The Latin American Debt

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5 Real Alternatives for Handling the Latin American Debt Problem

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The experience accumulated over the last six years (from 1982 to 1988) yields a basic conclusion: the methods applied up to the present time to deal with the DCs' foreign debt problem (and particularly that of Latin American countries) cannot produce a lasting solution.

Country-by-country negotiations with the international creditor community for restructuring of debt-service payments, the only form of attacking the problem permitted up to now, have placed vast burdens on the debtor countries, as much in the social and political spheres as in the economic sphere. These heavy costs result mainly from the adjustment policies the debtor countries have had to adopt in an attempt to strengthen their external sectors and improve their ability to service their outstanding debts. The restrictive economic policies they have been forced to apply, combined with massive currency devaluations aimed at reducing imports to compensate for the loss of foreign exchange earnings resulting from declining export prices, have produced a combination of deep recession and surging inflation.

This process explains the simultaneous rise of unemployment and inflationary pressure in the debtor countries, and the resulting contraction of their populations' purchasing power. The hardships have only intensified as time passed, due to the increasingly severe limits to growth and development imposed on these economies by the large-scale transfer of capital abroad which they have had to make in order to service their debts. In fact, debt-service payments have substantially exceeded the inflow of capital in the form of new foreign loans. As a result, we see the paradoxical situation of the poorest and neediest countries contributing capital to the richest ones.

However, even if it is self-evident that the foremost victims have been the debtor nations, the creditor countries have also paid a price. In particular, their industrial sectors have been hit by the decline of exports to Latin America.

Creditor banks have also suffered the effects of a decline in the value of their loan portfolios. Although they have been permitted to continue recording their Latin American debt holdings at face value, it is obvious that their real value is a great deal less; the deep discounts at which those assets are traded on the secondary market is evidence of the deterioration of their value. In addition, the banks have found themselves obliged to set aside large loan loss reserves, as the likelihood of full payment by the debtor countries becomes ever more remote. Furthermore, the maintenance of asset portfolios generally perceived as being risky has tended to depress the value of the most exposed banks' stock, thereby hurting their shareholders (see Sachs and Huizinga, 1987).

The negative result of this experience to date makes it clear why it is urgent to search for new and more realistic methods to handle the debt problem, achieving a more equitable distribution of burdens and sacrifices among the parties. A number of proposals are discussed below in order to determine the most appropriate route to the achievement of this goal.

SOME POSSIBLE SOLUTIONS

Numerous suggestions have been made since 1983 to try to find a solution to the DCs' foreign debt problem.[1] Among them are proposals to limit debt service payments through measures such as the establishment of fixed interest rates, automatic loans or capitalization of interest beyond a certain limit, ceilings for nominal or real interest rates (Wallich, 1983), and debt-service payments with equal present value (Palma, 1985).

Other proposals seek to tie debt-service payments to the debtor's ability to pay. Among these is the limitation of debt-service payments to a given percentage of each debtor country's exports, an idea which emerged from meetings with representatives of several Latin American countries. These meetings were held in Quito in Ecuador and Cartagena in Colombia in 1984.

Another possibility is the payment of foreign debt in the debtor country's national currency. Dornbusch (1988) has proposed that only commercial debts (credit lines for imports) and loans granted by multilateral organizations be paid in dollars, while interest payments on the rest of their foreign debts would be made in the national currency.[2] These local currency payments to the creditor banks would

then be deposited in the debtor country itself and capitalized so that it could be invested by the creditors in that country, or sold to domestic or foreign investors; but under no circumstances would they be transferred abroad. A scheme such as this would have the virtue of channeling interest payments into the development of the debtor country.

Among its advantages is a reduction of foreign exchange transfers from debtor countries to their creditors. This would help to mitigate the pressure on debtor countries and make it unnecessary for them to resort to massive currency devaluations to constrict imports. They would then be in a position to increase their purchases from abroad, which would dampen inflationary pressures.

To date, none of these options has been tested in practice. This is due in part to the rigidity of banking regulations in effect in industrialized countries, in part to the inflexibility of the authorities of those nations which insist on direct, country-by-country, negotiations with creditors, and in part to the preference of bankers themselves for direct negotiations, since any other option would impose greater economic sacrifice on them.

Debt Relief Proposals

Still other proposals, under the rubric of 'debt relief', consist of taking advantage of the discounts at which the debtor countries' financial obligations can be purchased on the market. This is a way of reducing the value of their debts, and consequently of debt service. The perception of high risk, reflecting the scant likelihood of collection in full, has led certain banks to sell assets at a discount – determined by the perception of financial solvency of each debtor – on the secondary markets (see Table 5.1 on the following page).

The reason why the creditor banks would be willing to condone part of the outstanding debts of these countries – whether by unilateral decision or through their discount sale in exchange for securities – is that the smaller the value of debt, the greater is the debtor's ability to pay, and the greater is the likelihood of collection by the creditor. This principle is illustrated by the debt-relief Laffer Curve shown in Figure 5.1 (see Krugman, 1988).

The graph tells us that if a debtor owes a relatively small amount, between 0 and A, its ability to repay the debt is relatively high; it could be said that the present value of expected repayment is equal to the value of the debt itself. In this case, we would be moving along the $0B$

Table 5.1 Prices of Latin American foreign debts on the secondary markets (cents of the US$)

	Dec. 1986	*Dec. 1987*	*June 1988*	*Dec. 1988*	*% difference Dec. 1986–Dec. 1988*
Argentina	48	36	26	21	-56.3
Brazil	60	45	51	40	-33.3
Chile	68	60	60	57	-16.2
Mexico	56	52	51	42	-25.0
Venezuela	70	56	56	40	-42.9

Source: Merrill Lynch International Bank and International Exposure Management Group.

bisector. But as the magnitude of the financial obligation grows, increasing the distance from point *A*, the smaller is the debtor's ability to pay, and the creditor's present value of expected collection will decline. This amounts to saying that the present value of expected repayment is continually lower in comparison with that of the debt as the distance from the bisector grows. Under such circumstances, it is in the interest of the banks themselves to increase the present value of their expected collections by condoning a part of the debtors' obligation, and thereby moving along the curve to the left.

Among the various debt-relief schemes is the one known as DES. It has been applied on a relatively large scale in the last few years. It

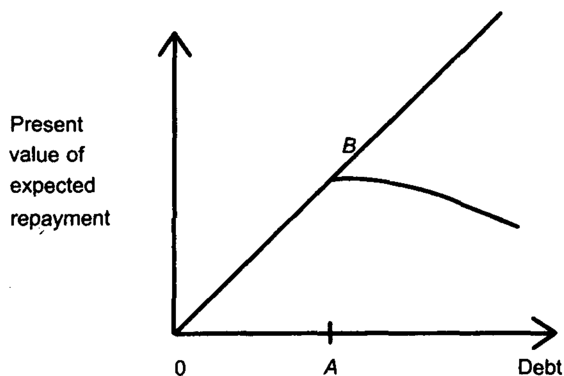

Figure 5.1 The debt-relief Laffer curve

consists of the purchase, at a discount, of foreign currency-denominated debts of DCs by individuals or institutions wishing to invest in those countries. The obligations are then sold to the debtor country government for national currency at face value or at a smaller discount than the one at which they were originally purchased, and the proceeds are invested in the debtor country.

A variant of this scheme is that of conversion of debts to equity holdings in a debtor corporation (debt–equity conversion). Here, the creditor of a corporation acquires part of the debtor's capital in exchange for the former's claim against the corporation.

The application of arrangements such as these has indeed led to a significant reduction in the foreign obligations of certain countries, stimulated foreign investment, and in some cases even encouraged the repatriation of capital held abroad by nationals of the country in question, but it has failed to solve the foreign debt problem entirely. One of the reasons for this is that the potential investment opportunities in most DCs are far smaller than their foreign debt obligations.[3]

Certain debt-relief proposals are known as buyback schemes. These are arrangements by which the debtor country buys a portion of its foreign debt on the market at the prevailing discount, paying for that purchase with funds drawn from its foreign reserves, its export earnings or financing provided by independent financial institutions.

The most serious obstacle to the large-scale application of buyback transactions is the meagre foreign purchasing power of the countries involved. The smaller the debtor country's financial base, the more limited is its ability to buy back its own obligations, even at a deep discount. But, on the other hand, if a debtor country were to decide to use its scarce foreign reserves to purchase a large part of its debt in order to take full advantage of that discount, the sudden increase in the demand for those assets would tend to raise their market price, reducing the discount and undermining the attractiveness of the operation.

Proposals have been made to solve that problem by asking the creditor banks themselves to lend the debtor countries the funds needed for discount purchases of their foreign obligations (round-tripping). There is not much likelihood of a large-scale application of that suggestion. The banks – and particularly the most exposed ones – would be apprehensive about the potential reaction of their financial authorities, who might require the creation of large reserves against those new loans or the accounting of all their debt holdings at the market price. In either case, the banks would suffer losses (see Williamson, 1988).

One more debt-relief scheme that has been proposed is the use of exit bonds. The debtor countries would issue foreign currency-denominated bonds and deliver them to the creditor banks in exchange for their current financial obligations. These bonds would give the financial institutions accepting them the right to decline participation in the new debt-service restructuring agreements, since their debt holdings would have been converted into securities. In most cases, the bonds would mature over quite a long period of time, and would be used by the debtor country to buy back its former debts at a discount.

However, the debt-relief measures attempted to date, in the form of purchase of obligations at a discount in exchange for bonds issued by the debtor countries, have had little success. The banks have shown relatively little interest in such arrangements, perceiving them as risky since there is no assurance that the issuers of those securities will be in a position to pay interest and principal at their maturity. The banks therefore require a full security guarantee for any bonds they accept.

A number of proposals have been advanced to overcome these limitations and make schemes of this kind more viable. One calls for an international agency to act as intermediary in the discount purchase operations, issuing the bonds in its own name and thereby becoming the new creditor of the debtor country. This is the thrust of several proposals, among them the one made by Jeffrey Sachs (1988), under which an international financial institution, such as the IMF, would create a financing facility through which it would issue bonds to be used to buy Latin American debts at a discount. Consequently it would act simultaneously as the debtor of the banks and the creditor of the indebted countries.

Their obligations, in turn, would be reduced by a percentage equal to the discount at which the IMF would buy the debts from the banks. The intermediary would then negotiate with the debtors on the conditions of servicing their new debts on terms more in keeping with their financial condition, as well as on the application of economic adjustment programmes. The funds paid by debtor countries to the IMF for debt service would then be used by that institution to pay the interest and principal at maturity of the bonds it issues in order to purchase the original debts at a discount.

In the event that the debtor country were unable to meet all its commitments towards the international body, the latter would absorb the losses and negotiate with the country in question on economic policy measures that would need to be implemented in order to

improve its financial ability. But it would continue fully serving its own bonds in the hands of the international creditor community.

Other proposals have been made along similar lines. One of them was put forward by Representative Bruce Morrison of the US Congress. It was accepted in principle by the Congress, which recommended a study by the Treasury Department with a view to its implementation.[4] Concretely, the proposal calls for the creation of an international entity (International Debt Management Authority), with financial contributions by the industrialized countries. These funds would be used to purchase DCs' debts at a discount on the international financial markets. Thereafter, the Authority would enter into negotiations with the debtor countries to establish the arrangements for their debt-service payments; their obligations would be equivalent to the amounts paid to buy the debts from the banks. At the same time, the economic policies the debtor countries would need to apply in order to be eligible for this reduction in the value of their obligations and debt-service payments would be negotiated.

DO CONDITIONS CONDUCIVE TO THE IMPLEMENTATION OF DEBT RELIEF ARRANGEMENTS EXIST?

It is important to state that the implementation of schemes such as those outlined above will not be easy. The creation and operation of international financial facilities involves a series of very complex operational problems which are quite difficult to solve.[5] However, if the parties, and particularly the financial authorities and governments of the creditor countries, have the will to overcome these obstacles there is a high probability of their being successfully applied.

More specifically, with regard to Morrison's proposal, the US Congress limited itself to ordering a viability study by the Treasury Department, so that the Bush Administration could decide on whether to pursue it or not. It is especially noteworthy that, for the first time, the US Congress took a position in favour of a solution along these lines.

Continued Intransigence

That is an important fact, since the Congress's support for an alternative might influence the executive branch to change its policy in the future. It is well known that the US financial authorities have

been the strongest supporters of the traditional methods for handling the debt problem up until now, and have consistently imposed these methods on the debtor countries, refusing to cooperate in the development of a practical and effective alternative solution.

That position was successful in buying time for the creditor banks which needed to strengthen their financial position in order to manage the crisis better. However, that goal was achieved several years ago (see Sachs and Huizinga, 1987). It therefore makes little sense for them to continue clinging to the traditional approach, arguing that the continuation of the Baker plan or an expanded version of it will lead to the solution of the problem. Since that plan was announced in late 1985, it has been clear that its implementation would not solve the problem because it involved only a highly conditioned grant of additional financial assistance to 15 debtor countries for a period of three years, and amounted to less than US$30 billion in the aggregate.

It was naive to think that, even if the plan were fully implemented, any important progress towards a solution could be achieved since the amount of new loans in question was relatively insignificant. The amount was very much smaller than the annual payments that Latin America as a whole had, and still has, to pay just in interest on its foreign debts.

As stated above, the implementation of debt-relief schemes through financial facilities acting as intermediaries for the discount purchase of debts from the creditor banks requires the establishment of a series of preconditions to provide some assurance of success. Among the most important of these are the loosening of banking regulations so that the creditor banks would perceive less risk in participating in these operations, since they would not impose costs in addition to those implied by the discounts at which the debts are sold.

It is likewise necessary for the authorities of the creditor countries to take a more flexible position, agreeing (among other things) to make the contributions to the international facility for debt purchases. This has been a serious obstacle up to now, due mainly to the intransigent attitude of the United States, whose financial authorities have stated time and again their refusal to contribute public funds for that purpose. They want to prevent the costs implicit in the implementation of any debt relief arrangement from falling on the US taxpayers.

So simplistic an attitude appears to ignore the fact that the taxpayers – or in a broader sense, the populations of the debtor countries – have been undergoing the greatest sacrifices and privations caused by the debt problem for the last seven years, in spite of the fact

that their shortcomings and needs are far more serious than those of the taxpayers of the creditor nations.

Other aspects mentioned as characteristics of the traditional processes of debt management are, on the one hand, the demand that each debtor country negotiate individually and separately with its creditors on the terms to be applied to the repayment of its obligations and, on the other, the intention that these agreements and commitments be established in a voluntary manner between the parties, without the interference of coercive forces pressuring any of them to accept particular arrangements.

The first of these principles has indeed been applied in full, and joint negotiations of the debtor countries with representatives of the creditor banks have been prevented up to now. However, the second has only been practised in part. In certain cases the rigidity of banking regulations, or those of the financial authorities of the industrialized countries, has prevented the achievement of reasonable agreements among debtors and certain creditors, in spite of the goodwill for their attainment; it has also helped to tip the balance in favour of the banks and against the other party. This has forced the latter to accept adverse conditions and terms which might have been avoided if there had been more interference by third parties in the negotiations.

We can conclude from the foregoing that, as long as these rigid attitudes persist, the possibility of adoption of any of the alternative arrangements discussed above is very limited. However, according to public statements by the current US administration, there is now a willingness to modify the traditional positions on the debt problem. Still, major changes are not to be expected since the main architects of the policy followed up to the present will hold key posts in the new administration.[6] Consequently it is reasonable to assume that many of the positions and concepts characteristic of the recent past will continue to make themselves felt in the years to come.

IN SEARCH OF AN ALTERNATIVE SCHEME

If that is the case, it will be necessary to develop an alternative which, by not coming directly into conflict with those principles and concepts, will facilitate the achievement of a common position among the parties and make it possible to solve the debt problem once and for all.

Below is a discussion of a proposal that was presented early in 1988. Based in large measure on the bonds-for-debt plan tried by Mexico at

that time, it attempts to define a functional system through which a solution to the debt problem can be found.

The Mexican Plan

The scheme proposed by Mexico and the Morgan Guaranty company of New York consisted of the purchase of a part of Mexico's foreign debt at a discount in exchange for dollar-denominated bonds issued by the government of that country, maturing in 20 years and having an annual yield equivalent to LIBOR (London Interbank Offered Rate) plus $1^5/_8$ per cent. The payment of their face value at maturity would be backed by US Treasury zero-coupon bonds, to be purchased by the Mexican government at a discount of approximately 80 per cent (see Figure 5.2).[7]

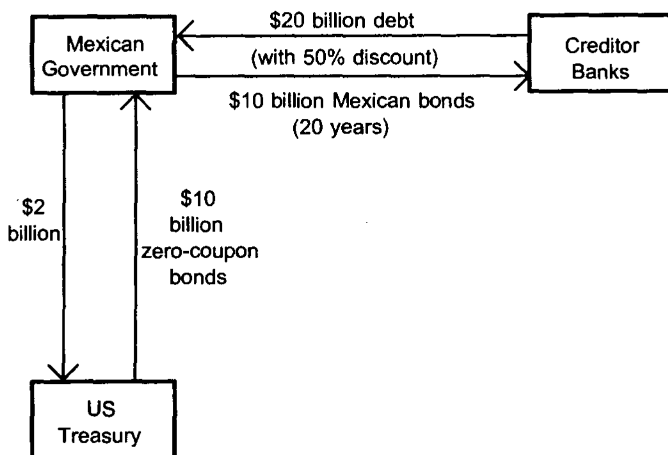

Figure 5.2 The Mexican bonds scheme

However, in the application of this initiative the results were quite disappointing. The initial intention was to purchase a total of US$20 billion of Mexican debt at a 50 per cent discount from its face value in exchange for the bonds described above. The banks were invited to bid on the amounts and discounts for which they were interested in participating, while the debtor reserved the right to accept or reject those bids, either totally or partially.

Once the process of analysis of the bids received was over, it was decided to conduct debt–bond swaps for only US$3.665 billion, at a discount of about 30 per cent. To do so, Mexico had to issue bonds of its own and purchase US Treasury zero-coupon bonds for US$2.557 billion.

One of the reasons for the very limited success of this scheme was the rigidity of banking regulations, especially those of the United States where the creditor banks were required to write off the discounts at which they were willing to sell their debt holdings as losses at the time they made their offer, or create additional reserves for future bad debts. They might have suffered this adverse effect on their portfolios even if the transaction was not consummated.

This led many banks, especially the major creditors, either to refrain from participating or to offer smaller discounts, not only due to the cost of simply stating their intention to participate but also because of the fear that the financial authorities might later require them to write down the rest of the Mexican debts they hold to the same extent. Furthermore, the regulators decreed that once the banks swapped their debt holdings for the Mexican bonds, they would have to deduct the value of those assets from their balance sheets and include that of the bonds they took in exchange, accounted at their market value. This also discouraged participation, since the banks feared that, in the absence of any guarantee of payment of the annual interest on the bonds issued by the debtor, the market would assign them a high risk factor which would depress their price. If that were to occur, it would impose further losses on the banks.[8]

A More Feasible Arrangement

The factors discussed above, in conjunction with others having to do with structural characteristics of the debtor countries' economies – such as a chronic shortage of foreign exchange available for purchase of the zero-coupon bonds to back the bonds for which their existing debts would be exchanged – made it difficult for a scheme such as this to be successful. In view of that constraint, proposals have been made to improve it and enhance its feasibility. One such proposal is the one put forward since early 1988, and which is discussed below.[9]

In this proposal, as in the case of the Mexican plan, the debtor country would purchase a part or the whole of its foreign debt at a discount in exchange for dollar-denominated variable yield bonds, which it would issue and back through the purchase of US Treasury

zero-coupon bonds. The difference lies in the fact that the interest payments on the debtor country's bonds would be secured, as well as the payment of their principal at maturity: an international body such as the World Bank would offer a guarantee of these periodic obligations. To do so, that agency would act as the intermediary between the debtor country and the creditors or bondholders, collecting the required funds from the former and making the scheduled payments to the latter. At the same time, surplus industrialized countries, such as Japan, Germany and other European nations,[10] would lend the World Bank the funds it would need to extend the guarantee of payment of the interest due on the debtor country's bonds (see Figure 5.3).

These funds would be used by the World Bank to finance a portion of the cost of acquisition of the zero-coupon bonds by countries lacking the means to do so themselves, and in part also to open contingent credit lines to the debtor countries, to be activated only if the latter were to demonstrate (under prestablished standards) that it could not meet the interest obligations on its bonds, or if those payments exceeded an agreed level.

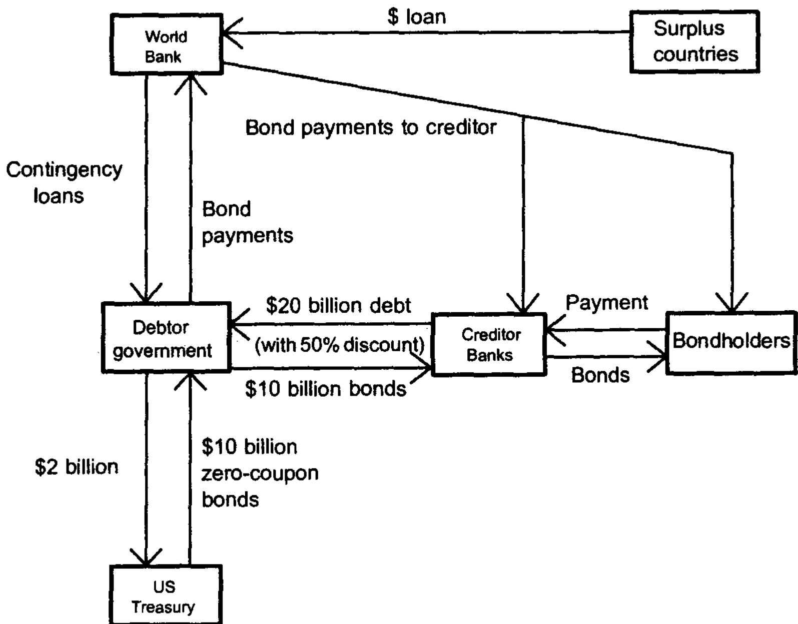

Figure 5.3 The proposed bond scheme

In that event, the World Bank would make the payments, as a result of which the debtor country's obligation to the Bank would increase in an equivalent amount. Service of that obligation would be scheduled in a manner in keeping with the country's ability to pay.

If the debtor country's insolvency were to persist or recur, the World Bank would continue to assume the payment of its obligations towards the bondholders by raising and activating the contingent credit lines. But the debtor country involved would be bound to adopt an economic adjustment plan under the Bank's supervision in order to restore its external ability to pay.

With the application of an arrangement such as that outlined above, one of the principal obstacles to the success of the Mexican plan – the creditor banks' risk of losses due to the low price of the debtor countries' bonds on the international security markets in view of the lack of guarantee for interest payments – would be overcome; on the contrary, both the regular payment of interest and that of principal at maturity would be fully guaranteed. As a result, there would be no reason for the market price of the bonds to be depressed to reflect the risk factor.

This scheme would also come very close to achieving an interest cap on the foreign debt. Although the bonds would be of variable yield (a condition without which they would not be acceptable to the creditors), payments exceeding a certain level provoked by rising international interest rates would be automatically financed by the World Bank. This would increase the debtor countries' obligations to the Bank, but the service of that new debt would certainly be much less onerous than payment of interest rates above the pre-established ceiling.

One possible obstacle to the application of this scheme is the shortage of international reserves and insufficiency of current foreign exchange earnings of the debtor countries. That would sharply constrain their ability to purchase the US Treasury zero-coupon bonds, and make it necessary to finance purchases in whole or in part.

As stated above, the fund administered by the World Bank would be one source of that financing, but it could not be used on a very large scale for that purpose since one of its most important functions – if not the most important one – would be to guarantee the payment of the interest on the bonds issued by the debtor countries through contingent credit lines. Furthermore, if an attempt were made to use the fund to meet both financing needs at the same time, it would have to be of very large proportions, and the viability of the scheme would

become highly questionable; the capital surplus countries might well balk at the size of the contributions they would be asked to make.

The problems mentioned above could be avoided by staggering the payments over a period of years, thereby reducing the concentration in time of the burden. Another possibility would be to complement the fund with another source of financing for the zero-coupon bond purchases. One way of accomplishing that would be a special issue of Special Drawing Rights by the IMF, to be lent to the debtor countries under favourable conditions. They could then be exchanged for the funds needed to buy the zero-coupon bonds.

Still another feature requiring careful study to assure the viability of this debt-relief plan – or any other involving the purchase of debts at a discount – is the determination of that discount. It will have to be pegged at a level that is reasonable and acceptable to all the parties. It might be wise not to make it similar to the one at which the debts are being traded on the secondary market at the time of the transaction so as to avoid the moral hazard of debtor countries' trying to deepen the discount by threatening to suspend payments, and thereby damaging the creditors' interests. On the other hand, it could not be set artificially low in order to benefit the banks unreasonably.

One thing that might help to determine the appropriate level of discount is the application of the principle of voluntary participation on the part of the banks, which should make reasonable and acceptable bids on the discount and on the amounts with which they would participate. This could only be accomplished if the regulatory rigidities – such as those in force in the United States, which require the banks to write off the loss implied by the discount at the time they announce their intention to participate – were eliminated.

Other regulations should be made more flexible, with a view to encouraging the banks to participate in the scheme: for example, they could be allowed to spread the loss implied in the discount sale of their loan holdings over several fiscal years, rather than taking the entire loss immediately. In that case, the banks would find it advantageous to participate. On the one hand, their losses would be kept to a modest level, and on the other, they might fear that if they refused to do so, or if they offered artificially low discounts, the debtor countries would react by giving a lower priority to serving those debts and might go so far as to suspend payments entirely; that would obviously depress the market price of those assets (see Corden, 1988).

The application of our proposed plan could lead to a solution of the debt crisis without any major obstacles. It would reduce the debt

burden for the debtor countries quite substantially, making it more bearable and rational,[11] and it would not conflict with several pre-established principles, the modification of which could be very difficult and time consuming. That feature might make it more viable than some other proposals, being still more favourable to the debtor countries but requiring conditions unlikely to materialize, at least in the near future.

Such a scheme would preserve the principle of voluntary participation on the part of the banks and maintain the bilateral relationship between debtors and creditors. It would even limit the contribution of funds to those industrialized countries which enjoy a balance of payments surplus and are willing to cooperate.

The specific contribution of the United States would be focused on the issuing and sale of the zero-coupon Treasury bonds, but it would not be surprising if the other developed countries were to pressure the largest creditor nation to make more substantial contributions, and give up the self-serving and even irrational position it has maintained over the past.

CONCLUSION

We can conclude from the foregoing analysis that the application of a scheme such as this, or any of the others mentioned, can be accomplished only if there is a will to cooperate among all the parties, and particularly the authorities of the creditor countries. They would have to be willing not only to cooperate, but also to take important steps to create an atmosphere conducive to the implementation of a solution to the problem.

In addition to the adaptation and loosening of the banking regulations to permit (and even pressure) banks to participate, and the willingness of governments and international organizations to engage in direct action, there is a need for a broader vision which goes beyond the solution of the foreign debt problem in and of itself.

At no time should it be forgotten that it is essential to reopen and maintain the flow of financing to the debtor countries which need it so badly for their development. Given the reluctance of the private creditor community to reopen the doors of the financial market to these nations – rarely going beyond small scale and short-term credit lines for imports, and continually threatening to suspend them – there is an urgent need to create and expand alternative sources of financing for the DCs.

That is why it is necessary to expand and strengthen the lending capacity of the multilateral financial organizations and other entities such as those grouped in the Paris Club. To do so would not only provide a flow of loans sufficient to finance investment in development projects, but would also permit the financing of imports and contribute to reducing the heavy dependence of the DCs on the private banks. Even if this were accomplished, however, it would by no means release the latter from their important role as lenders to the DCs, a role they must continue to play.

As stated above, a large number of steps need to be taken before we can really approach a comprehensive solution to the debt problem, and subsequently normalize the flow of capital to the debtor nations. Once again, this can only be accomplished with the will, commitment and effort of all the parties.

Notes

1. For a detailed analysis of many of these options, see Bergsten, Cline and Williamson (1985).
2. Dornbusch assumes that only interest should be paid on long-term bank debts. Principal payments would be postponed indefinitely through the extension of grace periods.
3. For a more detailed discussion of these schemes, see Instituto-Interamericano de Mercados de Capital, (1988).
4. See: US Congress, (1988).
5. For an analysis of the effects and difficulties of the application of this kind of solution, see Corden (1988).
6. See 'Bush Promises Review of US Strategy for Dealing with Third World Debt', *The Wall Street Journal*, 20 December 1988, p. A-2.
7. For more information on it, see The United Mexican Institute for International Economics (1988).
8. Most of the reactions of the US financial authorities to the Mexican plan are to be found in the SEC *Staff Accounting Bulletin*, No. 75.
9. See Palma (1988a and 1988b): the latter contains a study of the effects of implementating a scheme such as that proposed here on the Venezuelan economy.
10. Some of these countries, particularly Japan, have stated their willingness to contribute substantial amounts of funds for a solution to the debt crisis, or have offered their cooperation to permit the application of a scheme having that aim. It is possible that some of those contributions or forms of cooperation might be channelled into the creation of a guarantee fund such as that proposed here.
11. An econometric study was made recently to determine the effects on a heavily indebted economy, such as Venezuela's, of the application of several different schemes for dealing with the debt crisis. The result was

that a plan such as that proposed here would yield very favourable results (see Palma, 1988b).

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