

Comment on Larry A. Sjaastad's "Recent Balance of Payments Experience in Latin America"

By Douglas D. Purvis*

This is a very interesting and useful paper which provides insights into an important current problem. However, there is a sense in which the paper is incomplete; much of the interest in it hinges on an asymmetry which is left unexplained.

In the initial section, the paper documents the dramatic deterioration of the international balance on current account suffered by the ten major Latin-American Countries (LAC) in the first half of this decade. The major cause of this deterioration is attributed of course to the formation of the OPEC cartel and the subsequent quadrupling of the price of crude petroleum. Further, and this is of central interest to the problem to be posed, the current account deficits have been financed almost entirely by capital inflows (mostly government borrowing) and hence there has been very little impact on the overall balance of payments. The ability to finance via foreign borrowing is attributed to the availability of funds on international capital markets created by the OPEC countries large current account surplus.

The problem posed for the LAC is that this situation is not viable as those sources of borrowing will eventually dry-up. We are given two reasons for this; the temporary nature of the OPEC surplus and the increasing debt burden of the LAC with the consequent effects on their credit-rating. It is the first of these that I wish to take issue with.

It is the nature of financial markets that there are surplus and deficit units, and the sum of the surpluses must equal the sum of the deficits. In balance of payments analysis this is referred to as "Cournot's Law" which simply states that the sum of payments balances across countries must be zero. Hence it is not coincidental that the LAC deficits coincided with the OPEC surplus (especially in view of the fact that the rest of the world — which we shall henceforth refer to as OECD countries — also was experiencing a deficit). The surprising thing is, and this is

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presumably why *Sjaastad* emphasizes it, that all of the financing is done through borrowing and little or none through international reserve flows.

The asymmetry I referred to above arises when *Sjaastad* suggests that a reason for the non-viability of the current situation is that the OPEC surplus is dwindling. By virtue of Cournot's Law, if this is the case in our three-entity world (OPEC, LAC, and OECD), then either the LAC deficit is also dwindling and hence their need for finance is shrinking simultaneously with the international availability, or the OPEC surplus is being transferred to the OECD countries.¹ If the latter is the case, then the net financial surplus available to LAC is unchanged, and any non-viability of the situation apparently rests on a dissimilar willingness to lend to LAC be on the part of OECD and OPEC.

I would suggest that any effects of this type are of a second-order magnitude, and the real problem for LAC arises not as a result of any dwindling OPEC surplus but rather as a result of the fact that *financing* a deficit is only a short-run substitute for *adjusting* to it. That is, world capital markets in general will give the message to LAC that there is an intertemporal budget constraint operative, and that the terms at which it can finance consumption in excess of production will deteriorate through time. This is, of course, just *Sjaastad's* second point.

LAC must ultimately adjust to the new world conditions, and barring devaluation or other expenditure switching policies, it must finance during the deficit. By virtue of being able to borrow at attractive terms the real adjustment has until now been postponed. The real crunch of the OPEC crisis has yet to hit; when it does, the price of postponing the adjustment will appear in terms of the reduced credit worthiness of the LAC and the consequent poor financing terms available; this will mean costlier alternatives such as running down international reserves and faster real adjustment will have to be pursued.

¹ As *Bob Mundell* pointed out, this also suggests that one must look beyond domestic policies — especially for a small country — to find both the causes and the cures for payments problems.