro-cyclical policies

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[1] See for example recent articles published in the British press by economists Bradford DeLong and Lawrence Summers. The former refers to the Eurozone, while the latter focuses on the UK. http://www.theguardian.com/business/economics-blog/2012/sep/28/eurozone-lost-decades-north-south-divide
http://www.ft.com/intl/cms/s/2/28778894-fdcb-11e1-8fc3-00144feabdc0.html#axzz26fOTcEBj

[2] Krugman warned against an underpowered stimulus as early as November 2008 through a series of articles in his blog hoisted by The New York Times. See, for example, http://krugman.blogs.nytimes.com/2008/11/10/stimulus-math-wonkish/

[3] Papadimitriou, D. B., G. Hannsgen, & G. Zezza (2011).

are far away from those promised by their proponents.

Interestingly enough, while much discussion was raised regarding the amount of public debt that any stimulus program would end up raising and the sustainability of such new levels of debt once the crisis is solved, there has not been much concern regarding the debt overhang problem in the troubled economies. How should governments deal with inherited debt? Is some form of debt relief for the public or private sector necessary? Would a period of modestly higher inflation help reduce debt overhang? How should policymakers deal with its distributional consequences? These questions, that pose significant challenges, are usually disregarded by policymakers in industrialized countries.

The debt overhang has been defined as the presence of an existing "inherited" debt sufficiently large that creditors do not expect with enough confidence to be fully repaid. This issue has been studied at both the micro and macro levels[4].

There are a number of cases where debt overhang conditioned growth paths. Japan is the best known recent example among the industrialized nations. After the implosion of the 1980s bubble, Japan suffered from a debt overhang with a long lasting effect. While a long-lasting deleveraging process was taking place by indebted firms, during the 1990s, Japan was barely able to register any positive growth rate. Richard Koo (2009) and others have thoroughly studied this particular case.

Background experiences go far beyond the industrialized nations. Latin American countries also suffered from debt overhang after the implosion of the debt crisis of the early 1980s that resulted in their own "lost decade"[5] for development and it is a case worth revisiting. That is precisely the objective of this policy briefs series: by focusing on Latin America debt overhang of the eighties, we aim to draw some valuable lessons for today's post-crisis macroeconomic issues.

Conventional wisdom usually highlights that in Latin America most of the external debt at that time massively belonged to the public sector. Such idea, however, fails to address the important role the private sector played in growing the debt in most cases, during the booming phase of the credit cycle. Non-government-backed loans to the private sector came to represent a large proportion of the total outstanding debt[6] denominated in foreign currency. As restrictions on capital movements had been previously removed in many but not all cases[7], there were countries willing to accept all funds offered by highly liquid international banks.

The crisis unfolded after Latin America was negatively hit by two shocks: the rise of the international rate of interest and the reduction of the international prices of its main export commodities. The availability of financial resources plummeted and policy regimes prevailing in the region were soon

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[4] Paul Krugman (1988) and Jeffrey Sachs (1989) pioneered the use of the term in macro analysis.

[5] Although the origin of the term "lost-decade" is imprecise, its use became common to describe Latin America economic performance during the eighties. It became widely used by ECLAC and several scholars and, as mentioned, it was later used to describe Japan's evolution in the nineties.

[6] Devlin, R. and R. Ffrench-Davis (1995).

[7] This is especially true in those places undergoing liberalization experiments, such as Argentina, Chile and Uruguay.

proved unsustainable. Both creditors and private debtors pressured the public sector to assume the private portion of foreign currency denominated debt even when such debt did not originally hold any implicit public sector guarantee commitment[8)]. Such pressure turned to be successful. Debt transference was done through different mechanisms, although exchange rate insurances and/or preferential exchange rates for repaying debts were the most commonly used instruments[9)]. Hence, the debt overhang problem ended up being mainly a public sector problem and more specifically, a public sector debt problem.

Several rounds of negotiations that involved individual debtor countries, creditor banks, international financial agencies and governments of the home countries of creditor banks could not reach a sustainable solution until admitting with a seven-year delay that the debt could not be completely honored at its nominal face value and that a component of debt relief was a requirement for successful agreement. In that sense, the Brady Plan (which, as a matter of fact, was a follow-up of the second version of the previous Baker Plan) marked an important step forward in solving the debt dilemma by introducing debt-reduction operations. Such deferral was costly, both in economic and social terms throughout Latin America and "what could have been a serious but manageable recession turned into a major crisis" (Díaz Alejandro, 1988)[10)].

The importance of the Brady Plan in itself must not be overestimated, either. First, because it came too late into existence, seven years after the crisis had originated. As stressed by Ocampo (2013), the Brady Plan only surfaced after all solvency risks and prospects for failures for private international creditor banks had been faded away. In the interim, the enormous social cost of the adjustment had been fully absorbed by the Latin American countries. Second, because the actual reduction of the burden of the debt produced by the plan was relatively mild. However, the combination of both the Brady Plan with the return of low international interest rates reopened the access for Latin American countries to the global capital markets through rehabilitated bond issuing. That was its main success: only then capital flows towards the region were once again restored. The recovery of growth that followed in the region was important, though not very high for most countries.

In this series of policy briefs we take a renewed view at the Latin American experiences of the eighties from a current perspective. We look at the processes of debt build-up, facilitated by the macroeconomic regimes, where the liberalization of capital flows was an important pillar. As previously mentioned, both the public and private sectors incurred high levels of foreign debt rapidly, matching the need of credit placement by highly liquid international banks. Then, we turn to the

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[8)] Ocampo (2013) stresses the asymmetric nature of negotiations between banks supported by the international financial community and highly indebted Latin American states as an important reason behind the nationalization of large portions of private external debt.

[9)] In certain cases, there were also mechanisms of transference involved in bailout of the banking system.

[10)] This statement is also quoted in Ocampo (2013).

crisis period: the failure of successive incremental changes finally gave way to a macroeconomic regime change. The resulting macroeconomic adjustment came along with a high social cost, especially in terms of employment. The remaining stock of debt, however, will remain unbalanced with the flows of output and exports produced by these economies. The burden of debt became the most important conditionality to the economic policy for the remaining of the decade for most Latin American economies. Finally, we look at how the debt gridlock was finally solved, once the Brady Plan was implemented and more importantly lower international interest rates allowed for the resumption of capital flows.

We start here by taking a closer look to the Chilean case. Chile's experience is outstanding for both bad and good reasons: social cost of its crisis was the highest registered in Latin America, but it did recover growth before most of its neighbours and, furthermore, could successfully sustain the most robust post-crisis growth process in the region[11]. As it will be detailed, Chile enjoyed some key particularities, which became significant in the recovery process: the previous negative tendency of its terms of trade was reversed faster than in other cases, it obtained a broader foreign support from the international financial institutions that facilitated negotiations with the private creditor banks, and it pushed forward an aggressive program of debt-for-equity swaps. It is clear from its experience that relaxing the restrictions imposed by high levels of debt might have distributive consequences but enhances the growth process. Debt relief, however, should not be considered as a panacea or an isolated tool that can restart growth by itself. The revision of the experiences of other Latin American countries will follow suit in this same series of policy briefs.

I. The Chilean case[12].

This section will analyze the fundamental aspects of Chile's macroeconomic and financial performance during the eighties. Within that particular context, we intend to examine the debt build up and its interaction with basic aspects of the liberalization regime, the post-crisis macroeconomic adjustment and how that country managed to deal with the debt overhang problem. The case of Chile is particularly interesting since it has been often quoted as a successful adjustment that allowed that country to rapidly recover growth after a painful crisis, *vis-à-vis* the path that other highly indebted Latin American countries followed.

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[11] Also Colombia stands out for a positive evolution in the second half of the eighties. However, it must be highlighted that Colombia did not undergo a debt crisis, although the country did suffer from important disturbances in its balance of payments.

[12] This section is mainly based on the Chilean case study included in Damill et al. (1994).

In the first part, the paper examines Chile's liberalization experiment and its consequent crisis. The second part analyses the adjustment that included several unorthodox components, embracing certain measures to deal with the debt overhang issue. We shall conclude, however, that good policy is a necessary but insufficient condition. Good policy must be accompanied by a favourable external environment, in terms of both export prices and financial conditions, in order to achieve a successful rebalancing and recover growth. Additionally this combination of factors was not readily available for other highly indebted Latin American countries that had experienced similar crises at approximately the same time.

1. A macroeconomic experiment that favoured excessive debt accumulation.

The military dictatorship that overthrew president Salvador Allende in the early seventies and that governed Chile for more than a decade implemented a set of structural reforms after seizing power. Those reforms pursued both public sector adjustment and liberalization of the market forces from the previously highly regulated economic environment[13)]. The implemented macroeconomic policy framework in line with other southern cone liberalization experiments included the liberalization of the financial system, the deregulation of international capital flows, and the use of the exchange rate as an anchor of inflationary expectations. Those three policy pillars would have dire consequences resulting in a significant macroeconomic disequilibrium[14)] a few years later.

Table 1. Real Exchange rate in the pre-crisis era (Index 1986=100).

Year	Index
1976	63,6
1977	57,1
1978	68,1
1979	70,2
1980	60,8
1981	52,9
1982	59,0

Source: Central Bank of Chile.

13) Most markets were rapidly deregulated -with just the major exception of the labour market. On the evolution of Chile's labour market in the seventies see, among others, Meller (1984).

14) The relevance of these three specific policies resides not only on the effects induced by each one of them separately, but also on their interactions and feedbacks among them. The imbalance produced by a high level of domestic absorption, for example, induced by the exchange rate appreciation policy could be temporarily sustained because of the fluid access to the international credit market. An imbalance of such nature would be impossible to close for a lasting period in the face of credit rationing in the international credit markets.

The initial results of this combination of policies seemed encouraging. GDP growth, which had plunged abruptly in 1975 by more than 12%, reversed its previous negative tendency and registered an annual average increase rate of 7.5% between 1976 and 1980. At the same time, the government was able to generate a significant surplus and the economy observed a rapid rise in the degree of monetization.

Analysts and observers, however, were always concerned with the sustainability of the prevailing policy scheme. Several factors raised doubts about the long-term perspectives of the economy. First, the growth process was based on highly elevated level of domestic absorption (3% above GDP). Consequently, trade balance slipped into deficit systematically. Second, the mentioned high-level absorption did not originate from increased investment. On the contrary, the ratio between investment and GDP remained in rather modest rank and fluctuated around 17% during the entire period, below the average level of 20.2% registered in the 1960s. Third, the expected increase of domestic savings did not materialize.

Table 2. GDP growth, absorption and investment in the pre-crisis period.

Year	GDP growth (%)	Absorption/ GDP (%)	Investment / GDP (%)
1975	-12,9	101,2	15,4
1976	3,5	97,9	12,7
1977	9,9	101,8	13,3
1978	8,2	103,2	14,5
1979	8,3	105,3	15,6
1980	7,8	106,7	17,6
1981	5,5	112,9	19,4
1982	-14,1	99,8	13,8

Source: Central Bank of Chile.

Between 1976 and 1980, domestic savings only financed 76% of the gross domestic investment, while the rest relied increasingly on foreign funding. By the end of that period, the use of external savings was as high as 7% of GDP. The combination of successive trade deficits with a growing dependence on foreign funding drove the economy to a very fragile position. Any negative external shock would have been capable of reviving the gap and would have turned an imbalanced situation into a balance of payment crisis. That scenario played itself out after the Mexican moratorium of 1982.

2. The experiment comes to an end: crisis and unorthodox adjustment.

In 1981/2 the imbalanced situation mentioned above was deeply aggravated: the trade deficit attained a record level of 10.3% of GDP while the use of external savings to finance the external gap reached an unsustainable level equivalent to 14.5% of GDP. Additionally, government accounts rapidly deteriorated, turning a 5% surplus into a 5% deficit in just two years, as the banking crisis unfolded[15)]. At the same time, there were strong adverse changes in the international economic environment. First, Chile's terms of trade fell considerably during two consecutive years: they dropped by 13% in 1981 and similarly the year after. Second, there was a major increase in the international interest rate, which induced an enormous increase in the cost of credit, both foreign and domestic. The combination of these factors resulted in an unbearable burden for Chile. When both factors are taken into account, the resulting real rate of interest, i.e. deflated by the price of copper, was 46.9% and 33.2% for 1981 and 1982, respectively. Access to foreign funds was abruptly reduced for Chile as for other Latin American countries after the Mexican government declared an involuntary moratorium on its foreign debt in August 1982. The growth strategy based on high levels of absorption financed by foreign funds fell into pieces.

Table 3. Terms of trade and international interest rates.

Year	Terms of trade	FED funds rate (%)
1975	93,1	5,82
1976	102,3	5,05
1977	92,6	5,54
1978	89,1	7,94
1979	105,5	11,2
1980	99,1	13,35
1981	86,3	16,39
1982	78,7	12,24

Sources: Central Bank of Chile, FRB.

Initially, Chilean authorities were confident on an economic adjustment within the prevailing policy regime, with no need to further modify the exchange rate level. Nevertheless, any stabilization attempt pretending to maintain the basic parameters of the policy regime unaltered could not last after the external environment suffered the dramatic changes described above. Hence, the

[15)] The banking crisis started in 1980, after three banks began to loose deposits and fear spread to other financial institutions. Several banks and nonbanking financial institutions accounting for 45% of the assets of the financial system had to be intervened. See Kaminsky and Reinhart (1999).

devaluation of the Chilean currency in June 1982 did not merely imply leaving behind the previous exchange rate policy but also meant abandoning many of the non-interventionist dogmas adopted in the pro-market program of the previous decade.

Among the most important facts of this period is the collapse of the liberalized financial system. It was one of the fundamental factors in determining the depth and persistence of the effects of the negative external shock of 1982. Since the enactment of the financial reform, in the mid seventies, the resulting financial freedom regime had developed a series of structural anomalies. There was over those years an inefficient portfolio allocation by the banks and a growing over-indebtedness by the nonfinancial private sector. The liberalized allocation of credit by the financial institutions combined with a light supervision by the authorities resulted in risky lending practices. Banks disrespected maximum individual lending limits and relaxed collateral requirements[16]. There was also an oversized allocation of credit to firms that represented related parties and interests[17]. Furthermore, the notion that financial institutions assumed entirely the risks in a liberalized environment was already tainted after the monetary authorities participated in the bailout of some institutions at the very beginning of the pro-market experience in 1976/77.

The state could no longer play a secondary role after the financial crisis. The government had to organize a bailout that implied a massive state intervention into the financial sector. The Central Bank had to act as a lender of last resort to troubled institutions. Interest rates that had been previously set freely in the market were replaced with policy-suggested interest rates, and in an effort to forestall bank failures Chile's supervisory agency intervened in fourteen banks and another eight financial institutions.

[16] Physical assets used as collateral were often overvalued due to the currency appreciation of the previous decade.
[17] Nineteen percent of the portfolio was in such situation towards end-1982.

Additionally, the Central Bank launched a series of programs aimed at softening the private sector's heavy financial situation. The Central Bank bought overdue loans from banks. Mortgages, consumption loans and commercial loans were then restructured with an important component of state subsidy. Also, a preferred exchange rate was adopted for firms and individuals with outstanding foreign debt in order to facilitate interests and principal payments. Some foreign debt contracts were redenominated into the domestic currency. The fiscal costs of these programs (including foreign exchange losses of the CB) have been estimated at around 9 billon US dollars, nearly one third of annual GDP[18].

Three additional aspects related to economic policy during the crisis are worth mentioning. First, the exchange rate policy became rather chaotic, with a series of successive regime changes, spanning numerous different arrangements, from a flexible exchange rate to a passive crawling peg determined by the spread between the domestic and the international inflation. Foreign currency transactions were once again restricted for the public. There was also a significant increase in trade tariffs. Second, Chile agreed to follow policies recommended by the International Monetary Fund. Negotiations with commercial banks included the state's takeover of the private foreign debt –even those contracts that had initially no state collateral attached- in exchange for debt restructuring. As a consequence of these agreements, the public debt increased considerably. Lastly, it is important to remember the huge social cost brought upon the Chilean society by this crisis. Unemployment rose to a record high of 30% after GDP fell sharply in 1982/3. The negative tendency was shortly reversed in 1984, after the attempt to adopt more expansionist policies. These policies, however, were short-lived as they once again rapidly deteriorated the external situation, and reopened the external gap.

3. A trinity for debt diffusion: Structural reform plus privileged foreign funding and increased terms of trade.

In February 1985, under the guidance of a newly appointed economic minister, a new adjustment program was announced, aimed at avoiding the inconsistencies observed in all previous stabilization attempts. The new program led the economy into a recovery stage, with a high GDP growth and a considerable reduction in the unemployment rate. Between 1986 and 1990, GDP grew at an annual average rate of 7.1% and the unemployment rate fell more than 20 pp from its

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[18] Held and Jimenez (2001), Sanhueza (1999). Alternative estimates of the cumulative fiscal costs during the restructuring period amounted up to 41% of GDP (Hogart, G., R. Reis, and V. Saporta, 2002).

1983 peak of 31.3%[19].

Table 4. Growth and Unemployment.

Year	GDP growth (%)	Unemployment (%)
1986	5,7	12,1
1987	6,6	10,9
1988	7,3	9,8
1989	10,6	7,9
1990	3,7	7,8

Source: Central Bank of Chile.

Achievements during this period are linked not only to the implemented economic policies but also to the strong improvement in the external conditions faced by Chile, including a pronounced improvement of the terms of trade, volumes of exports and a privileged access to foreign financing. These factors were crucial for Chile's successful outcome and sets Chile's experience apart from those of other highly indebted Latin American countries, such as Argentina, Brazil and Mexico.
Better terms of trade and the increase in exported quantities also determined a favourable evolution of the financial indicators, due to their positive influence over the value of incoming hard currency flows. On the other hand, the government also pushed forward a very aggressive and effective program of debt equity swaps that strengthened the stock position by diminishing the level of the external debt.

Table 5. Terms of trade of goods.

Year	ARG	BRA	CHI	MEX
1980	100	100	100	100
1981	95,3	88,2	78,9	109,4
1982	88,6	85,7	70,4	123,3
1983	86,4	84,8	75,4	102,8
1984	102,5	89,8	76,6	93,4
1985	87,5	86,1	72,9	90,6
1986	81,2	109,5	74,8	73,0
1987	80,7	97,7	83,2	71,8
1988	87,9	105,3	116,5	61,9

19) In mid-1989 there was a new change of policies, linked to electoral reasons. Domestic expenditure was strongly encouraged with an expansive monetary policy, which had to be "cooled" later by the newly elected democratic government soon after taking office.

1989	85,4	100,5	128,5	65,3
1990	85,4	90,8	121,5	84,1

Base year: 1980=100.

Source: own calculations based on ECLAC data.

Between 1985 -the year in which this type of swaps began to be implemented- and June 1990, 9.6 b dollars (out of a total eligible debt of 14.2 b) were withdrawn from the stock of debt[20]. If the amount of outstanding total debt does not reflect the important reductions originated in the program (up to 45% of the external debt) is because Chile was receiving at that time other preferential net loans[21]. The swap program initiated the return to Chile of private capital. Flows not associated with the program were not resumed until 1989.

Two additional factors, other than the positive evolution of Chile's external situation, which significantly contributed to achieving a positive economic outcome during second half of the eighties were the progress made toward better balanced fiscal accounts and a greater order in the financial system. It is worth repeating that the Chilean society paid for these achievements an incredible high social cost (in social terms).

The bailout of the financial system by the state practically implied the nationalization of the entire sector. This was an unintended consequence of the numerous failed banks interventions and resolutions. Restructured financial institutions were later returned to the private sector. The re-privatization program was framed within a "popular capitalism" approach[22] that looked to broaden the number of shareholders. Other non-financial firms, previously considered strategically important, were also transferred to the private sector within the same framework.

After the restructuring, and with much stricter supervisory rules, the financial sector worked relatively well. In this way, Chile avoided the re-emergence of financial sector imbalances whereas other countries, particularly Argentina, could not. Other monetary indicators, such as the monetization coefficient (measured by private M3/GDP) never descended from 23% in the second half of the eighties. Furthermore, towards the end of that decade its level tended to increase, reaching pre-crisis records.

The huge amount of fiscal resources required to subsidize the financial sector crowded out the possibility of any expansion in social expenses, which was necessary to mitigate the harsh effects of economic adjustment on the most vulnerable segments of the population. In fact, public policies oriented to ease the effects of the very high unemployment rate became insignificant. During the

[20] Chile's debt-equity swap program was one of the earliest programs of this kind implemented in the region and it was one of the largest in relation to the size of the economy (9% of GDP). Ffrench-Davis (2001) Chapter VII presents an in-depth analysis of this program.

[21] Ibidem, Chapter VI.

[22] In line with the wider share ownership program pushed by UK premier M. Thatcher.

adjustment period, per capita social expenditures in health, housing and education suffered an important drawback. Moreover, real wages were reduced by 20% and the legal minimum wage was decreased by 40% (see Romaguera and Meller). Lastly, according to diverse studies, the number of households below the poverty line increased substantially. According to PREALC statistics, for example, the proportion of households below the poverty and extreme poverty lines in Santiago grew from 28.5% (1969) to 40.3% (1980) and increased again at the time of the adjustment to 48.6% in 1987. It must be stressed the fact that part of the increase of poverty took place before the crisis.

4. Interaction between macroeconomic evolution and external gap.

The process resulted in a mismatch between the income level and the stock of foreign liabilities that deeply affected Chile's economic perspectives. The relationship between debt and GDP (a critical stock-flow ratio) jumped well above 100%. As expected, the composition of flows itself was deeply affected (for a long period of time). The abrupt increment of the volume of interests that had to be paid abroad and the fall in the terms of trade led to a strong reduction of the national income. While towards the late seventies the payments that had to be made abroad represented 2.4% of GDP, during the next five-year period such proportion tripled to 7.7% of GDP. In 1985, it finally reached a maximum level of 11.1% of GDP. Later, the gradual recovery of the terms of trade, real GDP growth, and the implementation of the aggressive debt-for-equity swap program mentioned above, reversed the increasing tendency. Ever since 1986, the ratio of net payments abroad to GDP dropped systematically, but remained in relatively high levels for the rest of the decade. In 1989, it still represented 6.7% of GDP, which was much higher than in the pre-crisis period.

Driven by the price of copper—Chile's main export commodity-terms of trade began to recover after 1985, when prices reached a minimum level. Starting in 1986, recovery was sustained throughout the following years. Terms of trade continued to increase since then at an average annual growth rate of 8.1%. By 1989, terms of trade were already 36.6% higher than the trough level. In sharp contrast with the previous years, the value of its main asset was evolving at a much faster pace than its main liability. In fact, if the interest rate were to be adjusted by the evolution of the international price of copper the resulting real interest rate would have been a negative 10% rate between 1986 and 1989. Obviously, this was a key factor underpinning the restoration of Chile's financial health and wealth. It was favourably reflected in the evolution of the stock/flow indicators of financial fragility. The ratio of debt to GDP, for example, was reduced in the same period from 110% to slightly less than 70%.

The relationship between the stock of debt and exports improved substantially. Debt was around 5 times the amount of annual exports during the mid-eighties but only slightly over 2 times exports by the end of the decade[23]. This outcome was the result of both the improvement in the terms of trade and the increase in the volume of exports. In that sense, it is worth mentioning the favourable performance of external sales of other items rather than copper. The positive evolution of the non-traditional exports might be considered an achievement of export oriented policies implemented at that time. Particularly noteworthy was the establishment of an elevated real exchange rate that significantly improved the profitability in the production of tradable goods. The real exchange rate was at elevated level in 1984. The exchange rate policy managed to maintain the prevailing level during the following years and, despite some appreciation, remained at a substantially higher level than in the pre-crisis period. In this context, the proportion exported of GDP went from 23.7% in 1980 to 28.9 in 1989.The significant amount of foreign finance granted to Chile during the adjustment period can be clearly observed in the next Table. Between 1982 and 1989 the use of external savings as a proportion of GDP averaged 5.5%, with peaks as high as 10.7% (1984) or 8.3% (1985). It was a crucial contribution Chile received in order to overcome the most critical period of macroeconomic imbalances. Similar proportion of foreign financial support cannot be found anywhere else among the others highly indebted Latin American countries, making the Chilean case a particular one in the region. Chile's use of foreign savings became closer to the coefficients observed in other countries only after 1986, when its terms of trade and volume of exports had already increased.

Support through official lending received from the main international financial institutions turned to be crucial, both because of their size and because they eased negotiations with creditor commercial banks. Drawbacks in accomplishing monetary and fiscal goals established in the 1983 stand-by agreement was not an obstacle for the IMF to grant an extended fund facility arrangement in the amount of SDR 750 million. Between 1985 and 1987, the World Bank also provided a significant amount of funds through three Structural Adjustment Loans (SAL) of 250 million dollars each. The next table details the very active role of the international financial institutions in the Chilean case. Outstanding debt with IFIs grew from barely over USD 400 million in 1980-82 to more than USD 4.5 billion in 1989[24)]. It is worth noting that Chile received 30% of the joint IMF-WB net transfers made to Latin America in the 1985-87 period, whereas its economy represented 3% of the region's GDP[25)].

There were six rounds of negotiations between Chile and the international commercial banks between 1983 and 1990 that skilfully avoided the country from getting into arrears of its private debt during the entire adjustment period. This is also a salient characteristic of the Chilean process, since during the eighties most of the highly indebted countries of the region experienced debt services arrears for prolonged periods. Successive rounds improved the terms of agreement of the previous one, both in terms of the premium-above-Libor that had to be paid by Chile on its

[23)] Exports in 1989 were 55% higher than in 1981. Such an increase was equivalent to 9% of GDP. See Ffrench–Davis (2001), Chapter 5.

[24)] Total credit granted by IFIs multiplied by ten during the analyzed period. In this way, the rate of participation of IFIs in total Chilean debt went from less than 5% before 1982 to more than 25% in 1989.

[25)] The favourable treatment received by Chile is analyzed in Felix and Caskey (1990) and Ffrench-Davis (1992).

outstanding debt as well as to the payment schedule of interests and principal amortization.

With a greater amount of financial support available, Chile was able to make net transfers of resources abroad smaller than the average highly indebted Latin American country during the eighties. In fact, a study by ECLAC (1991) shows that between 1980 and 1989, in average, Latin America transferred abroad an annual amount equivalent to 2.6% of its total GDP. Instead, Chile – in average- only had to send 0.6% of its GDP abroad. Furthermore, at the beginning of the adjustment period, precisely when the financial support was most needed, Chile managed to make negative net transfers. As a matter of fact, between 1980 and 1984 Chile's net transfer were negative in an amount equivalent to 2.5% of its GDP while the rest of Latin America was making a positive transfer of 1.8% of GDP.

Table 6. Use of IMF credit (as % of GDP)[26].

Year	Argentina	Brazil	Chile	Mexico
1982	1,1%	1,3%	3,1%	0,8%
1983	1,4%	2,0%	4,1%	1,3%
1984	2,6%	2,1%	6,6%	1,6%
1985	2,5%	1,7%	7,5%	3,1%
1986	3,5%	1,4%	7,0%	3,7%
1987	2,9%	1,0%	5,4%	2,6%
1988	4,0%	0,6%	4,5%	2,3%
1989	2,2%	0,4%	3,7%	2,5%

Source: Own calculations based on World Bank data.

Chile's net transferences became finally positive after 1985 but its volume did not differ significantly from those that the other Latin American countries had to afford at the same time: in the second half of the eighties, net transfer was 3.7% of GDP for Chile, and 3.4% for the region as a whole. It is worth noting once again that smaller than average net transfers made by Chile had been agreed upon negotiations with IFIs and creditor banks. This was not the case of other countries in the region that could only reduce their net transfers by incurring into arrears with their interests payments. And even if the net transfers made by these other countries outsized the Chilean ones,

[26] Use of IMF credit denotes drawings on the IMF other than amounts drawn against the country's reserve tranche position. Figures include drawings under Stand-By as well as other types of agreements. Conversion from special drawing rights into dollars was done using end-of-period exchange rates for stocks and average-over-the-period exchange rates for flows (Source: WB data).

their payment arrears lead to a more conflictive relationship with the international institutions and private creditors -which required permanent and inconclusive negotiations. These dissimilar situations gave rise to completely different levels of uncertainty. There were countries that, such as Argentina and Brazil, were permanently exposed to news on ongoing negotiations that made achieving a minimum degree of stability and predictability in the evolution of the exchange rate very difficult to attain.

Conclusions.

The higher level of foreign financial support also meant that Chile avoided the fast process of aggregate adjustment that other Latin American countries had to experience. Specifically, Chile was in conditions to avoid the reduction in imports (as a proportion of GDP) to levels which were incompatible with the recovery of growth, since there was no need to generate a trade surplus as large as the accrued interests of its external liabilities. It was possible for Chile to maintain a reasonable import capacity. Imports fell abruptly once the external shock hit the economy in 1981/2, but it must be recognized that the prior imports levels were oversized because of the real exchange rate appreciation produced by the previous policy regime. In fact, during the implementation of the adjustment, Chile showed an imports/GDP coefficient similar or above the one registered during the more "normal" years of the liberalization period in the seventies. In the period 1975/79 imports were 20.7% of GDP, while in the period of exchange rate appreciation in 1980/81 they had reached an average level of 31.8% of GDP. Later, during the remaining of the decade, they averaged 23.1% of GDP.

It is important to understand that the combination of major support from the IFIs, significant improvements in the negotiation with private creditors and (private) debt reduction through an aggressive debt-for-equity swap program, resulted in a major shift in the composition of the outstanding debt, where the proportion of official credit institutions increased significantly its weight and while debt with the private sector decreased[27)] (even so, by 1989, debt as proportion of GDP was still high, representing 75% of GDP).

Financial support from international institutions, better terms of trade and the aggressive debt-for-equity program left Chile in a favourable position to take advantage of the international capital markets once the international interest rate returned to lower levels and private capital flows became once again available for the region. Management of such flows for a small open economy as Chile, taking into account the lessons learnt from the recent past, became then a priority issue for its economic policy during the next decade.

[27)] In 1982, liabilities with private commercial banks represented more than 4/5 of the total debt (See Ffrench-Davis, 2001, Chapter V).

Finally, it is worth noting that the fact that Chile enjoyed greater international financial support does not mean that the country had not made a significant effort in order to adjust its economy to the newly prevailing international conditions. As it has been already said, the economic policy of the period was decidedly outward oriented, encouraging the production of tradable goods through the induction of a favourable change in relative prices. Contrasting Chile's experience to other countries in Latin America emphasizes the fact that the significant availability of foreign support is a necessary –but not sufficient- condition for economic adjustment and restructuring.

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