Column 1 Central and South America's cumulative debt problem in the 1980s[29]

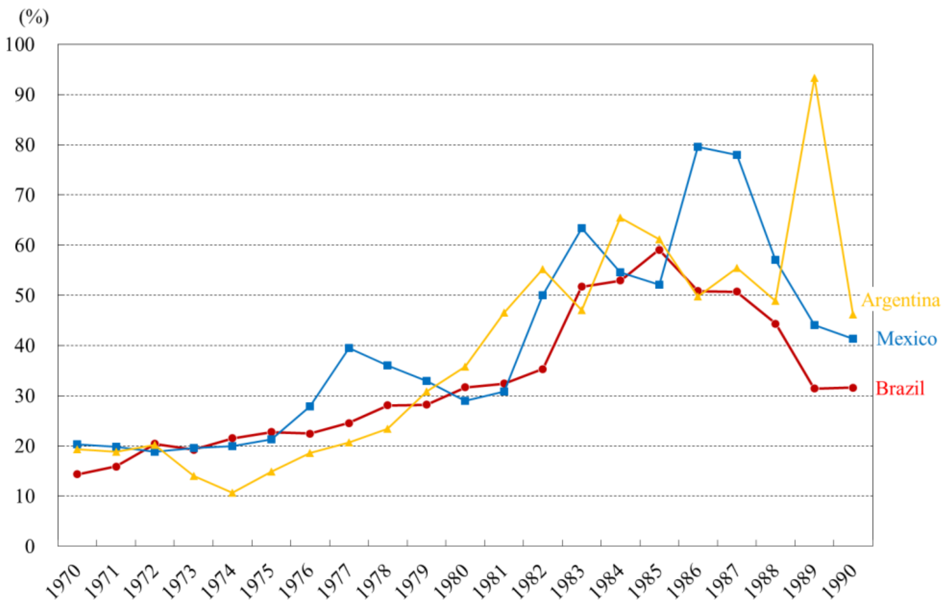
As a result of the advance of globalization, international interconnectedness has strengthened in various domains and the global economy has achieved remarkable growth. On the other hand, once a strong shock like the global financial crisis or the COVID-19 pandemic occurs, its effects spread rapidly across national borders. Therefore, as a negative consequence of globalization, vulnerable emerging countries have become more prone to the effects of global developments.

This column discusses the cumulative debt problem that struck Central and South America in the 1980s as an example case of the effects of developments in a country with a large economic size spreading to emerging countries and causing a crisis.

The beginning of the accumulation of debts in Central and South America lay in the two oil crises that occurred in the 1970s. In the first oil crisis in 1973, the oil price, which had until then stayed at around 2 dollars/barrel rose five-fold to more than 10 dollars/barrel, and in the second oil crisis in 1978, the oil price surged to more than 30 dollars/barrel. Because of the oil price upsurge, the value of oil exports by Middle East oil-producing countries increased, bringing to those countries huge amounts of "oil money" revenues, which were used for investment. The oil money flowed into Central and South American countries, which were continuing to register high economic growth rates at that time, as investment destinations that were expected to deliver high returns. As Central and South American countries needed funds that would drive their future economic growth, a vast amount of oil money was invested in infrastructure construction and economic development policy projects.[30] The outstanding amount of external debts owed by Central and South American countries in the 1970s was at a low level, equivalent to around 20% of GNI,[31] but the ratio of debts to GNI later rose and peaked in the 1980s, to around 80% in Mexico and to around 60% in Brazil[32] (Column Figure 1-1).

[30] Cabinet Office (1986) *SHOWA 61 NEN NENJI SEKAI KEIZAI HOUKOKU*.
[31] GNI (gross national income) = GDP (gross domestic product) + net income receipts from abroad (including incomes earned by people who work abroad (for a period shorter than one year). When expressing the debt size, the World Bank uses the ratio to GNI instead of the ratio to GDP.
[32] The ratio was 79.6% in Mexico in 1986 and 59.1% in Brazil in 1985.

Column Figure 1-1. Changes in ratio of external debt outstanding in three South and Central American countries (to GNI)



Source: World Bank.

What caused the cumulative external debt problem and how did the problem lead to economic and financial market turmoil? While there are multiple background factors,[33] here, we will discuss two major factors in detail.

1. Increase in the repayment burden due to rapid interest rate hikes in the United States

In the United States, the policy interest rate, which was around 5% at the beginning of 1977, was raised to 19% in 1981 in order to deal with the high inflation rate, which stayed somewhat above 10%[34] from around 1979 onward. As most of Central and South American countries' external debts were denominated in the dollar and carried floating interest rates, the interest rates on those external debts rose in tandem with the U.S. interest rate hikes, leading to a rapid increase in the debt repayment burden.

Furthermore, because of the narrowing of interest rate differentials between the United States and Central and South American countries due to the U.S. interest rate hikes, demand grew for investments in the United States, which delivered higher returns and provided a higher level of stability, and as a result, investment funds flowed out of Central and South America to the United States. The outflow of funds caused Central and South American countries' currencies to depreciate against the U.S. dollar, resulting in a further increase in the burden of repaying foreign currency-denominated debts, the value of which was inflated when converted into domestic currencies. In addition, inflation accelerated due to import price rises, increasing downward pressure on the economies of Central and South American countries.

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33 Another factor pointed out as the main cause of the Central and South American cumulative debt problem is the import- and consumption-oriented domestic economic structure that reflected past economic policies.

34 The inflation rate peaked at 13.6% in June 1980.

2. Decrease in foreign currencies earned by Central and South American countries due to export slumps

Besides the abovementioned U.S. interest rate hikes, another factor that caused the cumulative debt problem was a decline in revenues that could be used for debt repayment due to slumps in exports by Central and American countries and falls in prices of primary commodities.[35]

Specifically, volumes of exports from Central and South America dropped because the oil crises triggered a slowdown of the global economy and also because the rise of protectionism curbed trade. In addition, prices of primary commodities, which are the main exports items for the region, started to fall in 1980, resulting in the reduction of the amount of foreign currencies that could be earned through exports. Many Central and South American countries have vulnerable economic structures dependent on exports of primary commodities, such as agricultural products and mineral resources, so they are prone to the effects of economic conditions in export destinations and changes in prices of primary commodities. Indeed, the growth in the value of exports by Mexico slowed down considerably after peaking in 1980 and turned negative in 1985 and 1986. The value of exports by Brazil showed a similar trend, continuing to record year-on-year declines. Furthermore, prices of primary commodities trended downward from 1980 onwards and continued to record double-digit year-on-year falls. Because of this export slump, the ability to earn foreign currencies declined, a situation that made it more difficult to repay debts.

Under these circumstances, Mexico declared a default in August 1982, followed by a string of revelations about the difficulty faced by other Central and South American countries, including Argentina and Peru, in repaying external debts. In February 1987, Brazil declared a moratorium, which means a unilateral suspension of repayment of external debts. The outstanding amount of external debts stood at 97.7 billion dollars (1985) in Mexico and 102.0 billion dollars (1984) in Brazil.[36] As the Central and South American economies remained markedly stagnant in the 1980s, that period is known as “the lost 1980s.” That situation also dealt a huge blow to financial markets across the world, including financial institutions in developed countries that were creditors.

The current situation surrounding the global economy is similar to the situation at the time of the cumulative debt problem in the 1980s in that external debts owed by emerging countries are expanding and that the United States is rapidly raising policy interest rates. However, the impact of those developments has been limited, as shown by the fact that massive fund outflows have been prevented, because emerging countries, having learned lessons from the past, have been making efforts to improve their economic fundamentals while keeping a careful watch on domestic price trends and monetary policy moves in the United States and other countries. However, there are still countries whose debts continue to expand or which have fallen into a state of excessive debt. In 2022, Sri Lanka and Ghana defaulted. A careful watch should be kept so that debt problems can be prevented from developing into another global crisis.

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[35] Ministry of International Trade and Industry (now known as Minisry of Economy, Trade and Industry) (1988), *White Paper on Interntional Trade and Economy 1988.*

[36] Maruya, Y. (1987), *RATEN AMERIKA NO KEIZAI KAIHATSU TO SANGYOU SEISAKU—RUISEKI SAIMU KIKI KA NO SENRYAKU SANGYOU*; Institute of Developing Economies and Economic Planning Agency (1984), *SHOWA 59 NEN NENJI SEKAI KEIZAI HOUKOKU*.