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DEBT, DIVERSIFICATION, AND DEPENDENCY: LATIN AMERICA'S CHANGING INTERNATIONAL POLITICAL RELATIONS

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Latin America's Renewed "Dependence" on the United States

The debt crisis that spread throughout Latin America in 1982 revealed an unanticipated degree of economic--and therefore political--vulnerability in the region. Contrary to universal expectations, this vulnerability has proved almost uniform. Who now remembers the "political risk" evaluations used to rank Latin American sovereign borrowers according to creditworthiness? Highest ranked in 1980 by both Euromoney and Institutional Investor was Mexico, the nation that precipitated the debt crisis. Third in both rankings was Argentina, an earlier casualty because of the South Atlantic war. Second came Venezuela, currently also in extreme difficulties. Nearly all the countries in these rankings are at present behind on some portion of their external debt payments, although ironically two of the least well-regarded in 1980 (Peru and Jamaica) are among the best behaved in 1983. In general, the debt crisis has struck like a plague, affecting Latin American nations large and small, military and civilian, oil-exporters and oil-importers alike, whether the economy was run by Friedmanites, Cepalistas, or central planners. The impartiality has been remarkable.

Prior to the onset of the crisis it was generally accepted among observers from many schools of thought that Latin America was achieving at least a partial emancipation from earlier conditions that can loosely be characterized as "external dependency." In particular, many Latin American government were thought to be achieving a greater degree of autonomy and self-assertion in their relations with the United States. However, beyond these very general points of agreement lay some fundamental divergences of interpretation. Some emphasized the limited and conditional nature of this apparent emancipation, and the way it mainly served the interests of a restricted class of Latin Americans with good reasons of their own for preserving an essentially inequitable status quo. Others discriminated between certain Latin American republics that were pursuing approved paths of development (and were therefore progressively freeing themselves from past conditions of subordination) and other republics that through misfortune or misrule were failing to do so. Rival schools of thought promoted rival examples of enlightenment or misgovernment, but most shared an underlying assumption in the probability of progress.

United States policies toward Latin America were, for the most part, informed by a similar outlook. The Carter administration in particular saw itself as promoting an adjustment between the United States and Latin America that would reflect both the growing autonomy and maturity of countries in the region and increased United States awareness of the limitations of its own power. (The 1974 Linowitz report no doubt contributed significantly to the shaping of this approach.) Even under the Reagan administration, there were some elements of continuity--although, of course, the category of "approved" countries was redefined and the threat of "misrule" was specified in exclusively anti-Soviet terms. Major countries such as Brazil, Mexico, Venezuela, and Argentina have received far less attention under Reagan than the mini-states of Central America, and for the most part Washington has recently concerned itself with the major countries according to their alignments on the isthmian confrontation. This was far removed from the Linowitz approach, and yet even here one can detect some convergence of outlook. Until the debt crisis broke, the Reagan administration was also implicitly assuming an increased autonomy and assertiveness on the part of the larger states. Central America was excepted from this stance; and United States attention was concentrated on the region where external vulnerability was at its greatest, and where traditional forms of subordination to the United states were most characteristic.[1] But by expending so much effort (with meager results) on such a minor part of Latin America, Washington seemed to admit (or at least to demonstrate) its diminished leverage in the rest of the hemisphere.

The events of 1982 and early 1983 cast real doubt on all such assumptions. At least for the present, all the major nations of Latin America find themselves in the most urgent need of external economic assistance and support. They also find, as this chapter is mainly concerned to show, that their alternatives to dependence on Washington have withered on the vine. In the short run, their autonomy is diminished and their assertiveness curbed to an extent that few observers would have imagined possible as recently as two years ago. Moreover, in such matters the "short run" is prone to stretch out over a considerable period, during which lasting shifts in the international balance of forces can be expected. The debt crisis has suddenly renewed Latin America's "dependence" on the United States, giving Washington both opportunities and responsibilities that were not expected either by the Carter or by the Reagan strategists. The texture of United States-Latin American relations for many years to come will be determined by the quality of the United States response to this crisis.

An acute scarcity of foreign exchange (particularly dollars) produces a very direct and immediate form of "dependence" upon potential suppliers. The Latin American economies have in general become more "open" over the past decade, and their structural dependence upon imports of capital goods and intermediate inputs has if anything increased rather than decreased as a consequence of their "import substituting" policies. In times of prosperity they may have access to a wide variety of sources of foreign exchange, but in times of hardship many of these suppliers disappear. The residual supplier of foreign exchange remains Washington (a term intended to embrace both the United States government and the international financial agencies based in that city) and, consequently, in present conditions the economic policies adopted by the United States government may have a greater impact on Latin America's immediate economic well-being than anything the Latin American governments themselves may attempt. Later sections of this essay sketch the relationship between recent United States economic policy decisions and the present debt crisis.

However, the present acute shortage of foreign exchange will in due course be eased, by one means or another, and this immediate and direct form of "dependence" will eventually therefore be relaxed. Thus this essay also attempts to situate the present critical situation in its longer-term context. A review of Latin American attempts at international diversification shows that, after a period of apparent success in the 1970s, these efforts met with widespread disappointment and reversal in the early 1980s. In the longer term such diversification will probably be resumed, since it represents a strong secular trend that serves the Latin American interest in reducing dependence on the United States. This essay therefore discusses the same processes from the perspective of the United States, reviewing evidence which points to a long-term secular decline in the relative international strength of the United States and considering some of the problems of adjustment that this creates. The concluding section counterposes these secular trends and their recent reversal, sketching some implications of these two opposed processes for inter-American relations in the medium term.

The Debt Crisis of 1982

From October 1979 (during the Carter administration) until at least the autumn of 1982, the United States Federal Reserve Board pursued a severe policy of monetary restraint. This was designed to counter the inflation unleashed (or at least exacerbated) by the 1979 oil price shock, and to restore confidence in the dollar as an international reserve currency.

The Reagan administration asserted from the outset that the United States' most important contribution to world development would be the pursuit of "sound economic policies" at home. In February 1982 it was asserted that "both the United States and the rest of the world would benefit from a stronger and more stable dollar." Both at home and abroad, the key emphasis was to be placed on "the superiority of market solutions" and the priority of combatting inflation. Some countries, industries, and regions would of course find the transition to noninflationary and private sector-led growth painful, but "Market forces, rather than government bail-outs, will be relied upon to make appropriate adjustments."[2] With regard to developing country financing problems, the administration apparently believed that existing international provisions were fully adequate.

Within six months of this report, most of Latin America was in virtual default, and by late 1982 Treasury Secretary Donald Regan was publicly airing the need for a "new Bretton Woods." The world's leading finance ministers (encouraged by the Federal Reserve) were soon engaged in strenuous negotiations to expand the International Monetary Fund's (IMF) resources, maintain credit flows to developing countries, and reduce dollar interest rates. Unexpected developments in Latin America played a key part in producing this change of heart.

In August 1982 Mexico, by then the largest oil producer in Latin America, ran out of foreign exchange. Initially the Mexican government announced a 90-day moratorium on repayment of the principal due on its external public debt. Soon thereafter the moratorium was extended into 1983, and Mexico was forced into a series of drastic remedial measures--severe devaluation, unprecedented exchange controls, an "unthinkable" nationalization of the private banks, and of course, an emergency agreement with the IMF. For a short period just after the bank nationalization, it even seemed as if the Mexican government intended to include the interbank debt of these banks in the official moratorium on repayments. This would have been a shattering blow to confidence in the world's short-term international money markets, since it was not customary for international bankers to distinguish the national origins of such assets and liabilities --let alone to charge for them according to perceptions of sovereign risk. In the event, Mexico was persuaded to exclude such transactions from the moratorium, but the mere suggestion of this idea greatly aggravated the liquidity problems of other Latin American nations with internationally active private banks.

By early 1983 Mexico had not only imposed a moratorium on its international creditors, but had also, in effect, levied a "forced loan" from them. With the IMF's approval, international banks were required to increase their net dollar exposure to Mexico in 1983 by 7 percent in order to secure a rescheduling agreement. But as the price of oil proceeded to fall, in early 1983 it remains quite doubtful whether even this drastic series of measures will prove sufficient to restore Mexico to international solvency within a reasonably short period. Alternatively, falling oil revenues and continuing capital flight might produce an even greater conflict between the financial requirements of the external sector and the foreign exchange needs of the domestic economy.

The credit crunch faced by Mexico was certainly the most dramatic event of 1982, but in reality the financial crisis of that year extended far beyond Mexico--and, indeed, beyond the oil-exporting economies. Latin America as a whole was severely affected. Even before the Mexican crises, Argentina was already in technical default for reasons which were only partly related to the South Atlantic conflict of April-June 1982. By the end of the year, Brazil was far advanced down a path similar to that of Mexico. Under pressure to tap new sources of foreign exchange, Brazilian private banks had run up heavy liabilities on the interbank market. Thus they suffered severe side effects from the Mexican nationalization. In addition, Brazil's exports were hampered by the international recession, and its large external debt implied a heavy balance of payments cost when interest rates rose. In 1983 Brazil stands to benefit greatly from falling oil prices and from falling interest rates, yet its external finances are so overextended that even after an unprecedently large refinancing negotiated at the end of February 1983, commercial banks remain apprehensive that Brazil may require further assistance within the year. Venezuela, Chile, and Cuba are all engaged in comparable negotiations, together with many of the smaller Latin American countries. Indeed, virtually every nation in the region is either openly negotiating or on the brink of such action.

The New York Federal Reserve has reviewed previous such episodes and concluded that: (1) countries which do not promptly meet their contractual debt servicing commitments subsequently experience substantial periods of time in which the rate of lending declines; (2) once problems in a borrowing country become sufficiently serious for widespread payments delays to occur, they are likely to persist for some time (for example, of 19 countries in payments arrears in 1978, 15 were still in arrears in 1981); (3) the time and resources needed to negotiate a rescheduling agreement are considerable. The short-term gain to the debtor country of lowering its debt-service payments may be outweighed by the heavy loss in income over the extended period when bank lending falls and the domestic economy is forced to contract.[3]

The United States Federal Reserve's policy of severe monetary restraint launched in 1979 has within three years clearly succeeded in curbing United States inflationary expectations and strengthening the dollar, albeit at a heavy cost in foregone economic output. Tight monetary policy produces these effects by pricing or rationing credit out of the reach of the weakest borrowers. Who these may be is not known with certainty in advance. In this case, the United States monetary authorities were apparently rather surprised to discover that the weakest borrowers proved to be not, for the most part, United States corporations (who can, after all, offset their interest payments against their tax liabilities) but Latin America's "sovereign" borrowers. Since the "crunch" of late 1982, the Federal Reserve has hastened to relax its monetary stance, but confidence in Latin American's creditworthiness will take a long time to restore. In the meantime, development projects throughout the region (both the wasteful and the efficient) are more or less indiscriminately cut back, United States exports to Latin America are sharply reduced, and there is greatly increased pressure on Latin America to increase the volume of goods and services that it exports to foreign markets.

Latin American Export Patterns

World trade stopped growing in volume after 1979, and after mid-1981 it began to fall. There was a steepening decline in 1982, with signs that the fall will continue into the first half of 1983. Real prices for primary products other than oil fell to the lowest levels in over 30 years. Despite production cutbacks, the Organization of Petroleum-Exporting Countries (OPEC) was being forced to cut the dollar price of oil--unsurprising when stocks are high, the dollar is exceptionally strong, energy demand is weak, and real interest rates are at a crippling level.

Latin America is exceptionally vulnerable to a severe downturn in world trade. The region derives over one-third of its export revenues from oil and a similar proportion from the sale of other primary commodities. Not even the export of manufactured goods, a dynamic element in the region's trade performance over the past decade, will be immune from the current difficulties if protectionism continues to spread in industrialized country markets. Latin America has customarily run a substantial trade deficit, and its balance on current account has been heavily in the deficit ever since the 1940s. In recent years Latin America has financed these current account deficits by capital inflows that have mostly taken the form of "sovereign lending," that is, lending by commercial banks relying on government guarantees. Relatively little such capital entered the region in the form of direct investment. Often borrowing was undertaken on the assumption that debt could be serviced by the rapid expansion of the export revenues, and that inflation would rapidly erode the real burden of the debt. However, since 1981 many Latin American governments have found their export revenues far below expectations and still falling, while the real burden of their debt has dramatically increased, due to United States economic policies which have produced high nominal interest rates, a strong dollar, and disinflation.

Most Latin American governments were not unduly alarmed when the downturn began because they had experienced a similar cycle in 1973-1975. At that time, exports fell in dollar value by 7 percent in 1975, after rising 42 percent in 1973 and 58 percent in 1974. During the 1975 setback it had been necessary briefly to run down foreign exchange reserves, curb imports, and increase foreign borrowing. But on that occasion "recycling" had functioned quite smoothly, so that demand for Latin American exports quickly recovered. Indeed, the period 1975-1980 witnessed an impressive expansion of regional trade and investment, apparently justifying the decisions taken in 1975 to "ride out the storm" with foreign borrowing. With this precedent in mind, many Latin American governments initially faced the problems of 1981 with relative equanimity. But in fact, both the cyclical and the secular export trends should have given cause for alarm. In 1950, with 6.5 percent of the world's population, Latin America supplied 12.2 percent of world exports. It was still a region of export economies although the process of inward-oriented economic development already had a respectable history. But a quarter-century later, the pattern was very different. In the recession of 1975, Latin America's exports fell to a record low of only 4.2 percent of world exports. Since then there has been a small recovery, with the result that in 1980 when the region's share of world population had risen to 8.3 percent, its share of world exports had recovered to 5.3 percent. This was still a low ratio considering the region's foreign exchange needs, and renewed recession threatens to produce a further decline.

Of course, these aggregate statistics conceal some very important shifts in the commodity composition of Latin America's exports (notably a rise in the export of relatively sophisticated manufactured goods) and in their national origins. There was also a very significant rise in intra-regional trade and a substantial diversification of Latin American commerce toward new markets. These long-term developments both reflect and reinforce profound changes in Latin America's international role and in the geographical distribution of economic strength within the region. However, what the present cyclical crisis reveals is the persistence of many of the region's most longstanding trading problems, such as overdependence on a few volatile primary products, extreme vulnerability to fluctuations in United States economic policy, and a tendency toward unsustainable rates of foreign indebtedness.

During the 1970s, although world trade slowed, Latin American exports continued to expand (an average of 5 percent a year in volume terms from 1970 to 1980). In part this reflected the increased efforts of some Latin American countries (notably Brazil and Colombia) to promote the export of manufactured goods. Even so, if not for the oil price rises in 1973 and 1979 the region's share of world trade would have continued to fall. Energy products presently comprise between one-third and two-fifths of Latin America's exports (mostly crude oil, but also some natural gas), and four countries are now overwhelmingly dependent on this source of foreign exchange: Mexico, Venezuela, Trinidad, and Ecuador. The main market for Latin America's energy exports is still the United States.

As recently as 1965, two-fifths of Latin America's exports were the so-called "soft" commodities--coffee, sugar, bananas, and so forth. Most of these hot-climate products were sold to Western Europe and North America, but the Soviet bloc was also a significant market. However, the European Economic Community (EEC) has reduced its dependence on Latin American sources of supply for these products, and the United States has also proved to be a highly saturated market. Consequently, agricultural commodities have recently fallen below 30 percent of all Latin American exports, a decline that can be expected to continue. Only the Soviet bloc has proved a relatively dynamic market for these products, and it is obviously likely to remain a minor outlet for exports requiring payment in hard currencies.

Historically, Latin America's leading export sector was precious metals and (in this century) industrial minerals such as copper and tin. The Andean countries and Mexico were the major suppliers of these raw materials, which continue to be of considerable importance to certain regions. But since the Korean War, minerals have declined steeply as a proportion of total exports. Their current share is little more than 10 percent of total regional exports.

Thus if energy, agriculture, and mineral exports are considered together, primary products still constitute some three-quarters of Latin America's total exports to foreign markets. Many observers have noted the rise of Latin American manufactured exports, and indeed their contribution to the total has risen from about one-eighth in 1965 to about one-quarter in 1980. However, even in 1980 only 1.8 percent of industrialized countries' imports of manufactured goods came from Latin America, and this share included a substantial amount of unsophisticated or lightly processed manufactured items (for example, furniture rather than wood exports, steel bars rather than iron ore).[4] The analogies sometimes drawn between Latin America and Hong Kong, Taiwan and South Korea are therefore distinctly exaggerated. Indeed, it has been argued that these East Asian exporters pose an increasing competitive threat to their Latin American counterparts.[5] It is true that some very sophisticated export products have recently been developed in the region (Brazilian airplanes and tanks, for example), and transportation equipment has risen from virtually nothing to 5 percent of total Latin American exports in the short space of 15 years. There will certainly be more breakthroughs of this kind in the next several years, and their qualitative significance should not be underestimated. However, in aggregate terms it is difficult to see Latin America breaking away from specialization in various primary products as its main source of foreign exchange revenue for some time to come.

Excessive dependence on the United States market has long been a source of dissatisfaction in the region. In an extreme form, this dissatisfaction contributed to Cuba's complete breach with the United States in the early 1960s, which resulted in a wholesale diversion of Cuban trade toward the Soviet bloc and (in 1975) full Cuban membership in the Soviet-led Council of Mutual Economic Assistance (COMECON). The damaging consequences of that move were not lost on the other countries in the region, which have placed emphasis on gradualism in their diversification strategies. In percentage terms, there have been some very rapid increases in trade with the Middle East, Japan, and some African nations, but these transactions remain a very small fraction of the total. In absolute terms, the main success has been the rise in interregional trade within Latin America, encouraged by such agencies as the Latin American Free Trade Association (LAFTA), the Andean Pact, the Central American Common Market, and the Latin American Economic System (SELA). Since the mid-1960s this type of transaction has risen from one-tenth to over one-fifth of all Latin American exports, and in the present international climate, a further intensification of bilateral exchanges may well take place. Exports to western Europe have been the biggest disappointment, discouraged by EEC protectionism and by the preferences Europe has granted to former colonies in Africa and Asia. The net result is that the United States still absorbs over one-third of all Latin American exports, a proportion that has hardly varied over the past 20 years. The essential reason for this is that although there has been some success in directing, nontraditional exports away from the United States market, this has been offset by a rising dependence on United States outlets for various traditional export products, especially crude oil.

Latin America's Efforts at Economic and Political Diversification

Throughout the 1970s Latin America increasingly diversified its international links and acquired a more assertive and autonomous presence in world arenas. This may still be a long-term trend, but as this section will make clear, it was abruptly interrupted in 1982-1983. The economic crisis has pushed the political goal of diversification into the background; most countries of the region must judge their external policies in terms of their urgent need for economic assistance. The diversified links they were developing are, for the most part, proving unexpectedly fragile--in part because of the economic and political crises afflicting the rest of the world. For most governments other than the United States, Latin American problems are a rather low priority. If the present crisis persists for several years--and perhaps even longer--then Latin America's relation with the United States and the international agencies under Washington's direction will be so urgent that links with the rest of the world may be neglected.

Already Latin America's hopes of diversifying its international links have encountered a long list of disappointments and frustrations. There are some special factors that may explain some of the setbacks, notably the South Atlantic conflict and the Iran/Iraq war. But worldwide problems of trade and finance provide the council explanation. Though most acute in Latin America, similar constraints have operated through the world, causing governments to draw in their horns. Disentanglement from costly and speculative Latin American ventures has been widespread: (1) because of Latin America's visible economic difficulties; (2) because of the Reagan administration's political assertiveness; and (3) because Latin America is a dollar-zone, and Latin American trade goods were therefore made less attractive to the outside world when their costs rose with appreciation of the dollar. Most of Latin America's new partners have felt a lack of leverage in the region when things go wrong. Similarly, Latin American countries have also encountered difficulties several times because of their diversification attempts. Adverse experiences arising from links outside the Americas, together with a common sense of vulnerability to the United States and the exclusion from Washington policy circles, have caused Latin American governments to draw close together to some extent. But the limited comfort and solidarity they may offer each other is mainly psychological. The practical assistance they need is not, for the most part, available from within the region, especially since the debt crisis was diffused so uniformly across the region. So at least in the short term they will have to turn to Washington.

Thus far "Latin America" has been considered as a single unit. In reality, of course, there are a number of quite distinct subregions with different levels of economic development, contrasting trade orientations and diverse geopolitical interests. The most ambitious and wide-ranging attempts at diversification have been undertaken by Brazil. Much of what is said below about links to Africa, the Middle East, eastern Europe, and Japan applies largely to Brazil and rather little to other countries. Similarly, Argentina's efforts at diversification are sui generis because of its economic rivalry with the United States (both countries export temperate foodstuffs) and its political rivalry with Brazil. The countries that once formed the Andean Pact obviously have a disposition toward Pacific basin initiatives, with less interest in Africa or the Middle East. The nations of the Caribbean basin have often made relatively little headway in diversifying away from the United States since geographical endowments and economic convenience pull then so strongly towards it. There are a number of small exceptions to this generalization (notably the French territories of Martinique and Guadalupe) and one very major exception--Cuba, which faces quite different problems of diversification. Finally, Mexico presents another special case as a nation overwhelmingly oriented toward its northern neighbor, yet with the aspirations and potential of a middle-rank power in its own right. "Diversification" clearly has a variety of meanings for these different subregions. Yet in present conditions they all face rather similar frustrations and constraints. A brief survey of the main alternatives to "dependence" on the United States will show how all of them have been adversely affected by the debt crisis.

Soviet Union/COMECON

The key point is that eastern Europe went bankrupt (in terms of hard currency) a year before Latin America. Among the losers were significant Latin American interests. Indeed, Poland owed Brazil US $1.6 billion, which cannot be paid in the hard currency Brazil so urgently needs. Poland offered coal, sulphur, and an ice-breaker ship in lieu of cash, but Brazil has threatened to halt exports of iron ore and agricultural products unless Poland meets its obligations in full. Brazil was found to have the second largest exposure to Polish debt on a per capita basis because, long after more cautious exporters had pulled back, Brazilian companies eager to penetrate new markets continued selling on credit to Poland. This is one reason for Brazil's recent disappointing export figures.

What Latin America now needs is hard currency. But of the COMECON nations, only the Soviet Union (through its sales of oil and gold) generates a substantial hard currency income. As the international price of oil falls, Soviet foreign exchange resources are increasingly overstretched. Cuba is very expensive to Moscow in dollar earnings foregone, and there is now strong pressure in the eastern bloc to add to its Latin American commitments by shoring up the Nicaraguan revolution.

Apart from Cuba and Nicaragua, Soviet links with Latin America are limited by political divergences, by the lack of economic complementarity, and by the complications which may arise from United States hostility toward any convergence. Argentina provides a major exception to this because its grain surplus so neatly matches Soviet import requirements, and because Argentina is relatively resistant to United States pressure on such matters. Argentina refused to participate in the grain embargo declared by President Carter in January 1980, with the result that by 1982 about three-quarters of the grain it exported went to eastern bloc markets. Although the United States embargo has since been lifted, the Soviet Union seeks to strengthen its ties to alternative suppliers, especially since Argentina has been willing to commit itself to a 5-year grain agreement that guarantees a high minimum annual rate of delivery. On the other hand, there are few eastern bloc goods that Argentina wishes to purchase (in 1982 Soviet merchandise exports to Argentina were under US $30 million, or no more than 2 percent of the value of imports), so that payment is required in scarce foreign exchange. The Soviet Union is naturally very concerned to offset this deficit, and therefore it has taken a strong interest in Argentine plans to build seven nuclear power stations, reportedly selling heavy water for the reactors and sizeable quantities of enriched uranium. Soviet turbines are also used in Argentina's ambitious hydroelectric schemes, and presumably the Soviet Union responds sympathetically to requests for arms supplies. However, during the South Atlantic conflict the Soviet Union was careful to keep a low profile. And although the Argentine military was disappointed by the United States posture during that conflict there are major ideological obstacles to any serious convergence with the Soviet Union on political matters. As for the rest of Latin America, in the present climate of intensified east-west conflict and renewed economic vulnerability, the prospects for either political or economic collaboration with COMECON are distinctly limited.

Africa

In this region, too, Brazil took a leading role in developing new ties and new markets. African countries may not explicitly have defaulted on loans in the same way as Latin America and eastern Europe, but that is because they were never so creditworthy and their administrative machinery was always less developed. Nevertheless, Brazil took the risks and again inflated its export figures, at a severe cost in resulting bad debts. Nigeria was Brazil's most important market in sub-Saharan Africa, and it is now one of the OPEC members worst affected by the oil glut. "In round numbers, Brazil exported about US $800 million to Nigeria in 1981, but only US $400 million in 1982. The target for 1983 is a recovery to US $600 million of exports, but this will only be possible--if at all--on the basis of barter arrangements that circumvent Nigeria's shortage of cash."

Angola, a Portuguese-speaking nation directly across the Atlantic, was both a political and commercial commitment of interest to Brazil. This involvement may pay off in the long-term, but for the present Angola is a deeply troubled country and an uncertain trading partner. A large contingent of Cuban troops has been stationed there since 1975, when they served to repel a South African incursion. Tension with South Africa remains extremely high because of the unresolved status of Namibia and the civil strife within Angola. Cuba has stated that despite external pressure it will not withdraw its troops unless the government in Luanda requests it. So far Luanda has not done so (its own survival might be at risk), and so the Cubans stay on. However, they are being forced to pay an increasingly heavy price for staying there.

On the other side of the ideological divide, right-wing groups in the Argentine, Brazilian, and Uruguayan military showed some interest in the formation of a South Atlantic organization linking them with South Africa. But the South Atlantic conflict of 1982 and the trend back toward civilian government in South America have discredited that idea at least for the near future. In summary, therefore, Latin America's links with Africa are all troubled and fragile, with little prospect of early improvement.

Middle East

Here the prospects looked exceptionally good in 1980 and 1981. The economic complementarity was strong, and Middle Eastern markets were expanding faster than elsewhere. Furthermore, Latin American countries all have significant communities of "Turcos" or "Sirios" who speak Arabic, retain family ties in the Middle East, and are indefatigable traders, financiers, and middlemen. Venezuela, of course, had important ties dating back to 1960 when it encouraged the Arabs to join together in the founding of OPEC. Both Mexico and Brazil shifted away from earlier support for Israel following the 1973 Middle East war, and so they could collaborate with middle eastern governments at the United Nations and in third world assemblies. Arab businessmen have also shown an increasing interest in investments in Latin America. For example, in 1977 the Arab Latin American Bank (Arlabank) was established with 60 percent Arab and 40 percent Latin American participation. One declared purpose was to channel middle eastern funds into western hemisphere investments. The bank grew rapidly, and by 1982 it had established a presence throughout the region.

However, there have also been some substantial setbacks. Following the Iranian revolution, Brazil turned to Iraq as its major supplier of crude oil. Under a wide-ranging agreement signed in 1980, Iraq gave Brazil important oil supply guarantees and trading preferences in return for Brazilian iron ore exports, construction contracts, technical assistance from Petrobras, and above all, supplies of Brazilian armaments. Shortly thereafter, Iraq launched an attack on Iran which led to a prolonged war and crippled the trade agreement with Brazil. More recently, there have been signs of friction with Libya which may jeopardize several hundred million dollars of Brazilian exports to that country (mostly armaments).

The Latin American debt crisis of autumn 1982 was followed by an oil glut which signifies a drastic curtailment of Arab purchasing power and financial leverage. The buoyant middle eastern markets of two years ago are no more, and another promising route for Latin American diversification has been shut down.

Latin America's relationship with Israel has also undergone a series of jolting transformations. Following the Shah's downfall in Iran and the return of the Sinai oilfields to Egypt, Mexico became Israel's largest supplier of crude, accounting for nearly half of all its oil imports. Traditionally, Latin America had been a very marginal market for Israeli exports, but in 1980 Israel launched a serious export drive. Its comparative advantage lies in agribusiness, electronics, solar energy, construction and, above all, armaments. In 1982 Washington relaxed its embargo on the export from Israel of Kfir planes, and the Lebanese invasion provided a rich booty of Soviet-made weapons available for resale. Accordingly, Israel's military exports to Latin America have risen to record levels, with the conflicts in the South Atlantic and in Central America providing some especially promising opportunities. Israel's defense minister paid a visit to Honduras in early 1983, underscoring the importance of Israel's new links in the region and highlighting the political as well as commercial dimensions of this relationship. However, the fragility of these Israeli initiatives is quite apparent.

Japan

In the long term, Japan's highly advanced economy and low production costs make it a very attractive trading partner. During World War II, the Japanese communities on Latin America's Pacific coast were often interned and deported, but a very large Japanese colony in Brazil survived and achieved great economic success. Japan's capital-rich but land-and-natural-resource scarce economy appears to be highly complementary with that of Brazil. There has also been ample basis for exchange with other Latin American countries, especially since Japan's financial strength offered an alternative source of credit for Latin American development.

In several years these realities will undoubtedly reassert themselves. But over the past two years Japan's economic growth has slowed sharply, and the yen has weakened considerably against dollar-based currencies. As a result, Japan's demand for raw material imports from Latin America fell sharply, as did its willingness to invest in grandiose development projects (for example, iron ore mines to supply its steel industry). Latin American purchasers have found Japanese exports extremely competitive, but Japanese importers have mostly regarded Latin America as no more than a useful, but secondary, source of supply. Thus Japan ran a large trade surplus with the region until the 1982 crisis curtailed Latin America's ability to pay for imports. Before then, the region purchased about 6-7 percent of Japan's exports and accounted for around 4 percent of its imports. Indeed, in 1981 major Japanese exporters saw Latin America as a safety-valve outlet for products placed under trade restraint in western European and United States markets. For example, automobile exports to Latin America rose 40 percent in 1981 alone. However, Japanese importers resisted Latin American demands to act as a safety valve for their exports (for example, diverted Mexican oil exports). In October 1982 Japan's exports to Mexico were about 80 percent lower than the previous year's level; its exports to Brazil were about 50 percent lower. When the immediate crisis has passed, new trading patterns may well emerge. These may be quite different from precrisis arrangements, which proved unsustainable. For example, in November 1982 following unsuccessful trade negotiations at GATT, the idea of a preferential trading system in the Pacific basin was relaunched. This would link countries such as Chile to Japan's regional sphere.

Recognizing the severity of their trade imbalances with Japan, various Latin American governments urged Japan to offset the export surplus with increased investment. Mining and vehicle assembly projects were the favored sectors. Before the 1982 crisis broke, various Japanese companies showed an interest in the major Latin American countries. Brazil, the favorite before 1975, was displaced by Mexico as the preferred operating base. Japanese banks showed similarly poor timing, emerging as the most active lenders in the Eurodollar market in the first half of 1982, and therefore stepping into the gap left as United States and European banks reined in such lending. Consequently, when the debt crisis broke Japanese banks found themselves saddled with a US $10 billion exposure to Mexico and a US $9 billion exposure to Brazil. Although the Japanese government authorities have some responsibility for this situation (they liberalized the rules on foreign lending just before the bubble burst), they have made few concessions to help their most seriously affected banks. For example, in Japan no tax relief is available on debt losses. Given the bitter lessons of 1982-1983, it may be some time before either investors or bankers from Japan recover an appetite for Latin American ventures. Indeed, at a time of adversity and contraction, the Japanese are bound to give priority to their markets and suppliers in the Far East and to scale back their exposure in Latin America.

Western Europe

For Latin America in general, the major alternative to the United States--in either commerce or politics--must be western Europe. If ties with the European community could be strengthened, they would provide a solid and respectable counterweight to dependence on the United States. Conscious of this reality, and of the reorientations which might follow from the planned accession of Portugal and Spain to the EEC in 1984, Latin Americans have sought to cultivate new links with Brussels to supplement their longstanding presence in the major western European capitals. Acknowledging this, the European Commission plans to establish a Europe-Latin America Institute to act as a clearinghouse, information center, and focus of research. Unfortunately, these developments are less promising than they seem, and Latin America can expect rather little from the EEC either in terms of economic assistance or expanded market opportunities until progress is made in resolving the Community's severe internal difficulties.

About three-quarters of EEC resources are currently devoted to the Common Agricultural Policy, which cushions western European farmers from world market conditions and therefore stimulates the overproduction and stockpiling of food surpluses. This not only cuts Latin America off from potential western European outlets for its food exports, but it also depressed prices in third country markets when surpluses are dumped at a loss. Latin America sustains substantial losses from this dumping either directly (for example, in the case of cane sugar displaced by western European beet sugar) or more often indirectly through market distortions. Apart from agriculture, the EEC has proved a feeble bulwark against protectionism since unemployment in western Europe has soared. The Community does devote significant resources to aid to developing countries, and it has followed a fairly enlightened policy toward Latin America in the terms established for such assistance. But the principal aid beneficiaries are former European colonies in the southern Mediterranean, Africa, and Asia. It is doubtful whether much heed will be paid to Latin American demands for economic assistance while the existing beneficiaries of Community programs remain in severe difficulties. Although it is true that the accession of Spain and Portugal to the EEC may shift the internal balance of power in a direction more favorable to Latin America, that step remains problematical because of the additional demands from the Iberian peninsula that it would add to the EEC's overloaded agenda. Even if accession does take place on schedule, a number of years will elapse before Spain and Portugal will be sufficiently well integrated into the Community to press for any significant assistance to Latin America. Admittedly, recent Western European thinking has been closer than that of the Reagan administration to the Latin American viewpoint on responses to the international economic crisis (for example, on the necessary size of IMF quota increases). But this coincidence of perspective depends on the complexion of individual governments, which change according to the will of the electorate, just as in the United States.

Although the European community may have little to offer Latin America in terms of economic concessions, it might perhaps offer an important alternative source of political support. This is so in principle, and indeed the European Parliament has been increasingly assertive in international affairs, including human rights questions and the promotion of democracy.[6] But the powers of the parliament are still strictly circumscribed, and most Community decisions are reached by consensus among the member governments. This means that Brussels can take the lead on very few foreign policy issues. (The embarrassment over sanctions against Argentina during the South Atlantic conflict illustrates the difficulties.)

Thus the prospects for a Latin American convergence with Western Europe still depend heavily on the outlook of the major European countries considered individually. Under Chancellors Brandt and Schmidt, the West German government followed a quite active policy in Latin America--encouraging the Socialist International to increase its activities there, supporting Brazilian nuclear energy projects in the face of United States opposition, and offering limited support to the Sandinista government in Nicaragua. However, even at the moment of greatest apparent disagreement with Washington over Latin America, West Germany was never disposed to press its viewpoint too hard against firm United States resistance. Most Latin American issues were simply too peripheral to West Germany to justify more than a very limited commitment. Since November 1982 the Kohl government has shown itself to be much less likely to dissent from Washington's viewpoint or to pursue a forward policy in Latin America.

Since 1980 France's socialist government (recently reinforced by the Gonzalez government in Spain) has represented the main source of encouragement to those Latin American countries seeking to diversify their international ties. In political terms, it offers an alternative to the United States--as exemplified by the Franco-Mexican initiative on Central America and France's decision to supply helicopters to Nicaragua. France has stepped up its independent intelligence-gathering activities in Latin America, and it has sought to expand its arms supplies to the region. France has also proposed a more expansionary and development-oriented approach to the international economic crisis. As a source of ideas and encouragement, this is important. It is not so much a distinctly socialist position as a French nationalist stance that in some ways recalls General de Gaulle's Latin rhetoric of the 1960s. But to make some real difference to a debt-burdened region, France must achieve success in its domestic economic management; it must free resources for its Latin American ventures; and it must liberalize its imports. First and foremost, President Mitterrand must show that he can provide practical assistance to the fragile democracy in Spain--no easy task. And the French must convince the other Western powers that their own economic and political doctrines are in the best interests of the whole Western alliance, not just postures taken by "free-riders." Most Latin American governments understand the limitations of the French position, and at least in the short run they expect more comfort from France than real help.

Great Britain, after generations of disinterest in Latin America and withdrawal from the Caribbean in 1982, became unexpectedly involved in a major battle over--of all improbable issues--the sovereignty of the Falkland Islands. The aftermath of that episode overshadows all other Latin American issues as far as the British government is concerned. To restore its authority over 1,800 islanders, Great Britain incurred L700 million pounds in direct war expenses and several hundred casualties. It is estimated that the full cost of recapturing and garrisoning the islands for 4 years will be L2,560 million pounds, or over L1.5 million pounds per islander. Locked into a "fortress Falklands" policy, the Thatcher government has little scope for other initiatives that might aid Latin America to resolve its economic difficulties and to reassert its autonomy. In any case, the present British government will be most reluctant to dissent from Washington on any of the main outstanding issues.

Similarly, Italy has its own special reasons to avoid additional Latin American commitments. In the South Atlantic conflict, Italy felt obliged to go along with EEC sanctions against Argentina, but this was strongly resisted by Italians with family ties to Argentina. Central America raises other issues that are highly divisive within Italy. Finally, the failure in June 1982 of Italy's largest private bank, the Banco Ambrosiano, was apparently linked to its huge illegal operations in Latin America. The full story of this scandal (which culminated when the managing director of the bank apparently hanged himself from Blackfriars Bridge in London) may never be unraveled. However, enough information has been uncovered to show the deep involvement of the Vatican's top financial advisers, a Freemason's lodge (called P2) involving leading members of the extreme right in Argentina and Uruguay, and senior political, military, and banking officials in Italy. Bank of Italy inspectors making inquiries in South America have generally met with obstruction, and on occasion they have been treated like criminals. Consequently, Italian public figures may be wary of such Latin American financial entanglements for some time to come.

Finally, diverse nongovernmental organizations based in Western Europe have taken an active interest in Latin American affairs and have encouraged the region's attempts at diversification. The social, cultural, and humanitarian influences of these organizations may at times be quite important, but under present economic conditions they are mostly on the defensive. The Christian Democrat and Socialist Internationals are exceptions to this generalization because of their ties, respectively, to the international Roman Catholic church and to the Western European labor movement and leading political parties. However, Western Europe's Christian Democrats must be rather disappointed by the performance of their protege parties in various parts of Latin America and in Spain. Only in Venezuela, Chile, and El Salvador are the Christian Democratic parties a major force, and severe difficulties confront the movement even in those countries. Perhaps reflecting these problems of the World Union of Christian Democrats, Pope John Paul II has taken an increasingly direct and personal role in promoting Catholicism in Latin America, most notably with his visits to Brazil and Central America. Such direct pontifical activism overshadows the activities of local Christian Democratic parties. Of course, this type of action must be mainly religious in form, with the political and economic objectives kept in the background. Nevertheless, it is fairly clear that the Pope has tried to curb Catholic radicalism, strengthen the "center," and keep his distance from the Reagan administration. The Vatican may sometimes have a significant mediating role to play (as in the Argentine/Chilean boundary dispute over the Beagle Channel, and perhaps in the Central American conflict). But as an external prop to Latin American autonomy and international pluralism, it can only exercise an indirect moral influence.

Much the same is true of the Socialist International, despite its relatively flourishing Latin American affiliates. Most of its funds have come from West German social organizations. But as electoral fortunes have fluctuated within Western Europe, the initiative tended to pass from West Germany's Social Democrat Party to the French Socialist Party, and most recently to Spain. On some key issues the Socialist International has strongly supported positions opposed by United States policymakers. Yet in practical terms, it can only give its proteges quite limited support, as recent experiences in both Chile and Central America make clear.

Latin American Efforts at Self-Reliance

If Latin American countries wish to strengthen their autonomy and avoid renewed dependence on the United States, but can only obtain uncertain and limited external support from other sources, in principle they have the alternative of increased self-reliance. In fact, as already noted, intraregional trade has been one of the most dynamic elements in Latin America's export performance over the past decade. A series of regional organizations exists to promote international economic cooperation within the region. Unfortunately, these arrangements have also been affected by the current economic climate. For example, Mexico and Venezuela responded to the loss of oil revenues by reducing the price concessions they had granted to several Central American and Caribbean nations under the 1978 San Jose agreement. Such considerations left little room for measures specifically directed to alleviating Latin American economic difficulties. Furthermore, there have been such significant changes in the economic structure (particularly the industrial structure) of both the United States and Latin America that, in the longer run, readjustment to a relationship of greater parity seems inescapable. Similarly, with regard to international ties, Latin America's presently renewed dependence upon the United States must be attributed mostly to the falling away of other partners as a consequence of the recession, rather than to any long-term reestablishment of the conditions for United States preponderance. Finally, even though economic necessity may have strengthened the United States position in Latin America, there is now far less convergence of political outlook between Washington and Latin American governments than previously.

This section outlines some of the long-term trends contributing to the erosion of the United States leadership position. It also briefly considers the Reagan administration's effort to counteract these processes noting that the apparent success achieved so far may not prove sustainable in the longer run since the basic determinants of United States power continue to weaken. The concluding section relates this view of the United States' position to Latin America's medium-term economic and political prospects.

In relative terms, United States power has been gradually receding for the past 30 years. The United States' problems with the Soviet Union and with the international economy can only be properly understood if placed in this long-term context. Britain's experience with a much longer process of relative decline indicates that domestic opinion tends to lag behind, only becoming aware that things are not as they were during intermittent episodes of crisis. It is the essence of "relative decline" that change occurs gradually (almost imperceptibly) in the leading country, and that the citizens of that country are rather well placed to insulate themselves from uncomfortable truths about the outside world. What causes the relative decline is not a stunning defeat or an internal collapse in the leading country; instead, it is simply that other countries change faster, perhaps making greater sacrifices and striving harder to catch up. British awareness of how the Germans accomplished this after the heyday of Victorian ascendancy came in sudden, belated, and perhaps badly-judged bursts of alarm that occasionally broke through ingrained popular complacency. There is no need to dwell here on the anaologies with, for instance, United States-Japanese relations over the past generation. The essential point is that the successive bursts of concern (in 1971, 1975, and in 1983 --that is, at the bottom of each downturn in the United States and international economy) must be viewed as awakenings to a secular process of relative decline, not merely as conjunctural episodes.

The essential cause of the United States' relative decline is quite straightforward and not dissimilar from Britain's relative decline after the mid-nineteenth century. The advantages accumulated at the starting point were simply so exceptional that any sustainable form of international expansion or progress was bound to require a large element of "levelling up." Thus the United States' overwhelming lead in terms of military power was bound to be diluted as other nations (with United States assistance) recovered from the devastation of World War II. Some 52 percent of the world's merchant shipping was United States-owned in 1947, not a proportion that could be sustained in peacetime. Similarly, with only 6 percent of the world's population in 1945, the United States produced and consumed some 40 percent of the world's output. By 1950 this declined to 33 percent, and by 1970 it had fallen to 25 percent. In 1980, with under 5 percent of the world's population, the United States share of world output had declined to some 23 percent (which is still a high proportion). It was this military and economic base and the confidence it inspired (together with the accumulation of world gold reserves in Fort Knox, as a result of capital flight in the 1930s and 1940s) that underpinned the international role of the dollar. In 1948 the United States government held 74 percent of the total world stock of monetary gold. By 1958 this share had fallen to 54 percent, and by 1968 to 25 percent--a proportion that has remained generally stable since then.

Another crude indicator of relative economic power is even more telling: in 1940 the United States produced 63 percent of world oil output, with a large surplus available for export. In addition, United States companies operating in Latin America accounted for another 15 percent of world oil output, and Latin America's surplus for export amounted to 11 percent of world output. (In 1950 the United States still produced 52 percent of world output with a surplus for export, and the Latin American export surplus was equal to 14 percent of world output.) But in 1960, United States output had fallen to only 34 percent of world production, with little surplus for export. The Latin American surplus had declined to 11 percent. By 1970 the United States had become a substantial net importer of oil, producing only 20 percent of world output, while the Latin American surplus had fallen to 6 percent of world output. The Americas as a whole became a net importer of oil during the 1970s, a condition which seems certain to persist throughout the 1980s even if there is a great expansion of Mexican output. United States production is currently only about one-sixth of world output, whereas the United States still accounts for about 30 percent of world oil consumption. It was this structural shift which made OPEC so powerful in the 1970s. Although OPEC's power seems to be crumbling in the early 1980s as the demand for oil declines, the United States will continue to require a substantial volume of imported oil for the foreseeable future. Indeed, the United States oil deficit seems likely to exceed the Latin American oil surplus for the rest of the 1980s.

Thus by the 1970s the United States had become much less preponderant in international affairs than it had been two decades earlier. Nonetheless, it clearly remained the largest and strongest single power in the world. It was perhaps no longer in such a dominant position that it could more or less automatically secure the acquiescence of its allies on any matter which it regarded as sufficiently important. Yet United States public opinion was slow to accept this changing relative position, and in any case the United States policy-formation process was not at all well-adapted to negotiating with allies on the basis of full parity. It is difficult enough to steer a policy past all the domestic veto groups and special interests without then reconsidering the whole matter again in the light of external reactions. In any event there were and are many outstanding issues of alliance politics which almost inherently require leadership from a single power center.

Monetary policy is one major area in which a single leadership center may be unavoidable. The international position of the dollar recalls the preponderant role which the pound sterling played in world finance before 1914, despite the prior decline of Britain's domestic industries. An overvalued exchange rate, a tendency to keep interest rates relatively high, and the loss of competitiveness by many of Britain's basic industries, were all due to the need to maintain the international role of sterling before 1914 and--even more so--efforts to reestablish that role in the 1920s. Yet despite the urgency of these problems, Britain was in no position to disregard the requirements of the international economy, of which it was still such an essential pivot and beneficiary. At that time, no other country was capable of taking over Britain's international economic responsibilities, even after Britain's material capacity to fulfill this role had been fatally weakened by World War I. Charles Kindleberger has gone so far as to relate the 1929-1933 world depression to Britain's inability either to carry out its traditional stabilizing role, or to transfer its international financial functions to some other power.

Today's circumstances are, of course, in many respects far different from those of the interwar period. Yet the analogies are also quite apparent. For example, in the 1970s (like the 1920s) nearly all Latin American countries experienced quite rapid economic growth based on an increased "opening" of their economies to international trade. Between 1970 and 1980, total trade as a percentage of gross domestic product more than doubled for Argentina, Brazil, Chile, Ecuador, Mexico, Panama, and Venezuela, and it substantially increased in all other Latin American nations. Thus, the region is highly vulnerable to the present downturn in trade. The same trend has also affected the United States, which traditionally had an unusually low exposure to world trade and which has consequently paid little attention to the international dimension of its economic processes. Total trade rose from under 11 percent of United States gross domestic product in 1960 to 24 percent in 1980. As in the 1920s this rapid trade expansion was related to a liberalization of finance that proved unsustainable. After a long period in which credit was made available at a low cost (ex-post) and from a variety of sources (which were often none too severe in their imposition of conditions), an acute liquidity squeeze now threatens to impose high real interest rates for several years, even on those relatively favored borrowers which retain access to new funds. Developing countries which "normally" supplemented their domestic savings with foreign capital inflows now find themselves abruptly compelled to generate export surpluses to repay capital to their industrialized country creditors--and, in effect, to finance the United States budget deficit. This obligation arises precisely when world trade is most depressed, when commodity prices are at a deep cyclical low, and when protectionism is rampant. If these debtor countries as a group are unable to raise their exports enough, they will instead be forced to slash their imports ferociously, thereby depressing demand for United States exports and adding to the problems of the United States economy.[7]

Militarily, too, there has been a sea change affecting the United States' leadership role and the cohesion of its system of alliances. Symptomatic of this change is a series of episodes, no one of them providing conclusive evidence but cumulatively very striking: Washington's paralysis over Iran; its uncertain role in Southern Africa as the white supremacists gradually slip into wider and more overt conflict; the painful "necessity for choice" between warring allies in the South Atlantic;

and the inability to restrain an Israeli invasion of Lebanon that deeply compromised United States policies in the Middle East. In all these areas of international life, events have delivered a sharp rebuff to traditional assumptions underpinning the United States world role. Moreover, it has become harder to envisage effective conflict resolution by means of peaceful cooperation.

The commercial, financial, and military difficulties outlined above interact to undermine the United States-led post-World War II order. Ultimately, all these tensions acquire an expression at the political level. However, their causes are structural, not just narrowly political. Over the past generation the United States material ascendancy in the Western alliance has been substantially diminished, and its ideological basis has been weakened. Moreover, political leaders throughout the noncommunist world (not just in the United States) have responded to these difficulties by turning inward, looking to the national policy instruments available to pursue their objectives and showing less willingness to listen to the viewpoints of their international partners.

Note that all the growing difficulties mentioned above concern tension within the United States sphere of influence rather than conflict between the United States and Soviet spheres. This is not to suggest that the Soviet Union and its allies are unaffected by, or uninterested in, the tendency toward a breakdown of the United States-based liberal international order. But their role is secondary. Indeed, their alliance system faces problems not all that dissimilar from, and certainly not milder than, those afflicting the United States-led group of nations. Far from presenting a successful challenge to the international capitalist system, the communist world has shown signs of succumbing to many of the same failings, compounded by special problems of its own (especially in the area of food production). Even on the military front, the Soviet bloc displays many signs of vulnerability: a draining rivalry with China; great difficulty in stabilizing its defense perimeter in Poland and Afghanistan; inability to shape events in the Middle East or Asia; and, as noted above, only a very limited capacity for aiding its sympathizers and clients further afield. Neither in material nor in ideological terms can the Soviet system be plausibly presented to United States allies as anything like the overriding threat to a United States-led world order that it may perhaps once have been (for example, at the height of the Korean war). Of course, the East-West conflict is still active and dangerous. In fact, the danger of nuclear war may be greater than it has been for a generation. But Washington's view of the source of this danger is not shared by all United States allies. Many of the foreign opinion leaders who once accepted the official United States world view now consider that most of the major forces dislocating the liberal international order in the early 1980s have their origins essentially within the "Western" or "capitalist" world. A strategy of increased confrontation with the Soviet Union might serve to temporarily distract United States public attention from the real sources of dislocation, but if anything it widens the gulf in public perceptions between the United States and many of its allies, thereby contributing in the longer run to the further erosion of United States leadership position.

The Reagan administration aims to reassert United States leadership through an act of will, and at least in the short run (in contrast to the

Carter administration) it has achieved some degree of success in this enterprise. Although it seems hardly possible to reverse the above-mentioned long-term decline in the United States' relative strength, it is argued by some that a clear and sustained United States commitment to a few sound basic principles will at least restore Washington's authority and cause its friends to rally round once more. Once a number of liberal myths and illusions have been deflated, it need not take long to restore a strong and respected United States based on resolute hostility to the Soviet system and a commitment to sound money and market freedoms. From this point of view, the United States' recent disarray is to be explained by lack of resolution in economic management and by gullibility and confusion over the nature of the Soviet challenge, rather than by any reluctance to adapt to a necessarily reduced ascendency in world affairs.

From this perspective, it follows that firm and consistent United States leadership focusing attention on the East-West dimension of all international political issues can and will restore cohesion and effectiveness to the Western alliance. The Reagan administration's key idea regarding world politics has been that an inherently expansionist and totalitarian Soviet regime has profitted from United States nervelessness and Western disarray to shift the military balance in its favor. The Soviet system is viewed as inherently flawed, so that its only source of superiority is its capacity for military expansion and regimentation. This is taken to mean that the Soviet Union responds to internal setbacks by increased militarization and additional acts of external aggression (either overt or disguised). In this schema, the Soviet Union is credited with an outstanding capacity for duplicity, so that it can orchestrate an enormous range of apparently disparate opponents of Washington's policies, from the European peace movement to Iranian mullahs, to the Palestine Liberation Organization, to the Indians of highland Guatemala. This perspective excuses Washington from giving much weight to the bewildering array of apparent grievances expressed by its many critics and opponents. This perspective also affected United States negotiations with the Soviet Union. It generates a climate of mutual distrust, and it casts doubt on the wisdom (indeed, the morality) of making concessions to the Soviet Union, no matter how strong the apparent advantages to both sides. For from this perspective, only by making the United States much stronger and by forcing fundamental change on the Soviet Union can any great-power compromise or settlement be envisaged.

This determination to view virtually all international issues from an inflexible Cold War viewpoint may yield some short-term dividends, since it does impose a very clear and familiar pattern of priorities. Over the longer term, however, it may expose United States leadership to two main risks. First, it is always dangerous to either overestimate the threat from an antagonist, or to underestimate the recklessness of one's allies, for both these errors increase the risk of conflict by miscalculation. (Argentina and Israel both illustrated this point in 1982.) Second, a lasting reassertion of United States leadership would require the United States' allies not merely to acquiesce to the currently fashionable Washington view, but to identify fully with underlying United States assumptions. The Reagan administration has made Central America a test case of agreement with United States views, but this is a most unpromising issue on which to persuade Washington's allies that all the blame lies in Moscow and Havana.

Even in the short run, it remains unclear whether the reassertion of United States power in Central America is producing the required results. But in any case to establish Washington's long-term credibility on this issue would require the consolidation of stable and respectable pro-United States governments in the isthmus. Unless that can be achieved, the use of Central America as a test case will tend to undermine, rather than to reinforce, the United States' reasserted leadership.

The restoration of sound money and market freedoms constitutes the Reagan administration's other main strategy for reestablishing a strong United States. Here, too, some short-term dividends have been obtained from the adoption of firm policies. But the incidental costs have been higher than expected, and the longer term effects on the United States' international position remain quite doubtful. A tight monetary policy greatly strengthened the dollar and helped bring down United States inflation, albeit at a high cost in lost output and employment. Countries such as Mexico and Brazil, facing desperate dollar shortages, felt obliged to fall more into line with Washington on a number of disputed issues because of their urgent needs for United States financial assistance. But here, too, what Washington can secure is acquiescence rather than any change of heart, and it is evident (as has been pointed out above) that this tight money policy produced more severe consequences in Latin America than its authors had anticipated. When, rather belatedly, it became apparent how much United States bankers, United States investors, and United States exporters stood to lose from a liquidity squeeze of such severity, United States government policymakers abruptly changed tack. On this front, too, the Reagan administration's efforts to reassert Washington's position may not persuade United States allies of the rightness of its diagnosis, and they may not produce the improvement in material conditions that is a prerequisite for a restoration of United States leadership. The final section of this paper considers the medium-term prospects from a Latin American perspective.

Medium-Term Prospects for Latin America

There are in principle just three ways in which Latin America's acute short-term foreign exchange problem can be resolved. Each has quite different implications for inter-American relations over the medium term. A broad and sustained recovery of the international economy might, with some time-lag, produce a satisfactory solution based on market forces. In the interim, Latin American governments would confine themselves to the implementation of "sound" stabilization policies. This is, of course, the outcome advocated by the Reagan administration and generally favored by private bankers. The second alternative is along those lines envisioned by the Brandt Commission. An unassisted recovery will be too slow and too weak, and it will demand crippling and destabilizing sacrifices of foregone economic growth by debtor governments. Recognizing this, western policymakers might agree on some concerted program of economic stimulus and financial assistance, roughly similar to the postwar Marshall Plan. (Helmut Schmidt and Henry Kissinger have also made recommendations in a similar vein, and no doubt other variants of this approach will be elaborated.) The third alternative of either a strong "spontaneous" recovery or a successful package of emergency measures, Latin America's immediate foreign exchange problem will be "resolved" through some combination of deflation and internal economic restructuring that reduces the demand for convertible currency until it equates with a permanently reduced supply.

In practice, these three solutions are all likely to operate to some degree, the proportions varying substantially from country to country. Whichever of the three alternatives preponderates, the immediate acute scarcity of foreign exchange can be expected to ease off within a year or two in most countries of the region. When that happens, the present condition of extreme financial vulnerability will give way to some new pattern of relationships in which regional governments will recover at least some limited room for maneuver. It will make a great difference to the quality of inter-American relations which of these three methods of financial "adjustment" (a deceptively neutral term) prevails over the medium term.

A sound market-based recovery would presumably originate in the developed countries (probably the United States) and only reach Latin America after a substantial time-lag. The oil exporting countries in the region would receive less stimulus from this recovery. However, as interest rates fall and most export prospects brighten, some major countries (probably led by Brazil) would find it easier to service their foreign debt obligations and attract new capital. Reclutant to incur too much debt, these countries might turn instead to direct foreign investment, inviting the prospect of a large expansion in the role played by multinational corporations. With a strong dollar, United States-based corporations would be well represented, although Japanese and western European firms would also be attracted. To maintain fiscal discipline and provide tax incentives for enterprise, public enterprise would be reined in and social spending would be held down. Some time would pass before imports returned to pre-1982 levels, and it would take even longer for former levels of employment and real wages to be restored. Firm government would be needed in the meantime (not necessarily authoritarian, but resolute in the pursuit of "sound" policies), and recovery would come fastest in those countries in which policymakers were whole-hearted in pursuit of this strategy. These would also tend to be Washington's most loyal allies on general international issues, and so they might receive some supplementary assistance on that basis. This would, however, play only a small part in the recovery.

The future would be different for those countries which discourage foreign investment and vacillate over the pursuit of earlier levels of employment--that is, for those which are not united or whole-hearted enough to persist with "sound" policies. A "spontaneous" recovery would reach them later; their difficulties with foreign finance and the supply of imports would last longer; and little help could be expected from Washington without a change of heart--least of all if these countries also dissent from the United States line on other international issues. In this case, recovery would clearly tend to reinforce an inter-American system structured along traditional lines, with pro-United States and pro-business Latin American governments in the ascendant. However, it is also apparent even from this brief sketch that there would be many obstacles along the way. Even if the United States economy performed as required, several years would elapse before even the best-placed Latin

American countries could recover the levels of popular employment and consumption achieved at the beginning of the decade. In the meantime, "sound" policies would produce many losers and only a limited range of rather visible beneficiaries. It is overly optimistic to assume that many governments will proceed firmly and whole-heartedly along this route, especially if the industrialized countries remain in doubt concerning the breadth and durability of their recovery prospects.

Skepticism regarding the market-based solution has fed demands for a "new Marshall Plan," a "new Bretton Woods," or some other variety of concerted international program to ease the debt burden and boost development prospects in the developing countries. There is no single alternative for consideration here, but the various schemes all have several basic characteristics in common. For example, they all require a negotiated agreement among major western governments--a stringent condition considering the inability of the United States and its allies to reach consensus on the many other issues which divide them. In practice, it is only with Washington's approval that any such scheme could be launched. This applies to developing countries in general, but above all to any scheme for aiding Latin America. (Indeed, the Caribbean Basin Initiative was launched more or less unilaterally by the United States with only token assistance from its allies.) Therefore various major United States lobbies would have to be persuaded that an emergency package for Latin America has something to offer them. In fact, United States bankers and exporters do have substantial interests at stake in Latin America, and no doubt the security dimension could be emphasized.

A brief consideration of the conditions that would have to be met to secure United States endorsement of some Marshall plan-type aid program for Latin America makes clear what sort of inter-American system it would serve. Instead of rewarding "sound" policies, support would go primarily to those countries of greatest strategic importance to the United States or in greatest danger of collapse. Aid would come with conditions required by United States exporters, labor unions, bankers, evangelists, and whoever else could muster votes in Congress. It would probably tilt inter-American relations toward bilateralism and away from multilateralism. Enlightened policymakers would certainly try to promote nondiscriminatory assistance along the lines favored by Brandt or Schmidt, and some of their arguments might eventually prevail. But there are no votes in it. Unfortunately, therefore, the second alternative route to recovery is only likely to be possible (if at all) on conditions which are opposed to Latin America's desires for autonomy and self-assertion, and which are bad for the development process. It is important to press for an enlightened aid program but it is also necessary to be realistic about the chances for such an outcome.

The most likely prospect is that neither the market-based solution nor any concessionary aid program will prove swift or strong enough to resolve the foreign exchange difficulties faced by most Latin American countries in the medium term. Therefore, economic adjustment will be brought about mainly through deflation and/or internal restructuring. This can take many forms, and it can be accompanied by a variety of international orientations (as Latin American experiences of the 1930s can testify). In general, however, this adjustment process will add to the problems of maintaining regional cohesion and respect for constituted authority.

The discovery of renewed dependence on Washington and the frustration of Latin American hopes for a more pluralist international regime are bitter blows to many Latin Americans. Both the material and the psychological climate will make it more difficult for Latin American governments to deal with Washington, with other international power centers, or with each other on a basis of restraint and mutual cooperation. But the inter-American system, like the international community of nations as a whole, has performed poorly for some time now. The medium-term economic prospects for Latin America can only add to its burdens.

FOOTNOTES

[1] See my "Explaining Washington's Central American Policy," Journal of Latin American Studies, 15 (1983), pp. 321-363. (This is a special issue entirely devoted to Central American topics.)

[2] Economic Report of the President, Washington, D.C.: 1982, pp. 167, 169, 189.

[3] "Bank Lending to Developing Countries: Problems and Prospects," Federal Reserve Bank of New York Quarterly Review, Autumn 1982, pp. 27-29.

[4] Mario Movarec, "Exports of Latin American Manufactures to the Centres: Their Magnitude and Significance," Cepal Review (Santiago) August 1982, p. 76. Excluding Mexico's border industries, this "penetration percentage" falls to only 1.3%, only up from 1.0% in 1970. In 1980 over half (54%) of these manufactured goods were exported to the United States, 35% to the EEC, and 8% to Japan. Movarec provides a disaggregation of the figures for 1978 which confirms that much of these manufactured goods are only lightly processed.

[5] Gustav Ranis, "Challenges and Opportunities Posed by Asia's Superexporters: Implications for Manufactured Exports from Latin America," in Werner Baer and Malcolm Gillis, eds., Export Diversification and the New Protectionism: The Experiences of Latin America, Urbana: University of Illinois Press, 1981.

[6] I discuss this in "International Aspects of Democratisation," in Guillermo O'Donnell, Philippe Schmitter, and Laurence Whitehead, eds., Transitions from Authoritarianism in Latin America and Southern Europe, Johns Hopkins University Press, forthcoming 1985. The permanent head of the EEC delegation to Latin America, Dr. Manfredo Macioti, recently made a rather visionary appeal for western Europe and Latin America to join together in a strategy to roll back recession and relaunch the world economy. In somewhat more practical terms, he also called upon the EEC to support those Latin American programs for economic integration which are rooted in respect for parliamentary democracy and human rights.

[7] According to an official estimate, one of every six United States jobs now depends on exports. Sales to developing countries rose from 29% for all United States exports in 1970 to 39% in 1982. United States shipments to Mexico are estimated to have fallen by 60% between late 1981 and late 1982, while United States exports to Argentina fell 40% in 1982, and to Chile by 36%. One unofficial estimate indicates that developing countries may only purchase US $40 billion of United States goods in 1983, as compared to US $60 billion in 1982; Wall Street Journal, March 18, 1983.