Recent Capital Inflows to Latin America: Too Good to Last?

Think of how much impact Japanese, German, British and American bondholders have on Canada's currency and interest rates. Imagine the impact stock or bond investors could have on a country with a fragile economy and underdeveloped financial markets a tenth the size of ours.[1]

Although the LDC debt crisis has long faded from public memory, it was not that long ago that most economists believed that it could take decades for the commercial bank debtors of Latin America to be welcomed back into international capital markets. But recent net flows of financial capital to Latin America have recovered from their decline throughout the 1980s. Net transfers to the countries of Latin America are again positive. While the composition of these capital inflows has changed from commercial bank credit, to bond and portfolio equity financing, along with significant amounts of foreign direct investment (FDI), it is still possible that these flows could reverse themselves sometime in the future. A number of economists fear that the advent of a second debt crisis, albeit with different consequences, could be on the horizon. To understand how this could occur, it is important to understand the magnitude of these flows in recent years, as well as why international capital has once again been attracted to Latin America.

Magnitude of Recent Capital Inflows

Net resource flows to Latin America have been restored to their pre-debt crisis nominal levels and net transfers to the region have again become positive in the 1990s after being negative throughout the better part of the previous decade (Table 1). The composition of these flows, however, has changed. Whereas it was commercial bank credits that comprised the majority of resource flows in the years preceding the debt crisis, it has been portfolio equity, FDI and international bond issues that have increased since the beginning of the decade.

Just as commercial bank lending once was concentrated in just a few Latin American countries (Mexico, Argentina and Brazil), so too are the new capital flows. Argentina, Brazil, Chile and Mexico, for example, accounted for 86% of all FDI flows to Latin America in 1992.[2] The reason for the flows has changed, however, as debt-equity swaps have given way to the inflow of capital for

[1]Douglas Goold, "Mutual funds in the Third World," *Globe and Mail*, July 25, 1994, p. B9.

[2]*World Debt Tables, 1993-94, Vol. 1* (Washington: World Bank, 1993), p. 57.