FORGIVING LDC DEBTS: Only Modest Ag Trade Effects

If all of the international debt—government and commercial—of Brazil, Mexico, Venezuela, and Chile was miraculously cut in half overnight, U.S. farm exports would increase by less than one half of one percent.

This conclusion and the two reasons which undergird it run counter to the often heard "before and after" analyses which focus on developments over the last two decades. Such analysis says essentially this: "In the 1970s LDC debt went up; U.S. farm exports to these countries increased sharply. In the 1980s the high LDC debt levels were associated with declines in U.S. farm exports. Therefore, if the debts of LDCs were reduced, U.S. farm exports would increase."

Unfortunately, the world is not that simple. Some people think that the external debt of developing countries (LDC) like Brazil and Mexico, has had substantial negative effects on U.S. farm exports. They argue that forgiving such debts would lead to substantial increases in U.S. farm exports.

We disagree. Admittedly, the LDC debt crisis has had a negative effect on U.S. agriculture. However, the magnitude of the effect has been relatively small and the forgiving of these debts will not have large positive effects on U.S. farm exports.

U.S. Trade Effects

Our analysis indicates that forgiving Latin American international debt would have only modest effects on U.S. farm exports—and much less than some people believe. Suppose, for example, that somehow the United States and other international creditors forgave one half of the total government and commercial debt of Brazil, Mexico, Venezuela, and Chile. These four countries are important importers of U.S. agricultural products taking nearly 9 percent of U.S. farm exports in 1989 (Table 1). Thus, our analysis posits a write-off of $107.5 billion in 1986 (the base period for our analysis). Accordingly, the annual debt service of these four countries is set at $14.5 billion in contrast to actual debt service of $29 billion.

To understand why, it is important to look more closely at what happened in the 1970s and 1980s and why. To do so, we set out to answer these questions:

- How would world and U.S. agricultural trade be affected if the outstanding debt of four heavily indebted Latin American countries were forgiven?
- Which commodities would be most affected?
- How would other agricultural exporting countries benefit?

Barry Krissoff is Section Leader and Daniel Pick is Agricultural Economist in the Developing Economies Branch, Agriculture and Trade Analysis Division, Economic Research Service, U.S. Department of Agriculture.
export gains voiced by some vigorous advocates of debt forgiveness.

Why are the effects so small? For two simple reasons.

First, agricultural imports of developing countries tend to be basic foodstuffs: wheat, corn, oilseeds, and dairy powder. Consumption of these commodities are less likely to be squeezed in times of financial stress. Rather, curtailment of imports are more likely to be for luxury consumer goods. Consequently, these commodities gain less than other products when financial stress is relaxed.

Second, as foreign exchange became less available to developing countries in the early to mid-1980s, U.S. credit guarantee programs expanded and substituted for commercial borrowing guaranteed by the governments of developing countries (Figure). Thus, U.S. agricultural lending programs have helped U.S. farm product sales to developing countries, in general, and Latin American countries specifically.

Debt Accumulation

In the 1970s, Latin American countries borrowed significantly from foreign commercial banks, obtaining large capital inflows to purchase imported goods. The Latin countries continued to borrow in the 1980s, but the magnitude was much more modest and the funds came primarily from official government lending and international organizations. By the end of the decade, the Latin countries had reduced the proportion of their long-term foreign debt held by commercial lenders, mostly banks, from 70 percent to 60 percent. The loans in the 1980s, in effect, were used to service the debt accumulated in the earlier decade. However, outstanding debt continued to increase until the late 1980s. For most of the decade new loans exceeded the reduction in principal on debt already outstanding.

The changes in financial flows associated with borrowings, payments, and interest accumulations are exemplified by Brazil and Mexico. These countries each received long-term foreign financial inflows averaging over $5 billion a year in the 1973-1982 period. But they suffered from an average annual outflow between 1983-87 of $6 billion for both countries. Outstanding debt continued to rise throughout much of the 1980s peaking at over $120 billion for both Brazil and Mexico at the end of 1987. The scheduled interest and principal payments on these large external debts

Diversity of Opinion

In a testimony before the House Committee on Agriculture (May 10, 1989), the Secretary of Agriculture, Clayton Yeutter, stated that according to one estimate the debt crisis costs U.S. agricultural exports an average of $3 billion per year since 1982.

On the other hand, Robert Paarlberg in a testimony before the Joint Economic Committee (May 18, 1989) stated: "It has become something of a convention, here in Washington, to attribute all of this disappointing import decline to just one cause—the Latin American debt crisis. I do not deny that the debt crisis has played a role, and I do not deny that U.S. farm exports would profit from an easing of that crisis. But the magnitude of the export gains to U.S. farmers that might accompany an end to the debt crisis should not be exaggerated."

Table 1: U.S. Agricultural Exports

<table>
<thead>
<tr>
<th>Destination</th>
<th>1982</th>
<th>1987</th>
<th>1989</th>
<th>Percentage Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>$843</td>
<td>$418</td>
<td>$152</td>
<td>-50% -82%</td>
</tr>
<tr>
<td>Chile</td>
<td>346</td>
<td>40</td>
<td>39</td>
<td>-38% -89%</td>
</tr>
<tr>
<td>Mexico</td>
<td>2,723</td>
<td>1,215</td>
<td>2,757</td>
<td>-53% 1%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>898</td>
<td>459</td>
<td>887</td>
<td>-49% -35%</td>
</tr>
<tr>
<td>All Latin American Countries</td>
<td>$6,661</td>
<td>$3,765</td>
<td>$5,442</td>
<td>-45% -21%</td>
</tr>
<tr>
<td>Total All Destinations</td>
<td>$36,627</td>
<td>$28,709</td>
<td>$39,991</td>
<td>-22% 9%</td>
</tr>
</tbody>
</table>

Table 2: Effect of 50 Percent International Debt Forgiveness for Mexico, Brazil, Chile, & Venezuela

<table>
<thead>
<tr>
<th>Source of Effect</th>
<th>Increase in farm imports from all sources (Millions)</th>
<th>Increase in farm imports from the U.S. (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relaxation of Foreign Exchange Constraint</td>
<td>$278</td>
<td>$116</td>
</tr>
<tr>
<td>Increased Agricultural and Economywide Growth</td>
<td>131</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>$459</td>
<td>$131</td>
</tr>
</tbody>
</table>

was equivalent to more than one-third the export earnings of these two countries.

Clearly, debts of this magnitude place considerable pressure on officials allocating foreign exchange.

Limits of Debt

Debtor countries have only a few choices if they are to meet debt service obligations of the magnitude experienced by Brazil or Mexico. They can expand exports, spend less on imports, or seek debt forgiveness on loans from foreign creditors. Export expansion by LDCs was made more difficult when after the second oil shock and the increased oil prices, industrial economies increased protectionism. Contraction of imports reduces availability of capital inputs, necessary for improving economic growth, reduces availability of basic foods and other necessities, particularly for the poor; and creates economic inefficiencies.

Prospects for Debt

The prospects for significant increases in commercial lending to debtor countries like Brazil are dim. Even so, several debt plans and proposals have been suggested to ameliorate the financial

First Quarter 1991
The other three Latin countries—Venezuela, Chile, and Brazil—have embarked on new programs aiming at reducing their external debt. Venezuela, under the newly elected President Perez, embarked on new economic reforms to attract new investments, restore economic growth, and improve fiscal discipline. These reforms were coupled with a comprehensive financial assistance program to strengthen monetary reserves and provide new investment funds. The program calls for lending assistance from the IMF of up to $4.6 billion over a three-year period and includes special provisions for reducing external debt.

Chile, in contrast to Mexico and Venezuela, initiated its own program to reduce external debt. The program included debt conversion as well as debt buybacks. This effort reduced external debt by $6 billion, approximately one-third of Chile’s long-term bank debt.

Brazil recently began negotiating debt reduction by signing a letter of intent for a $2 billion loan from the IMF. However, since mid-1989, Brazil suspended interest payments on most medium and long-term debt to foreign commercial banks until an agreement on new financing can be reached. Brazil’s payment of debt principal obligations remain high even without interest payments.

U.S. Response

Special programs are used to subsidize U.S. farm exports. Some of these programs have expanded in recent years as other countries have heavily subsidized their exports and as LDCs purchases were constrained by international debt. For example, in fiscal year 1988 the U.S. credit guarantee programs (mainly GSM-102) accounted for over 10 percent of the value of U.S. agricultural exports compared to 3.5 percent in 1980. To qualify for the program, importing countries must offer good prospects as long-term markets for U.S. agricultural goods and must face external financial constraints. Approximately a third of U.S. exports under the special government programs are associated with Latin American countries.

Not only have U.S. agricultural export credit programs expanded, their regional emphasis has also shifted. In the early 1970s nearly two-thirds of the activities associated with these programs was focused on Asian countries. Today, Asian countries account for only 15 percent while Latin American countries account for over one-third. In 1986, nearly 100 percent of Brazilian, Chilean, and Mexican imports of corn, other coarse grains, soybean, oilseed, and wheat were purchased under GSM-102. In recent years, Venezuela has relied almost entirely on this program for imported wheat.
Longer Term Effects

Up until this point, we have focused on the relationship between financial stress and the ability to purchase agricultural imports. We postulate that importing countries will have smaller external financial obligations and therefore will use more funds for agricultural imports (Box above).

Two other sets of economic relationships need to be considered when gauging the effect of international debt on U.S. farm exports.

On the demand side, reduced financial stress is likely to increase financial inflows and stimulate economy-wide growth, thus generating higher incomes and increased purchases of domestic and foreign agricultural commodities.

On the supply side, more money incoming means more money to purchase capital inputs, fertilizers, and chemicals. These farm inputs can, in turn, generate increased productivity in the domestic agricultural sector and, thereby, reduce imports of basic foods. While these two long-run effects may not be equal in magnitude, they do affect the demand for imports in an offsetting manner.

In our analysis we considered these long-run effects by assuming that economywide growth and agricultural sector growth returned to the levels achieved during the 1965-80 period rather than the slower growth years of the 1980s. Thus, import demand is affected by a relaxation of a foreign exchange constraint, by an increase in income, and by an increase in agricultural production.

Commodity Effects

Our analysis of a 50 percent debt reduction indicates that these countries would expand their agricultural imports by $460 million per annum, of which the U.S. share would be $130 million. The relaxation of the foreign exchange constraint accounts for 60 percent of the increase in imports from all sources and 90 percent of the import increase from the U.S. (Table 2). Mexican, Brazilian, Chilean, and Venezuelan imports expand by all sources approximately $170, $210, $5, and $75 million, respectively.

The three commodities most affected by the increase in Latin American countries purchasing power are wheat, milk powder, and meats. Brazil and Venezuela would increase their imports of wheat by $73 and $21 million respectively. Mexico and Brazil would increase their imports of dairy powder by $41 and $27 million. Also, the results indicate that Brazil would import $83 million more beef and pork relative to the base period. Unlike wheat and other grains, which are mainly affected by the foreign exchange constraint, the effect on the consumption of meats is mainly due to larger income growth and the relatively high income responsiveness on meats relative to other agricultural commodities.

International Market Effects

The increased demand for agricultural products by the four Latin American countries under this scenario would lead to some upward pressure on world commodity prices. Although the increases would be small (less than 2 percent for most commodities), they would stimulate a production response in exporting nations. In the United States the price and production effects would mean an increase in the value of farm production of $235 million with most of the gain ($190 million of $235 million) in meats and grains. There would be little change in U.S. exports of oilseeds and products because Brazil would become more competitive in these markets.

Other exporting countries would experience improved agricultural trade as well. The European Community would expand net exports by $129 million, Argentina by $27 million, Canada by $35 million, Australia by $33 million, and New Zealand by $17 million.

In sum, the accumulation of debt and the associated debt service payments by developing countries have affected their ability to purchase agricultural imports. As a result, U.S. exports as well as other industrial and developing country exports have been less than what they could have been. Our analysis, though, indicates that debt forgiveness would have only a modest impact in improving U.S. and world agricultural trade.