The Debt Crisis: a re-appraisal

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The 1980s' debt crisis is a landmark in developing economies' growth and stabilization. According to the most quoted empirical articles, external shocks and vicissitudes gave rise to crisis just because of delays in stabilization policies, engendered by internal conflicts and institutional immaturity. I review some of these papers, and find out some problems — in the measurement of shocks and foreign indebtedness, namely - whose corrections lead to opposite results: external shocks and foreign indebtedness explain that crisis regardless of domestic policies. At the same time, the strong correlation of income distribution to terms of trade changes and foreign indebtedness suggest that inequality may have contributed differently to that crisis: either through an economic channel, or through a political channel based on delays in reforms.

Key-words: External Shocks; Indebtedness; Debt Crisis; Stabilization Policies; Trade Protection; Political Economy.

JEL Classification: F34; F42; E61; 011; 057

1. INTRODUCTION

The 1980s' debt crisis is a turning point in the recent economic history of developing countries: most of those that fell victim to it experienced not only a general stabilization crisis, but also a marked drop in their ongoing economic growth. True, some evidence suggest that this divergent growth may trace back to the post-1973's oil crisis. Yet, a general agreement persists on taking the 1980's

debt crisis as a reference for larger changes in developing countries' fortune, which brought about discussions on whether this divergence should be ascribed to bad luck (unfortunate exogenous events) or to bad domestic polices.

At first, exogenous shocks and financial market instability figured as the major reasons for the vicissitudes in that period (Cline, 1984, Resende, 1983). However, the influential article by Berger & Sachs (1988) demonstrating that, despite external shocks, only variables related to domestic economic policy decisions, or to the social environment, could predict the observed foreign debt defaults. Later on, Easterly *et al.* (1993) obtained that shocks may explain growth variations, which motivated Rodrik (1999, 1999b) to devise a more elaborated political economy analysis, where it is shown that external shocks explains that crisis only when mixed in a composite variable for social conflicts.

In the present paper, I intend to question these empirical findings that the 1980s' *debt crisis* was the outcome of bad domestic stabilization policies. Our reply takes for granted the theoretical foundation of those empirical analyses — i.e. the political models of macroeconomic policies — focusing simply on some serious empirical problems, namely in the measurement of the variables standing for shocks and external debt, in the sample choice and model specification as well. They all stem from Rodrik's unduly subsuming a balance of payment crisis into an analysis on growth variations.

After correcting the observed problems, our estimates yield an altogether different result: external shocks and debt burden are statistically significant to explain the odds of balance of payment crisis regardless of any indicators of bad domestic policies. These findings are in accordance with evidences around the 1990's financial crisis, that it dragged even countries with sound macro policies (Fratzscher, 1998), vindicating the concerns about international market working, emphasized by the earlier literature (Cline, 1984; and many others). At the same time, the findings do not reject the hypothesis of bad policies, but rather point towards an alternative political economy of the *debt crisis* that places *delayed reforms* as the central problem and makes room for the overwhelming effect of foreign indebtedness (see Pereira *et al.*, 1993)

The whole empirical analysis is presented in the Section II, beginning with an introduction to the subject. The following section concludes with a synthesis of the principal findings and suggestions for new developments in this research program.

2. RE-EXAMINING THE ROLE OF THE ECONOMIC FACTORS

In 1978, after a period of plentiful international credit to developing countries, international interest rates started rising, in response to the deteriorating macroeconomic environment in developed countries. In 1979, a second oil price shock took place, and, in 1980, to make things even worse, the US government implemented an austere macroeconomic policy that lifted international real interest

rate to 20%, from negative values (Sachs and Larrain, 1993: Table 22.5), pushing the world market into a severe depression. Already deteriorated by the *oil shock* (for the non-oil exporting countries), the export prices of many developing countries fell further, leading, eventually, to a widespread foreign debt default, triggered by Mexico's default in September 1982. The ensuing stabilization crisis was protracted and generalized, encompassing both recurring balance of payments crises and other macroeconomic imbalances.

In the Figures 1 through 5, below, we can follow the corresponding changes in Terms of Trade (TT) over this period, covering a selected group of developing countries. Except for some countries whose crisis happened after 1983, this is placed as the end period. As can be seen, dramatic changes in TT took place from 1979 to 1980: upward in the oil exporting countries (Figure 2 plus Indonesia, Tunis, and Egypt) and downward in the remainder. After 1980, during the world market depression, a new TT fall came about, hitting many oil exporting countries, as well as several Latin American countries (Figure 1 and 2). It was less general and severe in *Other Countries A and B*, and about absent in the East Asian countries, except for those belonging to the so-called *second tier* (Philippines, Thailand, Malaysia), whose exports were mostly resource-based (including oil) by that time. This second fall in TT, together with its final outcome, outlines a typical *debt deflation crisis* — to be statistically proved, though — so that I will associate this move in TT to a *deflation shock*.
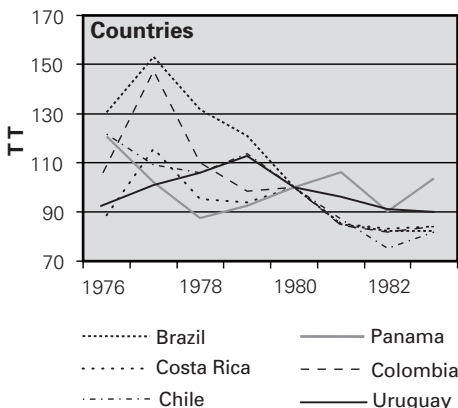

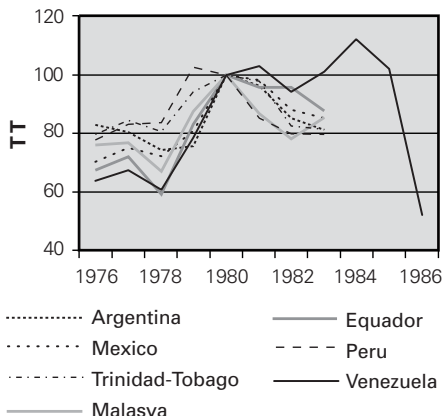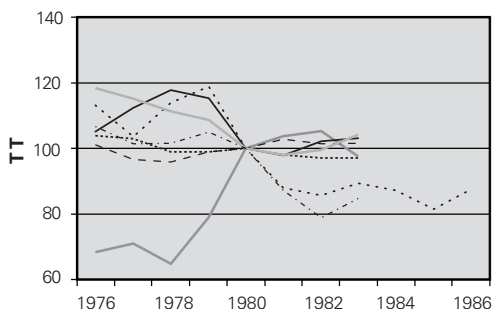**Fig 1. Non-Oil Exporting LA Countries**

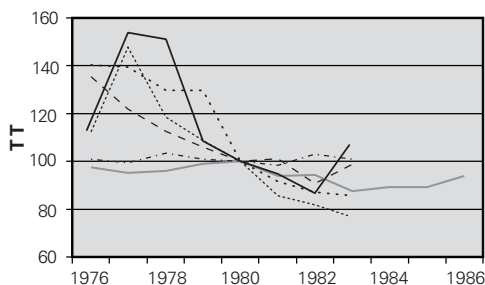**Fig 2. Fluctuating Oi Exporting**

Fig 3. East Asian Countries

·········· Hong Kong	——— Indonesia	——— Taiwan
······· Phillipines	– – – Singapoure	
·–·–·– Thailand	——— Korea	

Fig 4. Other Countries A
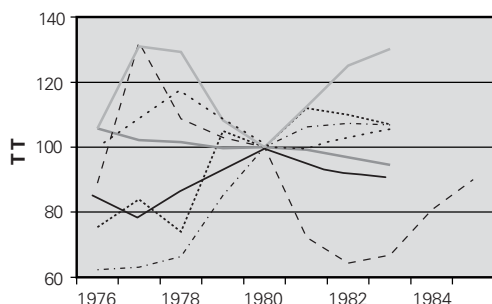
·········· Egypt	——— India	——— Portugal
······· Israel	——— Hungary	
·–·–·– Tunis	– – – Ivory Coast	

Fig 5. Other Countries B

·········· Kenya	······· Turkey
——— Sri-Lanka	——— Morroco
– – – Mauritius	·–·–·– Yugoslávia

No expert denied that the losses stemming from the fall in terms of trade and the interest rate rise contributed to the 1980s' debt crisis — *Debt Crisis* simply, henceforth. Yet, doubts remained as to whether or not those external effects sufficed to bring the crisis about. From the identification of policy mismanagement in countries that had to reschedule their external debt, Berg & Sachs (idem) — B&S, from here on — worked out an empirical model, where some explanatory external economic variables, such as terms of trade shocks, *per capita* GNP and a regional *dummy* for *financial contagion,* are placed together with a set of structural independent variables, supposed to constrain policy decisions, such as income distribution and the portion of rural population, and policy efficiency as well, such as trade openness. The regression model produced an astonishing result: all structural variables exhibited statistical significance for predicting the *Debt Crisis*, whereas none of the economic variables did so. This

evidence did a good deal to shift researchers' attention toward the political environment surrounding policy-making in these economies — see the survey by Alesina & Perott (1994).

In the early 1990s, with the 1980s' crisis driving a wedge into developing countries' growth records, economists started asking a new question: why growth persisted in some countries and not in others. Barro (1991) explored this question, grounded on new growth theories' treatment to permanent changes, and succeed to demonstrate the decisive importance of economies' social characteristics. Later on, Easterly et al. (1993), following a similar theoretical perspective, found out evidences that terms of trade explain growth variation in the 1970s and 1980s. In other words, good policies and social environment do not suffice: bad luck (i.e., random shocks) matters too.

Despite the relevance of these findings, these models and their covered period were not designed to explain the early 1980s crisis, but rather the question of growth variation (or persistence). Hence, they cannot claim to provide a definite answer about that crisis. Moreover, the observed statistical significance of external shocks cannot be taken as an evidence against the political economy of stabilization, given that this analysis, as formulated by Alesina & Drazen (1991), does not denies the impact of external shocks, but simply that they give rise to crisis when prompt macroeconomic adjustments are not adopted, because of political conflicts.

Rodrik (1999) took up the job of capturing the interaction among external shocks and domestic political resistance, or else of testing the argument that shocks lead to crisis only when domestic social conflicts are high. Along this reasoning, he proposes that the following composite variable should be tested:

$$\text{external shocks} \ \times \ \left(\frac{\text{social cleavages}}{\text{instittutions of conflict management}} \right)$$

The terms within the parenthesis stand for two groups of factors that, in Rodrik's analysis, wage social conflicts. Their specific justification is the following: "When social divisions run deep, there will be greater suspicion about other's motives, and a higher probability will be attached to an opportunistic grab for resources by the rival group … [in turn], when conflict-management institutions are strong, distributional outcomes will be less sensitive to any group's opportunistic behavior aimed at obtaining a disproportionate share of available resources" (Rodrik, 1999b: p. 9-10). That is, given limited resources, cooperation is the dominant strategy in the political game triggered by the sharing of a shrinking pie in the wake of external shocks, and either social cleavages or weak institutions prevent cooperation, and thus the adoption of the prompt and consistent policies. In this sense, the whole composite variable, presented above, stands for social conflicts, starting with the sharing a shrinking pie and extending to the political management of and attitude towards this trouble.

Indeed, Rodrik's new estimates show that terms of trade shocks alone cannot

predict crisis, but can do so within the above variable for *social conflict*, enabling him to conclude that " the crisis was the product of monetary and fiscal policies that were incompatible with sustainable external balances" (Rodrik, 1999b: p.77). The estimates also demonstrate that microeconomic distortions (e.g., trade protection) do not explain the macroeconomic instability, corroborating the case for a pure political economy analysis, around stabilization policies.

The question is that Rodrik's "terms of trade shock", the standard deviation of the first log-differences of the terms of trade over the 1970's[1], fits perfect to an analysis on growth variation, likewise Easterly *et al.*, but has no correspondence with the shocks at stake in the *Debt Crisis*. First of all, it is timely displaced: the critical changes in TT are those concentrated over the period 1979-1982, and not over the whole 1970s[2]. Secondly, taking TT shocks by the standard deviations, independent of their direction (positive or negative) contradicts all discussions so far, which always revolved around losses in TT in the unfortunate period of 1979 to 1982.

We should move back to earlier authors' perspective, such as B&S, and analyze the *Debt Crisis* as a particular balance of payment crisis, rather than an economic growth deviation, despite some correlation therein. Accordingly, instead of taking for dependent variable "growth change after 1975", as Rodrik, we should take "whether or not each country rescheduled its foreign debt with international authorities", whose data is exhibited in Table 1. To not condition the results to sample choice, we should keep to the same 33 developing countries from B&S[3] - middle income or large and effectively developing countries. Although rather smaller than Rodrik's sample, ranging from 50 to 100 countries and encompassing both developed and all less-developed countries, it is the most consistent sample for the problem under scrutiny, given that this (generalized) *balance of payment crisis* hit no developed countries nor most of the less developed countries. That is, the problem at stake revolves around large or effectively developing economies, which had been included in the international circuit of financial capitals (see Fisher, 2002).

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[1] Times the "average proportion of total trade to GDP". This weighting, relevant in the analysis of economic growth, to quantify the impact of the shock on the GDP, is not so for balance-of-payment crisis, which depends only on the values of exports (and imports) relative to external commitments. It is worth noticing that Easterly *et al.* terms of trade shocks was thus calculated: ".. the growth in dollar export prices times the initial shared of exports in GDP minus the growth in import prices times the initial share of imports in GDP.." (Easterly *et al.*, 1993: p. 8).

[2] As detailed below, economist associated TT changes in the 1974-1980 period to a stock problem — foreign debt accumulation — rather than a flow problem underlying 1980s' crisis.

[3] They actually work with 35 countries, but owing to lack of data for China and Hungary, only 33 countries (see Table 1 above) were tested for the TT, including one, Spain, already classified as developed by that time (according to the *World Development Report*, 1982). Since the sample was meant to contain only developing countries, we made a correction here, excluding Spain and incorporating Hungary, using update IMF's data, thus maintaining the sample's size.

Table 1: Reschedule countries by region

Latin America	Event	Date	East Asia	Event	Date	Others	Event	Date
Argentina	Yes	1983	Hong Kong	No	1983	India	No	1983
Brazil	Yes	1983	Indonesia	No	1983	Israel	No	1983
Chile	Yes	1983	South Korea	No	1983	Ivory Coast	Yes	1985
Colombia	No	1983	Malaysia	No	1983	Kenya	No	1983
Costa Rica	Yes	1983	Philippines	Yes	1986	Mauritius	No	1983
Equator	Yes	1983	Singapore	No	1983	Morocco	Yes	1986
Mexico	Yes	1983	Taiwan	No	1983	Portugal	No	1983
Panama	Yes	1983	Thailand	No	1983	Spain	No	1983
Peru	Yes	1983	*Average* 13%			Sri-Lanka	No	1983
Trinidad-Tobago	No	1983	Others			Tunis	No	1983
Uruguay	Yes	1983	Egypt	No	1983	Turkey	Yes	1983
Venezuela	Yes	1986	Hungary	No	1983	Yugoslavia	Yes	1983
Average	83%					*Average*	29%	

Note: "Rescheduler[1]" spans the top of the table.

Notes. (1) Yes (No): countries that did (not) reschedule their foreign debt in the indicated year.

B&S's measure of TT changes has its problems too. They correctly take 1983 for reference, a critical year, when foreign debt rescheduling exploded, but measure the corresponding TT change with respect to the average over 1970-75-80, an arbitrary long run equilibrium value of TT which blurs the change stemming from the oil shocks and the world market depression. The consequent bias is pronounced for two groups of countries, making up half the sample. The first one consists of the oil-exporting countries that experienced a sharp fluctuation in their TT, grouped in Figure 2 (at the end of the paper), most of which underwent at least one external debt reschedule. This rise and fall in their TT either vanishes or inverts in B&S' series, because the lower TT of 1970 and 1975 pushes up the relative value of the TT in 1983. At the other extreme are those countries (Panama, Korea, Taiwan, India, Israel, Mauritius, and Morocco), whose TT did not decrease with the world economic depression — it either increased or fell just slightly — but appear in the B&S series with considerably lower TT, because their averages over 1970 and 1975 are higher than the late 1970s' value.

Definitely, the average TT over the years shortly preceding those shocks is be the best base to measure their impacts, as can easily be checked from Figures 1 to 5. However, an unique base would hide the troubles experienced by the fluctuating oil-exporting countries (and Portugal), that is, their sizeable losses during the world market depression. Accordingly, TT shocks was measured in the following way — each characteristic, detailed below, differs from B&S' series:

1) *distinct two-years average bases*. For the fluctuating oil-exporting countries

(and Portugal), the base is the average TT over 1980-81, while for the remaining countries it is the average TT over 1979-1980. Including 1981, a depression year, in the base of the former group of countries, attenuates part of the price impact of the world depression, yet it manages to incorporate it, as well as part of their oil-shock gains. Equally, including 1980 in the base of the remaining countries attenuates part of their losses with the second *oil-shock* — it was the average 1980's oil price that specially changed with the late 1979's shock — yet it manages to capture them, as well as the ensuing price impact of the world market depression. Because of the fluctuating oil-exporting countries, a three-years average base was not avoided. The average over 1978 to 1980 lies below the 1983's TT, hiding their experienced losses, while the average over 1979-1981 overlaps the years when the main TT changes happened.

In short, these non-homogeneous bases neither erase nor invert the decisive changes in countries' TT in the four years preceding the *debt crisis,*

2) *ampler reference period*, in order to compensate for the loss of information (of one year) in the base period. It is the average over 1982-83, instead of only 1983; a realist procedure, given that TT started falling at least one year before the crisis.

Moreover, for those four countries that experienced their first debt-rescheduling episode only in 1985 or 1986 (see Table 1), their reference period is the average over the crisis year and the preceding one.

Foreign indebtedness in the late 1970s — for B&S and others the *stock side* result of TT changes in the 1970s, mainly due to the first oil-shock (in 1973) — is another key variable for explaining the *debt crisis*. Many authors used to argue that the 1980s' financial crisis came about because the interest-rate shock and the world depression happened when the level of external commitments carried by developing countries was very high (Resende, 1983). The argument is built on Minsky's (1982) *financial instability hypothesis* that stable adjustment to adversities depends upon the economy's debt structure — i.e., the weight of speculative or "Ponzi game" debtors — given lenders or investors' risk aversion (see Taylor & O'Connel 1989), exacerbated towards developing countries holding large foreign debt.

We take the ratio of "total debt services to exports of goods and non-factor services (TDSX)" in 1980, at the dawn of the world market recession - two years, at least, prior to the outbreak of the crisis. Taking TDSX one year before the crisis would tie its meaning to an indicator for capital flight or else to creditor's panicking to these debtors, while the focus is testing problems of external solvability. On the other hand, taking TDSX in 1975, as Rodrik, quite before the long period of over-borrowing, becomes meaningless.

GDP *per capita* and GDP growth, central in the analysis of economic growth, are included in Rodrik's regression on *bad policy*, but they have no theoretical justification for balance of payments crisis. They may actually work as control variables for the huge heterogeneity among countries in a worldwide sample, but, again, restricting the analysis to wealthier or larger developing economies seems

more reasonable. Eliminating unjustifiable independent variables, we give ampler and neater room for those standing for social conflicts to express their influence on economic policy decisions.

We shall maintain the political economic model specification to test the contributions of internal (domestic policies) and external (international market) problems to the crisis. That is, a set of independent variables, standing for the former and latter problems, are placed in the same regression model explaining the probability of foreign debt default — using probit models. A dummy variable for Latin America is also included, given the exceptionally large concentration of foreign debt default in this region (see Table 1).

With respect to the variables conductive to domestic policy mismanagement, they are grouped in terms of *social cleavages* and *institutional maturity,* as Rodrik. The former are proxied here by the following variables: (1) inequality in income distribution, given by the "ratio of income share of the top 20 percent of the households relative to the income share of the bottom 20 percent of the households" around 1980 (several sources, as quoted in B&S: p. 285); and (2) the murder rate per million inhabitant in 1980 (from Barro & Lee, 1994). With respect to institution maturity and strength, the following variables are considered: (3) log of public spending on social insurance, (4) the rule of law, measure on a scale from 0 to 4, and expressing the degree to which citizens are treated as equal under the law and the judiciary; and (5) the index ICRG (from the International Countries Risk Guide), based on an underlying numerical evaluation relating the rule of law, bureaucracy quality, and corruption, whose values range from 0 to 10, higher values meaning superior institutions (See Rodrik, 1999)[4]. Finally, an indicator of microeconomic distortion: (6) the "own-import weighted tariff on intermediate and capital goods"(from UNCTAD, as quoted in Barro & Lee, 1994)[5], standing for trade openness. We could not profit from the full set of social and political variables in Rodrik, because some of them cover a period other than the 1980s, some would cost an extreme reduction in our already small sample, and others are meaningless in our sample.

Since two independent economic variables (external shocks and total debt services) are maintained throughout, two social variables, at least, are included in each model. The first two models, presented in columns (1) and (2) of Table 2 below, test the impact of social cleavages. Model (1) is a benchmark in the *political economy analysis*: has income distribution together with an indicator of

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[4] Variables (3) to (5) were obtained from Rodrik's database, to which I refer the reader for further information on sources and measurements. With respect to ICRG, I decided to include it, despite being based on the average over 1980-1989, both for its importance in the political economy analysis and for deeming that that its value was greatly in the first half of the 1980s.

[5] This is the measure utilized by Rodrik, further detailed in our Table 2. We refrain from using other indicators of openness, such as Werner & Sachs indicator, because of their measurement problems, as pointed out by Rodriguez & Rodrik (1999). On the same ground, we preferred using B&S' indicator of bad income distribution, based on World Bank, rather than Rodrik's gini coefficient, because we could not fully access both its source and methodology.

microeconomic distortion (i.e., trade openness). In turn, models (2) through (5) go closer to the spirit of the most recent literature. We kept income distribution throughout for two reasons: (a) its leading position in describing countries' social matrix, and (b) because combining two variables for institution management goes against Rodrik's analysis — it also makes no difference to the statistical results. Trade openness was not introduced in the other models as it neither achieved statistical significance, nor changed other variables' significance.

Table 2. Probit Estimates of Foreign Debt Crisis1

Dependent Variable: Foreign Debt Reschedule					
Independent Variables	(1)	(2)	(3)	(4)	(5)
Constant				6.26*	6.15***
				(2.37)	(3.68)
Latin America	1.14**	1.12**	0.77	0.1	1.77***
	(0.7)	(0.57)	(0.67)	(0.65)	(0.99)
Shock	-1.74***	-2.34*	-4.24**	-4.97**	-11.6*
	(0.91)	(0.88)	(1.99)	(2.45)	(4.46)
TDSX	10.5*	10.8*	10.69**	13.79**	28.18*
	(3.54)	(4.03)	(5.02)	(7.54)	(9.17)
Openness	-3.54				
	(3.66)				
Income inequality	0.02	0.02	0.03	-0.01	-0.02
	(0.55)	(0.03)	(0.04)	(0.03)	(0.04)
Murder		(-4.60)			
		(14.9)			
Log social spending			0.62		
			(0.42)		
ICRG				-0.74*	
				(0.20)	
Law					-0.18
					(0.28)
N	29	32	31	31	31
% correctly predicted	89.7	90.6	90	90.3	90.62

1. Heterocedasticy corrected models, and tested according to Davidson and MacKinnon's LM statistics (Greene, 2000, Ch. 19).
Robust standard errors in parenthesis. Asterisks indicate the p-value of the t-statistics: * 1 percent; **5% percent; ***10 percent. The constant was excluded when not significant, according to Akakike, Schawrz, and Hannan-Quinn criterions.

Most remarkable about the new results is that *external shocks* and *foreign debt service* in 1980 are statistically significant in all five *political economy models*, with the predicted signs (negative for the former and positive for the latter), while no variable for social cleavages or political institutions management, except the index of institutional quality (ICRG), is significant. Therefore, international product and financial markets adjustments, in the forms of *debt-deflation* and *financial instability,* help to predict the widespread payment crisis, in the early 1980s, regardless of countries' policies or social environment.

A straightforward conclusion is that using new proxies for *external shocks* and *foreign debt burden,* measured in a closer correspondence with the events causing the *debt crisis,* sufficed to turned upside down the previous findings, supporting interpretations grounded on the political economy of stabilization. Restricting the sample to developing countries — i.e. to the wealthier or the most expanding ones — has also probably affected the statistical significance of the social and political variables. We can, then, say that some social indicators may explain economic growth among countries worldwide (see Easterly & Levine, 2002), but not differences in external macro-performance among developing countries in the early 1980s.

What about non-statistical significance of *trade openness* and *bad income distribution*? With respect to the former, Terra (1998) had already shown that its power to predict economies' performance in the 1980s is eliminated when we consider countries' foreign indebtedness. The most recent literature on trade restrictions and growth has been using wider indicators of openness (see Dollar, 1992, and Sachs & Werner, 1995), but, as noted by Rodriguez and Rodrik (2000), these indicators embody much information alien to trade restrictions. A problem not present in our indicator of openness (the weighted tariffs on imports of intermediate and capital goods), though it is not a perfect: the weightings might reduce the impacts of the restrictions on some imports, and the exclusion of consumer goods turns the indicator very incomplete.

Regarding income distribution, its statistical insignificance is somewhat striking, though similar result shows up in Barro (2002). In our case, an important part of the answer lies in the strong correlation of income distribution with the two financial variables — -0.40 with terms of trade shocks and 0.54 with TDSX — and with the dummy for Latin America (0.51) as well - see Table 3 below[6]. The same does not occur with the remaining social variables, which are weakly

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[6] Wald and LR statistics tests for the presence of redundant variable, which control for the effect of correlation, did not revert the insignificance of income distribution.

correlated with income distribution, the economic variables and the dummy. Besides explaining the low statistical significance of income distribution, these correlations also suggest that income distribution may indirectly explain countries' performance through its interactions with the economic variables. It deals, however, of a relationship upon an economic variable that determines or defines external performance, having no connection with the *political economy of stabilization policies.*

Table 3: Correlation matrix among independent variables

	Laam	Incdstr	Open	Murder	Lsec75	Icrge	Law	Shocks	Tdsx
Laam	1.00								
Incdstr	0.51	1.00							
Open	0.03	0.12	1.00						
Murder	-0.21	-0.22	-0.14	1.00					
lsec75	0.16	-0.29	-0.10	0.33	1.00				
Icrge	-0.19	-0.22	-0.26	0.20	0.15	1.00			
Law	0.06	-0.30	-0.10	0.32	0.41	0.50	1.00		
Shocks	-0.46	-0.40	0.38	-0.04	-0.03	0.01	0.03	1.00	
Tdsx	0.48	0.54	0.00	-0.14	-0.28	-0.28	-0.20	-0.31	1.00

laam: dummy for Latin America; Lsec75: log of social spending. For the remaining variables, see Table 2 and the paragraphs.

An economic channel, associated with an equality-led endogenous growth, lurks as a tenable story. That bad income distribution affects growth is something held by a variety of growth theories: from Kaldor's (1958) cost-pushed technical progress, with wages as the basic cost[7], to theories of social capability built on countries' capacity for absorbing foreign technologies, with income distribution acting as a central component (see Temple & Johnson, 1998, Fajnzylber, 1995), and the more recent analysis on inequality-constrained investments (Aghion & Williamson, 1998: Part 1). If we considering, next, that growth success dictates the strides towards the exports of price-elastic goods — a hallmark for technological *catch up* — then the whole nexus from inequality to TT behavior, during the world market depression, is established. Exports-prices elasticity is, indeed, the microeconomic basis of Taylor's (1991) macroeconomic model, analyzing the south's fragility to the north's macro-policies in the early 1980s. We are solely suggesting, here, an endogenous explanation for this stride towards the exports of price-elastic goods.

[7] Menezes-Filho et al's (1998) study about the impact of unions on R&D spending in the U.K. empirically supports this argument.

From another standpoint, we can refer the behavior of TT changes and foreign indebtedness to microeconomic inefficiencies, due to *delays in reforms* caused, in turn, by social cleavages. Income inequality strengthens the defense of the *status quo* — the fears of losses, alongside Fernandez and Rodrik (1991) — and thus the political resistance to structural reforms[8]. This is the political economy approach held by Pereira: "the effort to adjust the Lain America economies during the 1980s were impressive ..." [rather than populism] "the fiscal crisis of the state ... was the result of two factors: ... excessive foreign indebtedness of the 1970s and ... the delay in replacing the import-substitution strategy" (Pereira et al., 1993: p.27-28). And this delay is assigned to political problems related to, *inter alia*, income inequalities.

4. CONCLUSIONS

We cannot say that the 1980s' *Debt Crisis* was the product of monetary and fiscal policies that were incompatible with sustainable external balances, as drawn by Rodrik and many other political economy analyses. External shocks and international financial markets help to predict that crisis independently of domestic policies — only one indicator of the latter exhibits statistical significance. This new estimates took correcting the variables for terms of trade shocks and foreign debt burden, as well as approaching the phenomenom at stake as a *balance of payment crisis,* structurally related to wealthier or fast-growing developing countries that had access to the international capital markets.

The finding that debtors' financial burden in 1980 helps to predict their foreign loans default two (or more) years later, controlling for other economic (and political) elements, corroborates the *financial instability hypothesis* that the economy's debt structure conditions financial market adjustment, or that the global system is crisis-prone for wealthier developing countries that have access to the international capital markets (Fischer, 2001). There remains to know, thought, what led some countries to accumulate high external commitments by 1980.

Regarding shocks, the evidences do not actually support the view that the *crisis* was the product of external and not internal problems. This would be so in the framework of the political economy of stabilization policies and crisis, where terms of trade shocks are seen as external. However, the price effect of external shocks can be associated with structural characteristics of the economies — i.e., the degree of inefficiency of their productive resources[9]— which, in turn, can be referred to resistance to structural reforms. In this sense, delays in structural reforms, rather than in stabilization policies, was the crucial political problem.

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[8] An alternative reasoning for delays in reforms or in fiscal adjustment, presented by Pereira & Abud (1997), and unrelated to either social cleavage or institutions maturity, is the timing of the total transition cost. Delays occur when the procrastination cost is smaller than the adjustment cost.

[9] In this sense, shocks could not be uniquely associated with *bad luck*, as done by Easterly *et al.* (1993).

The strong correlation between bad income distribution and both fall in terms of trade and foreign indebtedness in 1980 reinforces this alternative political approach to the *Debt Crisis*. On the other hand, this same correlation calls forth an economic channel, with income equality dictating how fast and steady countries go through structural transitions that, ultimately, determine their capacity to face external vicissitudes, as shocks and world market depression. Anyhow, designing models that describe all these alternative causations from income distribution to external macroeconomic performance remains for later research.

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