

## The Debt Crisis

In 1982 the debt crisis was a world crisis, threatening the major commercial banks in the First World. Today, in the mid-1990s, it is usually thought of as a bad memory, as something that existed in the past, although the highly indebted countries, particularly in Latin America, still feel its effects. The 1980s were marked by high interest rates and rationed international liquidity; in the early 1990s low interest rates prevailed in the North, whereas the supply of loanable funds to the highly indebted countries—including those that did not negotiate their debts—exploded, perversely attracted by the high local interest rates the debt left as a heritage. Until 1989 elites and governments in the creditor countries viewed the debt crisis as an unsolved problem; today it is basically assumed to have been adequately addressed by the Brady Plan, although the highly indebted countries' economic performance remains essentially unsatisfactory.<sup>1</sup>

Albert Hirschman (1974:152) once said that the “understanding of a problem and motivation to attack it are two necessary inputs into policy-making and problem-solving, but the timing of the two ingredients could be significantly out of phase.” This is exactly the case with the developing countries' debt crisis. The diagnosis of the crisis and its possible remedies have been well defined and are known, but the solution that was found—the Brady Plan—was unsatisfactory to the debtor countries. The debt reduction involved was limited and did not present an effective remedy for the fiscal crisis of the state created by the debt crisis.

In the First World the motivation to face the crisis disappeared as soon as the threat of a world financial crisis was overcome. The Brady Plan is supposed to have solved the problem. In contrast, in the highly indebted countries the motivation to face the crisis exists or should exist, but the local elites realize that they have no power to obtain larger concessions from the creditors, given the unity of the elites in the creditor countries.

The foreign debt of the heavily indebted countries was the fundamental, although certainly not the sole, cause of the fiscal crisis that plagued Latin America in the 1980s. It still imposes a serious burden on the region, given the interest Latin America is supposed to pay to the creditor countries. Because of the strong adjustment, the entire region was engaged; and, later, because of the reduction of international interest rates, the region's indebtedness was reduced and debt ratios improved. Yet the fiscal crisis originat-

ing in foreign debt was not fully overcome in most Latin American countries, which were able to stabilize their economies but face low growth rates.

The idea of a global solution to the debt crisis, based on the creation of an International Debt Facility that would securitize the debt, is dead. The Brady Plan, proposed in February 1989, ended the debate on how to solve the debt crisis. It acknowledged that the debt crisis was not merely a liquidity problem—as the IMF, the Federal Reserve, and the banks had said when the crisis erupted in 1982—but also a solvency issue. Thus it adopted a debt reduction scheme through securitization of the old debt and the relative “delinkage” of the IMF and the World Bank in relation to the commercial banks. Yet the debt reduction made possible by the Brady Plan was meager. The Brady solution was timid.

The first country to negotiate its debt according to the Brady Plan was Mexico (August 1989). The reduction of its total debt was less than 15 percent.<sup>2</sup> But since that time, as the Mexican economy started to perform apparently satisfactorily, the confidence of local capitalists and international financial markets has increased, and capital flows to Mexico have boomed. The rate of growth has remained fairly unsatisfactory, and price stabilization has been based on an increasingly overvalued peso. However, because Mexico adopted or seemed to adopt all of the policy recommendations that originated in Washington and New York, confidence in the Mexican economy increased steadily. Only in 1994, when Mexico faced a current account deficit of around 6 percent of GDP, did the international financial system realize that the Mexican confidence-building strategy was ill founded. In fact, for the past few years Mexico has been engaged in a perverse trade-off between macroeconomic fundamentals and confidence building. In 1989 it had engaged in an equally perverse trade-off between the national interest—which was not adequately considered in the debt agreement—and, again, confidence building.

It is evident now that the correlation between the “solution” to the Mexican debt crisis represented by the 1989 Brady agreement and the flow of funds to Mexico was spurious. Mexico had not overcome its debt crisis. There is a relationship between the debt agreement and the performance of the Mexican economy because the country did gain the confidence of foreign investors, but this correlation is much weaker than is generally supposed. The moderately effective results the Mexican economy has shown are the consequence of a strict fiscal adjustment, a competent heterodox stabilization program that froze prices in December 1987, and bold structural reforms—particularly trade liberalization—rather than the result of the Brady agreement. The large capital flows that could be more directly related to this agreement—to the confidence the Brady Plan would have brought to the Mexican economy—in fact coincided with a strong increase in international liquidity and the reduction of interest rates in the United States. As

a consequence, a country like Brazil, which did not sign a Brady agreement until 1994, has also received sizable capital inflows since 1991.

The creditors' and debtors' approaches to the crisis immediately following the definition of the Brady Plan in 1989 were conflicting. Among the creditors, I should distinguish: (1) the official and dominant conception defined by the U.S. government and implemented by multilateral agencies in basic agreement with the major U.S. banks; and (2) a decreasing number of dissenters outside the executive branch of the creditor governments, which favored a significant and concerted reduction of the debt. Among the debtor countries I should distinguish the views of: (1) nationalists and populists; (2) government officials and business elites subordinated to foreign interests; and (3) a group of citizens that favored adopting a combination of pressures by the debtor governments—including quasi-unilateral measures—oriented to capture the discount in the secondary market in a concerted manner.

The views of the official creditor community, including governments and international financial institutions, have evolved over time. In the early years of the crisis, when major banks were at risk of insolvency, the dominant creditor approach was focused exclusively on saving the banks by demanding that the debtor countries pay—at least partially—their debts, no matter how desperate these countries' situation. Over time, as the countries adjusted their short-term balance-of-payments problems but remained in deep economic disarray, whereas the banks recovered, the focus has gradually shifted away from the banks and toward measures to relieve some of the pressures on the debtor countries. The interests of the banks and the national interests of the creditor countries, which at the beginning of the debt crisis were practically identical, have clearly diverged as the threat of a world financial crisis born of the debt crisis has disappeared, whereas U.S. exports to the highly indebted countries have continued to suffer. Following the Brady Plan and the Mexican and Venezuelan agreements, concern over the debt crisis waned because the problem was considered to have been solved, at least for the time being.<sup>3</sup> The creditors' strategy, in spite of the profound changes it had undergone, was still a "muddling-through approach"—a strategy of continual improvisation that avoided a definitive and rapid solution to the problem.

The phases of official management of the crisis are well known. In 1982 the debt was understood as a mere liquidity problem to be solved by a combination of new lending and sharp austerity in the debtor countries. In 1985 the Baker Plan was introduced, calling for more lending—which never materialized—and for growth with adjustment and structural reforms. The idea of a "menu of options" became popular. In 1987 and 1988 it became clear that the debt was a solvency problem, and the idea of debt reduction

became mandatory. Securitization—that is, the substitution of the old debt for new securities with a guarantee provided by the multilateral agencies—and the relative delinkage of the multilateral agencies from the banks in the negotiation process became dominant.<sup>4</sup> During these two years a consensus was formed that a new initiative should be taken in relation to the debt crisis—an initiative that included debt reduction through securitization. The Brady Plan, presented by the new U.S. secretary of the treasury, Nicholas Brady, arose from this consensus. The focus was on “voluntary debt reduction” through securitization. The IMF and the World Bank were to have additional resources to provide guarantees and other “enhancements” of the new securities to spur debt reduction. This was a major change in U.S. policy toward the debt and was also inspired by the views of Japan, France, and Italy. These views were never fully defined, but since 1988 it has become clear that these countries support a major change in the debt policy and movement toward a global solution to the debt.<sup>5</sup> Essentially, the Brady Plan was created because an increasing number of people in the political and economic elites of the creditor countries did not accept the liquidity approach. As the Baker Plan failed, they realized the self-defeating nature of internal adjustment policies when such policies were not coupled with debt reduction, and they supported a global solution for capturing the discount on the secondary market, tied to limited debt relief.

Within the debtor countries radicals and populists supported a moratorium on the debt that would allow in the short run an increase in wages and internal consumption. The Peruvian disaster is the best example of this attitude toward the debt. At the other extreme, the governments in the highly indebted countries—and their subordinate business elites—were eager to please the creditors and always bowed to their demands while adopting, in their speeches and official communiqués, a national-interest rhetoric condemning the debt and asking for debt reduction. Finally, the third group, which appeared in Latin America in 1987, proposed the adoption of firm measures, including unilateral suspension of payments—to force a concerted or negotiated securitization of the debt—combined with strong internal fiscal adjustment measures. It is fairly clear that this group had an important ally in the dissenters from the official view in the creditor countries, but it is also obvious that, in addition to this support, it was essential to use the only bargaining power a debtor country possessed: the possibility of suspending payments of interest. This group lost influence as Mexico negotiated its debt according to the Brady Plan and the dissenters in the First World practically disappeared.

**B**y 1990 some basic propositions about the debt crisis were well established. They can be summarized as follows:

1. The excessive international indebtedness in the 1970s and the resulting debt crisis were a consequence, on the one hand, of the belief that devel-

oping countries should and could receive capital flows for an indefinite period, ignoring the fact that loans follow a necessary cycle of payments and reimbursements, and, on the other hand, of the “Ponzi scheme” adopted by the banks and the multilateral agencies, according to which original lenders are paid with money supplied by later lenders, permanently rolling over the old debt (Payer 1991).

2. The debt crisis was a crisis of the highly indebted countries, not of the creditors. The danger of a world financial crisis had vanished, given the improvement in the capital ratios of the banks.<sup>6</sup>

3. The debt was a major problem not only because of the huge transfers of real resources to the creditors it implies but also because of its fiscal consequences. The foreign debt was essentially a government debt in Latin America. Around 90 percent of the long-term debt is state debt. Thus, the debt is an essential ingredient of the fiscal crisis of the state.

4. The debt crisis was the major, but not the only, cause for the relative economic stagnation of most of the highly indebted countries. Populist policies, based on resistance to eliminating the budget deficit and on the attempt to promote economic development and distribute income in the short run, were a second reason for this crisis.

5. The relative failure of adjustment policies in the highly indebted countries may have an explanation in populist practices, but its main cause was the self-defeating character of adjustment when the external debt was too high. Because the private sector in the highly indebted countries was able to transfer the foreign debt almost entirely to the public sector, the payment of interest on this debt aggravated the fiscal crisis, rendering the efforts to reduce the public deficit partially ineffective or self-defeating.<sup>7</sup>

6. In the first years of the crisis real devaluations of the local currency, which were necessary to achieve high trade surpluses, strongly accelerated the prevalent high inflation rates, which—particularly in the case of Brazil and Argentina—were subsequently inertialized through formal and informal indexation systems.<sup>8</sup> Since 1990 an opposite movement has taken place. The huge capital flows to Latin America led to the overvaluation of local currencies. As a consequence, inflation rates were reduced, but trade deficits appeared, and the local manufacturing industries were endangered. The threat to these industries was augmented by the fact that most Latin American countries are engaged in long overdue trade liberalization programs. Trade liberalization is essential to Latin America, but, combined with currency appreciation, it may be fatal to manufacture, as was the case with Martínez de Hoz’s Argentina.

7. Inertial inflation is resistant to conventional monetary and fiscal policy. A combination of conventional (orthodox) fiscal and monetary policy and heterodox policies is required. In the 1980s the successful heterodox Israeli (1985) and Mexican (1987) experiments in controlling inflation showed that a combination of income policies and orthodox policies is indicated when inflation is high and chronic or inertial.<sup>9</sup> This view was chal-

lenged by several heterodox attempts to control inflation in Brazil and Argentina, all of which failed. Yet when stabilization was eventually achieved in these two countries—in 1991 and 1995, respectively—it was the outcome of a combination of orthodox and heterodox policies.

8. Stabilization has been achieved in Latin America, and the economic stagnation of the 1980s gave way in the 1990s to modest rates of growth. Income per capita is finally growing again. Yet income concentration increased, wages remain very low, and the new democracies that were established in these countries in the early 1980s are far from consolidated. The coup in Peru in 1991 and an attempted coup in Venezuela in 1992 demonstrate this fact.<sup>10</sup>

9. Given the failure of the conventional (muddling-through) strategy, a combination of adjustment and financing, to deal with the debt crisis, in the late 1980s the consensus was that the debt burden should be reduced and real resources transferred to the creditor countries. The Brady Plan was the response to this realization. Yet because the flow of funds to Latin America again became positive as a result of the low interest rates in the creditor countries and the high interest rates in the region, the motivation for a real or definitive solution to the debt crisis vanished.

10. The Brady Plan was a major advance because it meant the creditor countries recognized that the debt must be reduced; that securitization is the best way to achieve this end; that the IMF and the World Bank should support the policy of debt reduction, including the supply of collaterals; and that these two institutions should be partially delinked from the banks.<sup>11</sup>

11. The strategy of the creditor countries eventually changed in the right direction, but the limited scope of the Brady Plan indicates the hesitation and dilemmas faced by the governments of the creditor countries regarding the debt. They knew a solution should be found to the debt crisis, but they did not want to confront their own banks. The Mexican agreement demonstrated this fact. Debt reduction was unsatisfactory; the fiscal crisis of the state was not fully overcome; macroeconomic balance was only partially achieved; growth rates remained very modest despite large cash inflows; and eventually, in December 1994 the country faced a very serious crisis.

**T**he Brady Plan was limited as a solution to the debt crisis. To understand why this was the case, it is necessary to distinguish clearly the two basic strategies regarding the debt crisis that dominated the debate on the subject in the late 1980s. The idea of debt reduction, which had been taken as a threat to the banks a few years earlier, was eventually accepted. Securitization was the basic strategy used to achieve this result. Yet the problem was how great this reduction should be. On one side were those who favored a concerted and global reduction of the debt based on the creation of an International Debt Facility that would manage the entire process

on a case-by-case basis. On the other side, since February 1989, was the Brady Plan—firmly supported by the major creditor countries—which favored “voluntary,” market-controlled debt reduction.<sup>12</sup> I call the first the concerted approach and the second the voluntary or, more precisely, the free-rider approach to debt reduction.

The concerted approach can be summarized as follows. First, the securitization of the long-term debt of the highly indebted countries—that is, the conversion of the debt into long-term bonds, capturing the discount in the secondary market—should be the basic financial device used to solve the debt crisis. These new bonds would make sense for the banks only if they were guaranteed by the creditor countries. The organizations to offer this guarantee should be the IMF and the World Bank, given that both multilateral institutions were directly involved in managing the debt crisis and that their main stockholders were the creditor countries.

To reconcile their policies, the Bank and the IMF should create an International Debt Facility (IDF), which, in addition to giving guarantees to the new bonds, would administer the debt crisis. The board of the IDF, after evaluating a country’s economic capacity to pay its debt—taking as the basis, but not exclusively, the discount in the secondary market—and after debating the issue with debtors and creditors, would make a concerted (but not necessarily unanimous) proposal regarding the discount the country would be entitled to receive. It would then make a once-and-for-all offer to the banks; the free-rider strategy would not be permitted.

To receive this discount, the debtor country would have to meet the conditionalities agreed on with the IDF. The discount would be permanently dependent upon the ability of the debtor to adjust and maintain its adjusted economy.

The cost of this alternative would be low to the creditor countries, although there would be a cost for offering guarantees. Thus a fund should be established by the creditor governments in the IDF.

If the creditor governments had adopted this approach, it would have been possible to envisage an effective solution to the debt crisis. The creditors, however, stayed with the Brady Plan—that is, the market or free-rider approach—rejecting the creation of an IDF and not supplying the IMF and the Bank with the special funds needed to back the guarantees. Thus the achieved debt reduction was unable to effectively contribute to the solution of the fiscal crisis. The burden of fiscal adjustment remained fully local.

**T**he banks, which are specialists in semantics, liked to call their approach to debt reduction the “voluntary or market approach,”<sup>13</sup> as if the concerted or global approach were not also voluntary and based on the market. The first and more important difference between the two approaches is that one allows for the free-rider strategy and the other does not. A sec-

ond difference is that the free-rider approach favors debt-equity conversions as a good strategy to reduce the debt, whereas the global approach excludes such deals.

The idea of market-controlled debt reduction had been around for some years before 1989, but the actual accomplishment of debt reduction had been rare. The main channel for debt reduction had been debt-equity swaps, which, ironically, are typically harmful to the debtor country. In fact, despite the enormous pressure from commercial banks for such programs, they have been suspended in almost every country that introduced them.

Debt reduction schemes should be measured against the standard of restored creditworthiness of the debtor country. Specifically, debt reduction should be extensive enough to allow the debtor country to service the external debt on the revised contractual basis without the need to refinance interest payments, and to allow the private sector in the debtor country to attract suppliers' credits, trade credits, and project finance on a decentralized basis.

Under "voluntary" arrangements, a small number of banks can frustrate the comprehensive settlement of a country's debt. In a voluntary debt reduction mechanism each creditor is free to choose whether to participate. Nonparticipation means the creditor continues to hold the original claim and can attempt to collect as much as possible on that claim. Thus there is a basic arbitrage condition attached to voluntary schemes: participation in the scheme must, on the margin, be no worse than holding out and sticking with the original claim. In a voluntary scheme the creditor must compare the value of the existing claim after debt reduction with the value of the alternative claim made available through participation in the debt reduction scheme.

But an obvious paradox arises, best illustrated by the case of certainty. A full restoration of creditworthiness would imply that all claims on the debtor, including "old" debt that does not participate in the debt reduction process, will rise in value to face value. The secondary market price of the old debt will be 100 cents on the dollar after the debt reduction if full creditworthiness is indeed restored. Thus under certainty there would be no motivation for an individual creditor who has a small share of the overall debt to participate in a voluntary scheme if the creditor receives something less than 100 percent of face value.

The result, which was formally demonstrated by Helpman (1989), is that voluntary debt reduction may be impossible as a market mechanism even when the creditors as a whole would benefit from the reduction relative to the status quo. Thus the insistence that debt reduction be voluntary actually hurts the creditors as a whole.

"Voluntary approach" is an appealing expression, but it is misleading. What was really the alternative to the concerted approach to reducing the debt was the free-rider approach—the last version of the muddling-through approach adopted by the creditors since the beginning of the debt crisis.

Stanley Fischer (1989:320–321), who analyzed the possible solutions to the debt crisis, favored the creation of a debt facility. But he warned that even this scheme “creates a free rider problem. If the International Debt Discount Corporation [IDDC<sup>14</sup>] buys up much of the developing country debt and makes some form of debt relief possible, then the credit of the debtors improves. Those creditors who stayed out of the IDDC have a capital gain. For that reason an IDDC would have to find some means of ensuring almost complete participation by the creditors.”

We see then that the Brady Plan was insufficient to face the debt crisis. Its limited character stemmed from two other factors in addition to its insistence on the voluntary approach: it did not provide funds for the IMF and the World Bank to offer guarantees, and it said nothing about a joint action of the two institutions to create a debt facility. Given these limitations, the discount the highly indebted countries received under the Brady Plan was small, if any. More important in solving the debt crisis were, domestically, the exchange rate devaluations and fiscal adjustment and, internationally, the reduction of interest rates in the early 1990s.

**I**f a concerted securitization of the debt is a better solution to the debt crisis, why has it not materialized? Why has the Brady Plan set a limit for the creditor countries? It is not difficult to identify the obstacles to the concerted approach—obstacles that originate in both the creditor and the debtor countries.

On the creditors' side, the barriers to a concerted reduction of the debt were: (1) the inherent collective action barrier to comprehensive debt reduction; (2) the problem of precedents; (3) the problem of public-sector bailouts; (4) the distorted incentives of the large banks; (5) the structure of the bargaining cycle (see Sachs 1989b); and, more recently, (6) the relatively strong performance of the countries that signed a Brady-type agreement.

The inherent collective action barrier is related to the insistence on the voluntary schemes I have already discussed. The problem of the precedent applies especially to small countries; a solution to the debt is not reached, given, as the banks would say, “the risk of a precedent.” Concerted debt reduction is also difficult because of the continuing signal from the official community that public money will rescue the faltering negotiation process; to the extent that the banks limit new lending or debt reduction, they know the official community will make up at least part of the difference in official lending to the debtor countries. Additionally, the large U.S. banks strongly resist debt write-downs because of the less developed countries' greater exposure relative to capital, because they have superior access to debt-equity swaps than do small banks, and because they will be better off if another, smaller creditor voluntarily makes a concession to the debtor. Finally, in the negotiating cycle the bargaining power of the debtor countries is weakened because an agreement with the banks has been made the *sine qua non* of

good relations with the creditor governments. In the case of the Brazilian moratorium in February 1987, this phenomenon was quite clear. Solidarity among creditor governments, multilateral agencies, and banks was fairly evident.

**T**he debtor countries were obviously interested in reducing their debt when the problem was on the agenda of the creditor countries. This interest was first officially manifested at the Acapulco meeting of eight Latin American presidents in November 1987. But the elites in the debtor countries and their respective governments were unable to exert sufficient pressure on the creditors to adopt the unilateral decision of suspending the payment of interest and reducing the debt for three reasons: (1) they feared retaliation; (2) they identified ideologically with the creditors; and (3) the elites suffered less as a result of the debt, which, particularly in the case of debt-equity swaps, may be a source of speculative profits.

Bankers always threaten retaliation, and despite the fact that these retaliations never materialize, they continue to frighten debtor elites. In all instances of moratoria retaliations have been minor. In the case of Brazil the declaration of the new finance minister in February 1988 that the moratorium caused more harm than benefits to the country because of retaliations is meaningless. He was merely trying to justify suspending the moratorium and signing a conventional agreement with the banks, which had solved none of Brazil's problems. In fact, retaliations against Brazil were minimal. The commercial banks moderately reduced their short-term credits, and the World Bank—for the first time that year—presented a negative cash flow with Brazil. This may have caused a loss of reserves of, at most, \$1.3 billion against a gain of \$4.3 billion—the interests that should have been paid in 1987 to the commercial banks on long-term loans.

In fact, the banks have no interest in suspending their short-term loans to the highly indebted countries. They receive large spreads from these loans, and the discount for them in the secondary market is very small. If they decide as a retaliation to suspend these credits, the debtor country will not pay, and the loan will be immediately transformed into a long-term credit with a much larger discount in the secondary market. The loss for banks will be abrupt and large. They are well aware of this fact and thus do not retaliate. Banks are interested in making profits—now and in the long run. Threats may help to achieve this goal; retaliations will not.

A second obstacle for the local elites seeking to exert stronger pressure on creditors, which in certain cases should include the declaration of a moratorium, is their ideological identification with the creditor countries. They want to be part of the First World. They want respect, and they identify the First World with the banks and the U.S. government. They are only now beginning to realize that elites in the creditor countries are divided, that the First World should not be reduced to only the bankers, and that an increas-

ing number of very influential citizens in the First World are pressing for a concerted debt reduction.

Finally, the poor rather than the elites are the ones who suffer as a result of the debt crisis. For some, the debt offers a chance for speculation and profit. Debt-equity swaps in particular make possible huge gains for local bankers, brokers, investors, and lawyers. In fact, these swaps are not merely inefficient—as is the case with the “voluntary” debt-bond swaps—in solving the debt crisis; they are a false solution that harms the economies of the highly indebted countries. Few effective investments result from these conversions. For the beleaguered public sectors of the highly indebted countries, they represent the exchange of an external debt for an internal debt—generally at a higher real interest rate—or for printing money. In the case of Brazil, where the internal debt consists of quasi money (overnight maturity), we have the worst of both worlds: with debt-equity conversions, the state pays higher interest rates while printing quasi money.

**T**he failure of the conventional (muddling-through) approach to the debt crisis, the limitations of the Brady Plan, and the lack of motivation to adopt a global securitization solution to the crisis led an increasing number of countries into a state of arrears in the late 1980s. Negotiations basically lost focus because the “new money” device—the basis of the conventional approach—proved illogical even from the standpoint of the banks. The only alternative to new money was sizable negotiated debt reductions, reductions professional managers of the banks could not accept.

Arrears are undeclared moratoria. They are the obvious and, in fact, the only alternative when negotiations fail. This is the situation with the debt crisis of the 1930s, as Robert Devlin (1989a:234) reminds us: “At the outset of 1988 the situation of [Latin America] began to display some remarkable parallels with the debt crisis of the 1930s. . . . Only a few countries maintained a regular payments status with their creditors; the majority of debtors in fact were, in one form or another, in a state of arrears even on rescheduled debt service.”

Arrears are not a solution to the debt crisis. They are a negative form of responding to it, as long as nothing is really solved. Economic theory holds that economic agents behave according to expectations—expectations that are rational and self-fulfilling for some economists and that underline the uncertainty of economic behavior for others. But expectations are always based on facts. If the economies of the highly indebted countries tend to be victims of a fiscal crisis and if a substantial part of the budget deficit originates in the interest paid by the state on the foreign debt, expectations regarding inflation will necessarily tend to be high. On the other hand, investors will tend to have negative expectations about the economy of a country that has an enormous unpaid debt.

The arrears problem was eventually solved when exchange rate devalu-

ations produced trade surpluses in most Latin American highly indebted countries. In some countries Brady agreements also played a role in regularizing debt payments. The problem was solved definitively when the cash flows changed direction and the transfer of real resources to the creditor countries was stopped.

**I**n 1989 the probability that a debtor country would incur a state of arrears or adopt a quasi-unilateral solution was high; today there is no such probability. The debt crisis was not fully solved, but today its burden is smaller than it was in the 1980s. The relative success of the Brady Plan, the reduction of international interest rates, and the change of direction of international cash flows led the elites in the creditor countries to see the problem as having been solved.

Between 1986 and 1989 the elites in the creditor countries were divided. The realization of this fact was a decisive factor in convincing me, as finance minister of Brazil, to propose a concerted solution to the debt crisis in 1987. I would not have made these proposals if I had not known that a large sector of the elites in the creditor countries favored some kind of debt relief.

At that time, however, the sectors of the elites that were sympathetic to the debtors always assumed that the initiative should come from the creditor governments. It was difficult for them to admit that an initiative to reduce the debt could come from the debtors' side. Today, even this mildly favorable attitude has vanished because the Brady-type agreements are supposed to have successfully provided a long-lasting solution to the debt crisis.

Thus the creditor countries' motivation to solve the debt crisis has vanished. The debt is no longer a source of crisis for these countries, and the new international liquidity has created a worldwide belief that the crisis is also over for the debtor countries. This is only partially correct because the interest burden remains high and straps a heavy fiscal burden on the highly indebted countries. Governments in the debtor countries owe around 90 percent of the debt and have a limited fiscal capacity to pay. Thus in addition to causing real resources transfers, the debt crisis remains a major fiscal problem that is reducing growth rates in the debtor countries and will continue to do so for many years. Yet it is no longer a problem for the banks or the creditor countries and thus is no longer a part of the international agenda. The problem survives only through its effects in the 1990s: modest growth rates and lagging living standards in Latin America.