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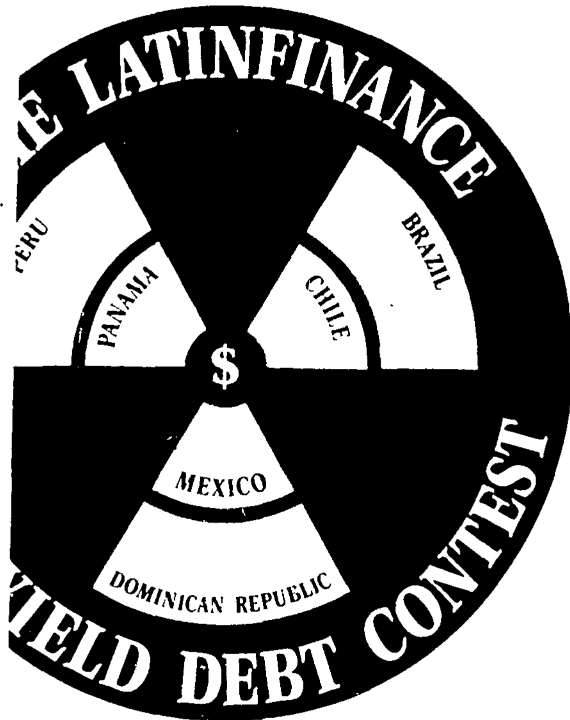

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A Proposal for Flight Capital

Bringing it All Back Home

By Pedro Palma

With help from multilateral institutions, high-yield, low-risk Latin American securities could coax capital flight back to the region.

Countries seeking foreign private capital could issue dollar-denominated bonds to be transferred to the international financial institutions, which would offer those securities on the world's financial markets and guarantee service payments.

By providing guarantees to bond purchasers, the multilaterals could broaden Latin America's access to foreign and domestic capital alike

Multilateral institutions such as the World Bank and the InterAmerican Development Bank would collect the funds for interest payments from the debtor country and make the payments to the bondholders. At the same time, they would provide the debtor countries with contingent credit lines to guarantee interest payment, which would be activated when the debtor countries found themselves temporarily unable to pay.

Both the country and the agency involved would have to study carefully the investments to be funded in this way; they would have to determine whether the projects justified new borrowing and whether the country would reliably be in a position to honor its additional obligations. The institution would also supervise the use of the funds and ensure that the debtor country maintained rational economic policies that minimize the risk of being unable to serve its new obligations.

By providing credible guarantees to potential bond purchasers, this arrangement would broaden the region's access to international capital of all kinds, whether from private sources, banks, or institutions, while encouraging the return of national flight capital.

Relatively little money would be needed to fund the contingent credit lines opened to guarantee the bonds, since agreements between the institutions and debtor countries would minimize the likelihood of default. Additional funds would then be available for direct financing of these multilateral organizations to Latin American countries.

A number of potential problems might undermine the viability of such a scheme. One is the proliferation of Latin American bonds on the world financial markets, as existing bank debt is increasingly converted into securities. Those bonds could crowd out bonds for new investments—and severely limit the Latin American countries' access to world bond markets.

Several debtor countries are about to reduce outstanding debt or debt service obligations through these conversions under new agreements with creditor banks. Many of the banks which accept the new bonds will offer them on the market in an attempt to liquidate their exposure. As a result:

- Debtor countries will face a major obstacle to future restructurings of payments on their remaining obligations. When the bonds spread through the international investment community, the debtor countries will no longer have a compact group of banks with which to negotiate for new payment terms. They will be forced to pay on time or will find themselves excluded from the international securities markets. The new rigidity of their obligations will make it harder than ever to attract new development financing.
- The international financial markets might raise assessments of the risk attached to the bonds. The more that circulate, the lower the perceived probability of payment. Such a perception would not only depress their market prices, but also lead purchasers of future issues to demand deeper discounts, unless the bonds carry an ironclad guarantee. Such guarantees would require large amounts of funds to back them up, which in turn would limit the possibilities for this financing alternative and restrict Latin America's future access to foreign capital.

Attracting essential new investments in Latin America is increasingly challenging. The region cannot rely on restricted public and private foreign credit. Nor can it stake its economic health on the world market, where competition for funds is daily growing stronger.

The region must look to the large pool of Latin American capital invested outside its borders. It will hardly be easy to bring it back. Its owners will be interested only in attractive local opportunities whose potential financial yield is not only competitive with what they can earn abroad, but high enough to compensate for the added risk of investing in Latin America.

Bringing flight capital home, while difficult, is not impossible. It will depend on new economic policies aimed at creating attractive investment opportunities, and on the implementation of financial engineering schemes that channel repatriated funds into high-yield, low-risk Latin American securities offered on the regional and international markets.

International financial institutions such as the World Bank and the InterAmerican Development Bank could play a crucial role in the recovery process. They must not only continue to provide direct funding; they must help make Latin American securities acceptable to the world markets.

Pedro Palma is president of MetroEconómica, a Caracas consulting firm