Chapter 4

The great Latin American debt crisis: a decade of asymmetric adjustment*

(a) Introduction

In the 1980s, Latin America experienced the worst economic crisis since the world-wide depression of the 1930s. A common link running through this crisis was external indebtedness to the international private banking system.

The crisis was spawned in the 1970s by a systemic process in which three parties – debtors, private creditors and governments and their multilateral institutions – were protagonists. The debtor party, which included most of the Latin American countries, incurred debt at a pace and at levels that were difficult to sustain: that is, they were guilty of short-sightedness. In effect, debtors fell into the trap of taking the easy way out of their flagging inward-looking development strategy by boosting their spending capacity (for consumption and/or investment) through use of external bank loans. This was a drawn-out, expanding process, which gained increasing momentum between 1976 and 1981.

For LACs to incur debt, lenders had to be willing to provide the resources. They showed no reticence to do so; in fact, beginning in the 1970s market dynamics made them very eager lenders. This eagerness became magnified when they actively sought to transform the abundant financial resources they were attracting from oil producing

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countries into LDC loans. Indeed, breaking the norms of traditional banking, they aggressively marketed themselves in the region in search of borrowers. It was during this process that prudential safeguards and guarantees were gradually relaxed. Banks, then, clearly bore a share of the responsibility in the gestation of the crisis.

The third party were the multilateral institutions, such as the International Monetary Fund (IMF) and the World Bank, and the governments of the industrialized countries. In general, they had a benign view of growing indebtedness from private international markets and encouraged debtor countries to remove restrictions on capital flows to their public and private agents. It apparently did not occur to these international institutions that the abundance of financial resources and the low real interest rates in effect were, in part, a cyclical rather than equilibrium phenomenon and that the situation could suddenly reverse itself. Indeed, some IMF officials noted on the eve of the crisis that: ‘The overall debt situation during the 1970s adapted itself to the sizeable strains introduced in the international payments system... Though some countries experienced difficulties, a generalized debt management problem was avoided, and in the aggregate the outlook for the immediate future does not give cause for alarm’ (Nowzad et al., 1981).

The reversal of the situation occurred in 1982 and it was widespread. The abrupt cut-off in bank financing to Latin America plunged the region into a serious crisis that spread all over the region and lasted an entire decade. The abrupt macroeconomic overadjustment caused by a shift from a superabundance of external funding to a severe shortage carried a very high economic and social price. Indeed, the debt crisis left an indelible mark on Latin American society. For one thing, economic growth was seriously retarded, giving rise to the commonly used term ‘lost decade’. For another thing, the model in vogue in Latin America, based on inward-looking import substitution and state intervention, was dealt a death blow with neoliberal-style strategies emerging to take its place.¹ The vigorous post-war Latin American growth was brought to an end. Between 1950 and 1980, the average GDP growth had been an annual 5.5 per cent, one of the highest in the world during that period.

When external credit was cut off by bank creditors, the LACs were forced to curb their spending. They thus went from a situation in which they were spending more than they produced to one in which they had to spend less than they produced. This phenomenon reflected the fact that a sizeable amount of domestic resources had to be channelled into effective servicing of the external debt; this is what is known as negative