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EXORCISING ASIAN DEBT: LESSONS FROM LATIN AMERICAN ROLLOVERS, WORKOUTS, AND WRITEDOWNS

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The Asian crisis has once again raised the issue of how relations between lenders and debtors might be better managed to prevent the recurrence of such problems. In considering alternative schemes to reform international institutions, regulate financial intermediaries, improve debtor policies, and the like, scholars and policymakers have looked to the historical record to see how problems have been handled in other situations. Yet few have examined the lessons that the Latin American debt crises offer to Southeast Asia. In fact, some are skeptical about learning from earlier crises. For example, Joseph Stiglitz has recently argued that "models about crises that developed in response to the Latin American debt crisis in the 1980s are completely inadequate for understanding the causes or solutions of the East Asian crisis."[1] The most recent case of massive financial intervention prior to the current Asian problems was the Mexican peso crisis of 1994-5. And before this recent crisis, the debt workouts beginning in 1982 may provide lessons from the past.

The purpose of this paper is to show the relevance of debt resolution efforts in other regions in earlier historical periods to current Asian problems. I will argue that the lessons of Latin American debt rescheduling efforts in the 1930s-40s, 1980s, and the most recent Mexican crisis are quite germane to increasing our understanding of orderly debt workouts. In particular, I will suggest that efforts by international institutions such as the IMF, or bargaining between lenders and debtors on their own, have often failed to generate solutions to debt problems. Instead, recent frequent intervention by the United

[1] Stiglitz (1998), p. 2.

States and other creditor governments – including earlier less common but crucial actions by the United States and others going back to earlier in this century -- have been decisive in resolving debt crises. An analysis of the Latin American experience suggests that calls for leaving debtors and lenders to work out their own problems, or the prevalent view that the IMF has been doing an adequate job in managing debt crises, are misguided.

Section I begins with an overview of some common assessments of the management of debt crises, focusing on intervention by creditor governments. I suggest that the common wisdom on intervention is misleading, and does not adequately reflect the more intricate and complex history of creditor government intervention and international institutional roles. This section then presents a brief schematic of debt bargaining that focuses on the key actors in negotiations. Sections II-V then examine instances of debt bargaining going back to the 1930s and 1940s, the 1980s, the 1995 Mexican crisis, and current Asian crisis, respectively. In concluding, I consider some implications of comparative analysis for debates about the resolution of international financial crises.

I. VIEWS OF DEBT CRISIS MANAGEMENT

The conventional wisdom about the historical record of debt rescheduling has been summarized succinctly by Barry Eichengreen and Albert Fishlow.[2] They argue that the resolution of debt crises during the era of bond finance in the 1930s was characterized by minimal government intervention. By contrast, in the 1980s, they suggest that "Lending and coordination of debt restructuring by the IMF arguably prevented the crisis

[2] Eichengreen and Fishlow (1996).

from spreading further." In examining the 1995 Mexican crisis, they do find that intervention took place less through "multilaterals like the IMF as through the leadership of the United States."[3] The underlying logic of these assessments is that in the 1930s, bond financing did not pose a systemic risk, as compared to the 1980s. As to why the United States should play the lead role in the Mexican crisis of 1995, Eichengreen and Fishlow discuss American interests in Mexico in preventing economic collapse with consequent problems in immigration and a "perceived failure of the U.S.-promoted model of liberalization and privatization."[4]

Is this assessment of the history of intervention in debt rescheduling accurate? In the sections that follow, I will show that the United States was much more involved in earlier debt resolution efforts than Eichengreen and Fishlow have indicated. For example, in the 1930s defaults, the United States generally did not intervene directly to help bondholders. Yet most Latin American rescheduling negotiations also did not conclude in the 1930s -- instead lasting well into the 1940s and 1950s. And in the case of two major debtors, Mexico and Peru, the U.S. attitude proved critical, with differing U.S. considerations and actions leading to a highly favorable accord for Mexico, but an equally unfavorable agreement for Peru. In the 1980s, the evidence also does not support the view that the IMF played the highly positive role that they indicate. Indeed, it was only when the United States responded to the 1987 Brazilian moratorium and the 1988 Mexican political crisis with the Brady Plan (which called for significant debt writedowns), that the crisis that affected nearly all Latin American countries in the 1980s (and many others as well) moved toward resolution.

[3] Eichengreen and Fishlow (1996), p. 4.

The importance of understanding U.S. motivations and actions, as well as the relationship of its policies to international institutions and the debtor-lender relationship goes beyond quibbles about historical detail. How the United States has chosen to intervene, and on whose side it has done so, reveals U.S. strategic, political, and economic motivations, as well as shedding light on the path to bargaining outcomes. Moreover, understanding the motivation of the U.S. and creditor countries more generally helps us to consider questions of institutional designs and reform in international institutions that might facilitate the management of international debt crises.

To better understand how debt reschedulings have taken place, and the role of creditor governments, it is useful to consider the nature of the bargaining game. As I have argued elsewhere,[5] we can consider strategic interaction between lenders and debtors as involving a multiplicity of actors. Figure 1 illustrates ten possible bargaining relationships: Among similar actors, we have interaction (1) among debtors; (2) among lenders; (3) among creditor governments; and (4) among international organizations. In addition, we have six remaining interaction possibilities among pairs of different types of actors. Although one could analyze each of these relationships, we need not examine each in detail in order to understand the basics of debt rescheduling negotiations.

FIGURE 1 HERE

In practice, the debt rescheduling issue-area initially encompasses the terms of rescheduling (which include spreads, fees, and repayment arrangements),[6] the amount of new loans made available to debtors, and the type of adjustment debtors must follow (if any)

[4] Eichengreen and Fishlow (1996), p. 36.
[5] Aggarwal (1996). The following discussion draws heavily on parts of Chapter 2 of this work.
[6] "Spreads" refer to the difference between the bank's cost of funds and the interest rate charged to the borrower. "Fees" are charges for managing and initiating loans.

as part of their arrangements with lenders. This characterization of issues involved in negotiations relies on the empirical pattern observed among bargainers: in general, they restrict their discussion to these financial matters and to concern about future relationships with their counterparts. As long as actors involved in negotiations accept the bounds of the issue-area, negotiations will revolve around the resolution of such issues while the types and numbers of actors involved in negotiations should remain the same.[7]

Empirically, most private debt rescheduling discussions have initially involved individual debtor countries on one side, and bondholders or bankers on the other. Banks and bondholders have generally succeeded in forming coalitions (of varying cohesion) to bolster their position. By contrast, debtors have historically failed to unite in a common negotiating front, although they made several efforts to do so in the 1980s.[8]

By linking debt to security or trade issues, debtors and lenders have often attempted to involve creditor governments (CG) in negotiations. When debtors have succeeded in linking debt to a CG's national interest, these governments have at times provided financial aid and also pressured private lenders to make concessions to debtors. Yet CGs have also faced appeals from their bankers (or bondholders) to become involved as their allies in debt negotiations.[9] Private lenders have often called on their governments to enforce contractual provisions of their loans, cloaking their pleas for creditor state intervention by invoking the "national interest." At times, of course, creditor governments have become involved in debt

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[7] In more technical language, the bounds of the issue-area can be determined by "cognitive consensus" among actors on which issues are interlinked. For a theoretical discussion of this point, see in particular Haas (1980).
[8] Lipson (1985) examines bank efforts to unite in the 1980s; Aggarwal (1987) analyzes the differential success of banks and debtors in uniting.
[9] Bulow and Rogoff (1989) formalize a three-way bargaining game in which sufficiently large gains from trade allow the banks and debtors to secure "side payments" from creditor governments.

negotiations of their own volition to meet their own strategic, political, or economic objectives.[10]

How do CGs make their intervention decisions? I argue that three considerations are important: strategic security concerns, financial concerns, and political concerns.[11] With respect to security interests, these depend on factors such as the types of political alliances CGs have with other major powers, the number of competing major powers in the system, the importance of international financial institutions, and the nature of economic competition with other CGs. The outcome of debt rescheduling on lenders can affect CG security interests in several ways. For example, decisions by a debtor and its lenders to engage in equity swaps, whereby lenders receive assets in debtor countries, will influence the terms of competition among creditor governments. Also, active intervention by one creditor government to aid its banks can put the banks in non-intervening countries at a considerable financial disadvantage. The decision by Japanese banks in the late 1980s to pool their developing country loans under the guidance of the Japanese government for rescheduling purposes has had strategic implications for U.S. interests in its own banks.

With respect to financial concerns in their lenders, the primary factors are (1) the amount of money loaned by banks domiciled in the CG to the particular debtor as compared to the total amount of loans made by the CG's lenders to all debtors; and (2) the amount of the CG's lenders' loans to the debtor in proportion to the total amount of loans made by all lenders. The first factor is an indicator of the vulnerability of the lenders located in the CG;

[10] Naturally, creditor governments may not always see eye-to-eye on debt rescheduling issues and are likely to bargain among themselves over the sharing of costs in rescheduling. Fishlow (1985) examines differences among governments in earlier debt rescheduling episodes.
[11] A more precise analysis of creditor government intervention calculations can be found in Aggarwal (1996), chapter 3.

the second influences the CG's level of interest in taking the lead in rescheduling matters as the primary government actor.

Finally, with respect to political issues and their relationship with debtors, CGs are concerned with the impact of debt rescheduling on their trade relations, political alliances, ideological concerns, and possible spillovers to areas such as immigration. Severe economic adjustment programs generally lead to sharp cuts in imports and to increased efforts by debtors to promote their exports, both of which are likely to strain trade and other relations between the CG and the debtor. For example, increased immigration pressure from Mexico, resulting in part from its economic problems, has led some analysts to call for a more active role by the U.S. government to aid Mexico. A similar argument has been made with respect to the fragility of democracies in Latin America and the deleterious effects of continued adjustment programs on governmental stability.

Lastly, in times of perceived threat to the international financial system, international institutions such as the IMF, the World Bank, or the League of Nations have become actively involved in the debt rescheduling process. In particular, these institutions have often responded to pressures from creditor countries that wished to encourage specific policies in debtor countries without being directly associated with their promotion.

To simplify, we can consider the debt bargaining game as one between a group of lenders (with varying degrees of unity), facing a single debtor, with the possibility of intervention by creditor governments and/or international organizations. In the next four sections, we examine the negotiations that took place in several historical cases with an eye to better understanding the involvement of the United States and other creditor governments.

II. DEBT BARGAINING IN THE 1930S AND 1940S

The United States, predominant creditor of the 1920's, sent abroad nearly $9 billion from 1919 to 1929, accounting for about two-thirds of all investment.[12] Lending fluctuated considerably during this period, with major declines in 1921, 1923, 1926, and 1928. Some observers remained optimistic about continued lending, but by 1929 borrowers paid over a billion dollars more in interest, dividends and amortization than they received in new loans and investments. The last severe drop in 1928 (due to the diversion of funds to the U.S. stock market) crushed the servicing prospects of both European and Latin American borrowers. Lending picked up in 1930 and 1931, but was too little too late. The deflationary shock to the world economy had taken its toll: depression had set in. By 1933, twelve Latin American countries and ten European countries suspended at least part of their debt servicing.[13] Although some Latin American countries restored partial servicing in the mid-1930s, by 1937, 85 percent of these bonds were in default.[14] In 1935, slightly over $1.5 billion of a total $1.866 billion in outstanding bonds were in default. The amount in default declined to $750.5 million by 1945, before falling to $127 million by 1952.[15]

Following the default of large numbers of countries, debt negotiations between bondholder groups and debtors began almost immediately. Yet resolution of these debt problems would come only in the 1940s and 1950s.[16] The cases of Mexico and Peru, both heavily indebted countries with a long history of debt rescheduling going back into

[12] Aldcroft (1977), 241. The following discussion of lending draws on this excellent review of financial markets in the 1920s. For other analyses of this period, see the citations in this work.
[13] Winkler (1933).
[14] See Felix (1984) and his references on bond defaults.
[15] UN (1955), p. 157.
[16] See United Nations (1955) for a summary of the outcomes of Latin American debt rescheduling during this period.

the early part of the 19^{th} century, are particularly illuminating in examining the debt rescheduling effort and the role played by the United States.

Mexico

Whereas most countries went into default in the 1930s, Mexico had been in default since 1913, following the severe chaotic conditions after the departure of Porfirio Díaz.[17] Various efforts to come to an agreement with bondholders failed prior to the 1920s. In the first half of 1922, negotiations between Mexican Finance Minister Adolfo de la Huerta and the International Committee of Bankers of Mexico (ICBM) (formed in 1919), resumed. A number of issues hampered these negotiations. The Mexican government insisted that any debt settlement include a new loan. President Alvaro Obregón argued that without new funds, Mexico would probably be unable to live up to any agreement. Members of the ICBM stipulated, however, that no new loan would be granted without a debt agreement and official American recognition of the Obregón government.

The State Department's continued concern over Article 27 of the new Mexican Constitution, which asserted control over land and subsoil rights, lessened the likelihood of American recognition. Following complex negotiations, Huerta signed a new debt accord in June 1922, consolidating Mexico's foreign and railway debts, and certain internal obligations held by foreigners. This tentative accord awaited ratification from Obregón. Despite the lack of a new loan in the accord, de la Huerta assured Obregón that obtaining new loans would be simple after the agreement's ratification, judging from his previous negotiations with the bankers. In addition, the preamble of the accord stated that the ICBM recognized the "difficulties with which Mexico has had to contend and the limitations upon her capacity for the immediate payment." It desired to cooperate "with the Mexican government in the solution of its problems and in the upbuilding of its credit."[18]

Obregón, however, refused to ratify the agreement, stating that he was skeptical of the "good faith and sincerity" of the committee.[19] Instead he directed de la Huerta to immediately open negotiations for a new loan. But Thomas Lamont of the ICBM reminded de la Huerta that no loan was possible until the United States recognized the Obregón government, stating that

> the American government during the past year often explained that it did not encourage its citizens to make loans to governments not recognized by the White House.[20]

Realizing that recognition from the United States would not be forthcoming without a debt agreement,[21] Obregón reluctantly signed the de la Huerta-Lamont debt accord in August 1922; the Mexican Congress ratified it in September. Following this accord and the Bucareli Conference that led to additional treaties of interest to the United States, Washington extended formal recognition to Obregón's government in August 1923.

Despite this new agreement, by 1924 Mexico was once again in default. At this point, the United States demonstrated little interest in the bondholders' problems because it had resolved some of its other key objectives with the Bucareli agreement. Additional agreements in 1925 and 1930 failed to generate significant debt repayments, and Mexico once again defaulted on these agreements soon after they were concluded. Efforts to resolve

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[17] This discussion of Mexico and the following discussion of Peru relies heavily on Chapters 9 and10, respectively in Aggarwal (1996).
[18] Economist, July 1, 1922, p. 15 and Turlington (1930), p. 289.
[19] Turlington (1930), p. 294.
[20] Wynne (1951), p.71 and Official Documents Relating to the De La Huerta - Lamont Agreement, #70, cited in Turlington (1930), p. 294;
[21] See The Economist, July 1, 1922, p. 16.

the default continued throughout the 1930s; but for the most part, the United States showed little interest in the debt negotiations.

This aloof attitude changed dramatically with the onset of the Second World War. Following preliminary feelers in early 1940, the United States began to negotiate a settlement of outstanding issues with Mexico. By late 1940, the United States had proposed a draft agreement addressing outstanding claims involving agricultural and oil claims. Mexico-United States governmental level relations fundamentally improved with the signing of an agreement in 1941.[22] The accords included a promise by Mexico to pay $40 million in compensation for agrarian claims and the establishment of a joint commission to determine the amount of compensation owed the oil companies. The United States also agreed to a trade treaty and to commitments to purchase silver to back the Mexican peso, and to make loans to Mexico through the Export-Import bank. America's interest in deferring to Mexico because of its broader objectives is reflected in the pressure it put on the oil companies to take the $23 million settlement offered for the Mexican oil expropriation of 1938. When the companies objected, the State Department told them to either take it or accept nothing; the oil companies relented.[23] With these arrangements in the works, the U.S. government had no interest in helping the lenders in their negotiations with Mexico over its debt.

The U.S. interest in a quick resolution of the debt problems at this point was not lost on the ICBM. After proposals and counterproposals, a new agreement was reached on Mexico's direct foreign debt in November 1942. Overall, the Mexican government would pay 23.7 cents on every dollar of secured debt bonds, and only 14.2 cents on every dollar of

[22] For a good discussion of the terms of the U.S.-Mexico agreement, see Cline (1953), pp. 248-249. For other discussions, see Cronon (1960) and Wood (1961).
[23] For discussion of these negotiations, see Cronon (1960), Wood (1961), and Krasner (1978).

unsecured debt bonds. Over $500 million in direct government debt (principal and interest) would be paid by $50 million in debt service.[24]

Peru

After the 1929 stock market crash, Peru's financial difficulties multiplied. The drastic decline in the value of Peru's leading exports cut the nation's purchasing power, limiting its ability to import, and shrinking government revenues from import taxes.[25] Between 1929 and 1932, the value of Peru's exports fell from 335 million soles to less than 180 million soles, decreasing the government's income by 45 percent.[26] In May, 1931 the government issued a decree suspending payment on the interest until December, and diverting funds due on the national loan for the "purpose of paying off all arrears of salaries and pay of all Government employees and forces."[27] In January 1932, the Peruvian government passed a law indefinitely extending the moratorium on the entire external debt service.

At this stage of the negotiations, the United States showed a great deal of sympathy for the Peruvians, especially because they had cooperated with a mission by Edwin W. Kemmerer, an American economics professor who had been recommended as an impartial advisor for Peru. Throughout the 1930s, negotiations dragged on between the bondholders and Peru without sign of resolution. With the onset of the Second World War, as in the Mexican case, the U.S. government began to take a more active interest. With an eye on security concerns, the United States was reluctant to push the

[24] Wynne (1951), p.97-8; Economist, December 5, 1942, p. 709.
[25] State Department archive (hereinafter SD) 823.51/619, p. 1.
[26] Werlich (1978), p. 211.
[27] SD 823.51/677.

Peruvians very hard, despite significant pressure from bondholders. In fact, the Export-Import Bank agreed to a loan of $10 million for Peruvian purchases from the United States. Shortly thereafter, Peru expropriated planes from the German airline Lufthansa; soon thereafter, in March 1941, it closed Transocean, a German shipping group.[28] The U.S. government continued to encourage negotiations between the bondholders and Peru, but its primary motivation for involvement was clear.

In November 1942, Nelson Rockefeller suggested that the U.S. government buy Peruvian bonds and convert the total amount to Peruvian soles, which Peru would pay on low interest.[29] Such an action, however, would have antagonized the Peruvian Bondholders Council and other financial groups, and thus was rejected by the State Department. Efforts to resolve the debt came to nought, despite continued negotiations between Peru and the Council. By the early 1950s, however, the Council had convinced the World Bank to help it block loans to Peru. In July 1951, Peru began to make overtures to the Council for a settlement of its outstanding debt. As expected, the Council's block of its credit strongly encouraged Peru to be more forthcoming. In April, when Peru had sought a World Bank loan to develop its Port of Callao facilities, it asked if the World Bank "would be willing to make such a loan without waiting for a final settlement of Peru's eternal debt." In response, World Bank President, Eugene Black, wrote back to Peru:

> …if the President [Peru's] would indicate to the Bank that Peru was prepared to negotiate with the Bondholders' representatives, and, if a reasonable settlement could be negotiated, to recommend its approval by Congress, the Bank would consider making such a loan before final settlement had been reached.[30]

[28] Carey (1964), pp. 106-107.
[29] SD 823.51/1470, pp. 1-3.
[28] SD 823.10/7-3151, Annex C, p. 1.

In response to this direct linkage, Peru moved quickly to accommodate the Council's demands. By July, President Black announced that the Bank would be willing to negotiate with Peru to conclude the Callao Port loan, but still insisted that "Before concluding the negotiations, however, I would expect to receive confirmation that the President is prepared to make a recommendation to Congress...."[31]

In discussions with U.S. government officials, Peruvian Ambassador Fernando Berckemeyer clearly recognized the direct linkage of successfully signing an accord to receiving a fresh supply of World Bank loans. After discussing the various projects for which Peru sought financing from the World Bank, the U.S. embassy acknowledged Berckemeyer's perspective:

> the only hindrance to the immediate establishment of these credits is the lack of a satisfactory settlement for the Peruvian foreign debt ... and he feels optimistic that with the proposed offer for settlement that he hopes to get from his Government, this hindrance will be eliminated.[32]

By August, Peru was willing to address the objections the Council had raised with regard to Peru's 1947 offer. Peru offered to pay back interest on the bonds, and the principal in full.[33] As some disagreements continued on the date from which back interest would be calculated, the British government increased their pressure. When the World Bank appeared to consider making Peru a small loan, the British took "violent exception to the loan," warning that "'the city' [London financial interests] will have nothing further to do with the Bank if the Bank pursues such a course."[34]

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[31] SD 823.10/7-3151, Annex C, p. 1.
[32] SD 823.10/8-151, p. 1 of Enc. 1.
[33] SD 823.10/8-1351.
[34] SD 823.10/9-1351.

Although some minor obstacles involving the question of succession of rights on the new bonds (whether payment of arrears went to present owners or to owners who did the exchange), and the base for revision of the 1947 offer,[35] the Peruvians essentially acquiesced to the bulk of the Council's demands. In short, with strong pressure from the British government and international institutions, the Peruvians had little choice but to agree to considerably more onerous terms than Mexico had negotiated in 1942.

In summary, both the Mexican and Peruvian cases illustrates a rather more complex history than a simple hands off policy by the United States on debt rescheduling. While the lack of a systemic threat kept the United States from dramatically intervening in Mexican debt negotiations, a host of other concerns often became linked to the debt issue and affected their resolution. And when strategic U.S. interests became involved with the onset of the Second World War, the U.S. clearly leaned in Mexico's direction against the bondholders. And in Peru, while the U.S. was reluctant to press Peru during the war, it had little trouble in going along with the bondholders' use of the World Bank to secure their objectives. Nor, I might note, did the World Bank resist this linkage to private debt negotiations. Moreover, it is worth keeping in mind that the longstanding lack of Mexican and Peruvian access to sources of lending as a result of their default and inability to come to a resolution with bondholders demonstrates that lack of intervention was hardly propitious for a quick resolution of debt problems.

III. THE DEBT CRISIS OF THE 1980S

[35] SD 823.10/12-1851.

OPEC's successful manipulation of oil prices in 1973-1974 has been seen justifiably as one of the most significant events in political relations between developed and less developed countries (LDCs).[36] The impact of this price increase on the international financial system has been equally striking. In 1973, the medium- and long-term debt of LDCs (over one year in maturity) was $97.3 billion; by the end of 1981, it had soared to $425.2 billion. By 1981, the crisis began to take shape. Faced with strong inflationary pressures, the United States pursued tight monetary policies that both drove up interest rates on existing loans (which had been made at floating rates) and induced a recession in the developed countries, thus hurting export prospects for the debtors. In addition, capital flight from many debtor countries exacerbated the crisis as did worsening terms of trade for debtors. For non-oil producing debtors, these shocks, combined with steep oil prices before 1981, were threatening. For oil exporters such as Mexico, the effect of an oil price plunge in 1981, higher interest rates, and worsening export prospects proved lethal. Although Mexico was not the first to seek bank rescheduling (Poland and Argentina needed to reschedule as early as 1981), its massive debts of over $80 billion proved too much for the existing rescheduling mechanisms to handle. By August 1982, Mexico neared complete default. As banks continued to retrench, Brazil, Argentina, and other major debtors found themselves in similar crises. By 1983, over 25 countries were in arrears, initiating more than a decade of rescheduling efforts that only drew to a close in the mid-1990s.

Although the IMF was an active participant throughout the debt rescheduling efforts, the United States and other creditor governments led the process through bridge loans in the first instance, and later through the Brady Plan debt writedown. Indeed, the

[36] The discussion in this section draws on various chapters in Aggarwal (1996).

IMF strategy of continuous rollovers and jumbo loans, while initially shared by the United States, merely prolonged the resolution of the debt crisis and ensured that Latin America would lose a decade of growth.

To examine the active role of the United States during this period, we can consider the case of Mexican debt rescheduling. It is worth noting that the U.S. also undertook very similar actions in other Latin American countries. As we shall see, the U.S. was an active participant from the start, and enlisted the IMF to help in debt rescheduling. The effect of initial U.S. policy was to prolong the debt crisis. Only in the late 1980s, when faced with growing political and strategic concerns, did the United States take decisive action to end the debt problem.

On August 13, 1982, Mexican Finance Minister Silva Herzog met with U.S. Deputy Treasury Secretary R.T. McNamara, a Managing Director of the IMF Jacques de Larosière, Chairman of the Federal Reserve Paul Volcker, and then Secretary of the Treasury Donald Regan in quick succession. His message was that Mexico could no longer meet its obligations and needed immediate help.[37]

Although sympathetic, de Larosière insisted that Mexico would have to acknowledge any help provided by the IMF, and insisted that Silva immediately begin work toward developing an economic adjustment program.[38] For his part, Volcker telephoned the major central banks about an impending $1.5 billion loan, of which the Fed had agreed to provide half. Meanwhile, the Mexicans called the heads of Chase, Citibank, Morgan, and Bank of America to arrange a meeting for the following week.[39]

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[37] Delamaide (1984), p. 1.
[38] Kraft (1984), p. 7.
[39] Delamaide (1984), p. 3.

Silva then turned to Regan directly to solve the cash flow problem. After tough negotiations, the U.S. Treasury agreed to provide $2 billion in cash: $1 billion as prepayment for Mexican oil and $1 billion in credit toward U.S. food exports to Mexico.[40] Taking advantage of Mexico's vulnerability, the U.S. government secured a $50 million negotiation fee and a 20 percent discount on the oil.[41]

On August 18, the Federal Reserve called a group of central bank deputies to an emergency meeting at the Bank for International Settlements (BIS) in Basel. The central bankers decided to give Mexico a $1.85 billion credit, of which the United States agreed to contribute $925 million. The bridge loan was to be released in three tranches with disbursement of the first third hinging on the negotiation results between Mexico and the IMF over austerity measures.[42]

The United States Government and the IMF also pressured commercial banks to participate in a loan to Mexico. On August 20, Silva Herzog met with an advisory committee of Mexico's bankers and then with over 800 bankers in New York, requesting a 90-day moratorium on principal repayments; Anthony Solomon, head of the New York Fed, pressured the banks to cooperate with the Mexican financing program.[43]

Following an intense period of complicated negotiations during which the money center banks and creditor governments pressured smaller banks to participate in the loan, the advisory committee and Mexico agreed to a new package on December 8. It called for a new $5 billion jumbo loan, to be repaid in six years, with a three-year grace period, at an interest rate of 2.125 percent over the U.S. prime rate or 2.25 percent over LIBOR, topped

[40] Washington Post, August 15, 1982.
[41] Kraft (1984), pp. 15-16.
[42] Kraft (1984), p. 18.
[43] See Kraft (1984), pp. 21-22 for details.

by a 1.25 percent fee.[44] Twenty billion dollars of debt owed by Mexico from August 1982 to the end of 1984 would be rescheduled and repaid eight years with a grace period of four years at an interest rate of 1.875 percent over LIBOR and a fee of one percent.[45] Despite problems with recalcitrant banks, prospects for an agreement improved following a bridge loan of $433 million by the large banks in February 1983. The final agreement, signed on March 3, 1983, involved 530 banks.

Over the next couple of years, the main effort on the part of the IMF and bankers was to roll over loans and ensure that Mexico continued to fully service its debt. The Baker Plan, promoted by the United States in 1985, failed to alter the basic course of debt negotiations. Thus, despite U.S. government concern for Mexico's stability and its implications for trade, immigration, and drug trafficking, little changed in the pattern of debt negotiations. Domestic pressure to do more came from outside the Bush administration. For example, the Governor of Arizona, Bruce Babbitt, was an advocate of giving Mexico greater support, warning that Mexico was "the ultimate domino." He went on to complain that the Administration was placing too much pressure on Mexico and that Republican assistance to the PAN could endanger the PRI's willingness to promote a more open Mexican political system.[46] Others argued for more active American government intervention to ensure that the banks made additional concessions to Mexico to tackle the problems created by the earthquake. On the whole, the United States appeared willing to nudge the banks and Mexico toward continued cooperation, but remained unwilling to actively promote major reduction in debt. Despite growing political problems in Mexico, the IMF continued to insist on Mexican adherence to an adjustment program. It still saw

[44] Wall Street Journal, February 25, 1983.

itself as the stabilizer of the international financial system and the arbiter of debt negotiations between banks and debtor countries.

Signs of a new U.S. attitude came in October 1988, following the Brazilian debt moratorium of 1987 and serious political instability in Mexico following the 1988 elections. As oil prices fell, and concern grew about Mexico's political and financial problems, the United States cobbled together a $3.5 billion bridge loan to Mexico in the hope that this offer would give President-elect Carlos Salinas some breathing room.[47] Still, Mexico's problems continued to worsen.

Following discussions of debt reduction schemes in the latter part of 1988, U.S. Treasury Secretary Nicholas Brady proposed a new approach in March 1989 to handle the debt crisis, based in part on a plan proposed by Japan and France in 1988.[48] This action placed the United States firmly behind the process of debt reduction. Brady proposed that debt reduction and/or debt service reduction be combined with increased lending and continuation of growth-oriented economic adjustment. The United States endorsed debt reduction as necessary to help reforming countries break out of the debt cycle, viewing excess debt and net transfer of resources as stifling economic recovery in countries that could otherwise serve as important export markets. IMF Managing Director Michel Camdessus also endorsed Brady's proposal. Camdessus stressed that countries willing to enact domestic reforms "need to be able, from the outset, to count on a more adequate alleviation of the present drag of debt-service payments on their adjustment efforts."[49]

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[45] International Herald Tribune, December 15, 1982.
[46] Los Angeles Times, May 28, 1985, Part II, p. 5 op-ed article.
[47] The Economist, October 22, 1988, p. 70.
[48] Economist, March 18, 1989, p. 110.
[49] IMF Survey, March 20, 1989, p. 91.

Following Brady's speech, Mexico's Finance Minister Pedro Aspe met with US officials.[50] Mexico submitted a letter of intent to the IMF, requesting $3.6 billion through the Extended Fund Facility. The request also included specific proposals for debt and debt-service reduction on its $57 billion commercial debt. The Fund concurred with the Mexican proposal, and in May 1989 the two parties agreed to a three-year extended arrangement including an immediate disbursement of funds from the Compensatory and Contingency Financing Facility (CCFF).[51] Most importantly, this unprecedented arrangement included debt reduction. Thirty percent of each purchase under the EFF was to be set aside for debt and debt service reduction, and pending agreement with its creditor banks, Mexico would be allocated up to forty percent of its quota to support reduction. The Fund displayed its support of debt reduction by disbursing the cash to Mexico before the debtor had reached an agreement with its creditors.[52]

Despite U.S. endorsement of debt reduction, the banks were reluctant to make concessions to Mexico. By late July 1989, however, the stalemate was finally broken. That month Secretary Brady was scheduled to accompany President Bush to the G-7's annual economic summit. French President Mitterand, who had proposed alternative strategies for resolving the debt crisis and consistently clashed with the U.S. over the proper handling of the situation, was to be the host of the summit. Bush administration officials worried that Mitterand would attempt to embarrass the U.S. over the debt issue.[53] Earlier, with an eye

[50] Financial Times, March 14, 1989, pp. 1-2.
[51] Of the SDR3250.7 million package, SDR2797.2 million was from the EFF and SDR453.3 million was from the CCFF. The CCFF was created in August 1988 to expand the utility of the Contingency Financing Facility. The CCFF portion in this case was more compensatory than contingent. In 1988, the decrease in prices for petroleum, coffee, and tomatoes, combined with both damaged crops necessitating more imports of Mexico's main cereal imports and increased prices of these same imports, causing serious damage to the trade balance. See IMF Survey, May 29, 1989, p. 175.
[52] The Economist, April 29, 1989, pp. 15-16.
[53] Wall Street Journal, July 7, 1989, p. A8.

toward the summit, Secretary Brady personally telephoned the chairmen of the largest New York banks urging them towards settlement. The U.S. government thus accelerated its efforts to produce an agreement prior to the Paris summit to deflect criticism of its new approach.[54]

Strong intervention by the U.S. Treasury Department finally brought results. After four months of talks between Mexico and the 15-bank steering committee, Brady convened a meeting with both sides in Washington, and produced an agreement.[55] The July package presented Mexico's creditors with three options. The first option was to reduce the principal of the debt by thirty-five percent. This entailed exchanging loans for thirty-year bonds at sixty-five percent of the face value of the loans. These bonds would pay interest at 13/16 percent over Libor (the same rate as before the discount). The second option was interest-rate reduction. Here banks would exchange their loans for thirty-year government bonds with the same face value, but with a fixed interest rate of 6.25 percent. The final option on the menu was the extension of new loans in proportion to outstanding exposure. Except for the amount reduced, banks were to offer new loans worth 25 percent of their outstanding exposure, with a fifteen-year payback period (beginning after a seven year grace period), at an interest rate of 7/8ths over Libor.

Of the $48.5 billion of medium and long-term debt covered by participating banks, 41 percent chose the principal reduction option. This cut the face value of $20 billion worth of loans by 35 percent, yielding a savings of $625 million annually, assuming then-current interest rates of 9 percent. Forty-nine percent of the banks chose interest reduction, meaning that nearly $24 billion of the debt would pay 6.25 percent interest, yielding an

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[54] Wall Street Journal, July 7, 1989, p. A8.

annual savings of approximately $700 million for Mexico. However, to purchase the U.S. zero-coupon bonds used to guarantee the exit bonds, Mexico borrowed $5.8 billion from the World Bank, the Japanese Export-Import Bank, and the IMF.

The negotiations in the 1980s indicate that the U.S. and other creditor countries, rather than the IMF, proved to be the decisive actor. Creditor governments initially supported the rollover and jumbo loan approach to debt rescheduling (which ultimately proved futile) as well as promoted a new approach to debt rescheduling. The original effort to simply roll over debt and insist on full payment with drastic Mexican adjustment clearly favored the banks. Only as dissent increased in Latin America, posing strategic concerns as well as domestic criticisms in the U.S., did the U.S. government pursue debt reduction. While this action was ultimately endorsed by the IMF, it did not take any initiative during the 1980s to fundamentally alter the course of debt negotiations that strongly favored the banks. As we shall see, the underlying pattern of the U.S. role would be repeated in the 1995 peso crisis to which we now turn.

IV. THE 1995 MEXICAN CRISIS

In March 1994, when Mexican PRI Presidential candidate Luis Donaldo Colosio was shot on the hustings in Tijuana, a financial crisis was averted by timely and effective policy management.[56] The crisis was managed by officials from the Finance Ministry, in particular José Angel Gurria. Gurria was an experienced negotiator who had participated in Mexico's debt negotiations as well as the financial services negotiations in the NAFTA. In March 1994 he was the head of Nacional Financiera, one of Mexico's most

[55] The Economist, July 29, 1989, pp. 65-66. For a discussion of the Mexican agreement, see Aggarwal

powerful development banks. Gurria understood that a major run on the peso could occur.

In an effort to head off a speculative attack, officials at Finance activated a $6 billion swap facility that had been negotiated between Hacienda and the U.S. Treasury (the leading Mexican official responsible was Guillermo Ortiz). Although negotiated "secretly" around the time of the debate between U.S. Vice President Al Gore and NAFTA-critic H. Ross Perot, the swap facility had been known to insiders for months.

To gain time in order to get approval from the U.S. government to activate this Fund, Aspe, Ortiz, Gurria, Miguel Mancera (the head of the central bank), and other finance officials, with the agreement of the President, decided to shut down the Mexican stock market (or Bolsa de Valores) for a day. Ortiz called Lawrence Summers, Undersecretary for International Affairs at the U.S. Treasury, who activated the Exchange Swap Fund. Then the Mexican finance officials "began trying to win back investor confidence by calling everyone they could think of around the world from traders to chief executives."[57] The management of the crisis caused by the assassination of Colosio demonstrated how growing economic integration required the construction and maintenance of increasingly complex domestic and international coalitions. Although the bargaining around the assassination led to a positive payoff for Mexico and foreign firms, it did not address the roots of the balance of payments problems which continued to grow. In particular, it did not reduce the government's reliance on foreign savings which left it little room for policy mistakes.

(1990).

[56] This section draws heavily on Cameron and Aggarwal (1996).

[57] The Wall Street Journal, 28 March 1994, p. A6.

The growing strength of foreign investors was demonstrated in the aftermath of the Colosio assassination, when a group of mutual funds sent the Mexican government a list of suggestions to bolster the currency. According to The Wall Street Journal, "To lend weight to their advice, the funds said they were willing to pour an additional $17 billion into Mexico this year if the government enacted reforms."[58]

The second crisis began shortly after Ernesto Zedillo met with Carlos Salinas in the presence of Pedro Aspe in November, less than two weeks before the transfer of government, and discussed a devaluation of the peso. Aspe opposed the measure, in spite of declining reserves, and Zedillo and Salinas accepted Aspe's position. A similar meeting had been held in September 1994, in which Guillermo Ortiz has favored a devaluation, and no action was taken. Not only had Rudiger Dornbusch, Aspe's former teacher at MIT, insisted on the need for a devaluation; so too had Lloyd Bentsen, U.S. Secretary of the Treasury.

On December 8 Minister of Finance Jaime Serra outlined his "Economic Criteria for 1995." The document was prepared in consultation with members of the outgoing administration (including former Finance Minister Pedro Aspe, former President Carlos Salinas, and former Undersecretary of Finance, Guillermo Ortiz). Business analysts judged the document insufficient and called for a correction of the current account deficit. Luis Germán Carcoba of the Business Coordinating Council called for a meeting with Serra, which was scheduled for December 15th. Although capital flight had already begun and the peso had risen to the top of the band (3.46 peso to the dollar), Serra remained optimistic.

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[58] The Wall Street Journal, 14 June 1994, p. 1.

The next day Serra gave an interview to The Wall Street Journal in which he denied the possibility of a devaluation. The following Monday the peso broke through the official band and the stock market fell by 4 percent. In the evening, an emergency meeting was held between Serra, Miguel Mancera (of the Bank of Mexico) and members of Mexico's business elite. Although an agreement to widen the band rather than let the peso float was reached, comments by Mancera hinted that Mexico did not have the reserves to defend the peso against another serious attack. The meeting gave the bankers the opportunity to buy dollars prior to Serra's announcement of the devaluation, and billions of dollars fled the country in a matter of hours. "It's the first time in history that a devaluation was consulted on," commented former finance official Jesús Silva Herzog.[59]

The outcome of the bargaining in December 1994 was sub-optimal for all major players. As a result, a new bargaining game was initiated, with the U.S. taking the lead role, and more concern for the linkages between financial solvency, NAFTA, and political stability. Although the economic costs of the devaluation were sufficient to suggest that the crisis was a significant event for a large number of powerful private actors, they do not capture the fears among policy makers of linkages between economic disruption, immigration, political unrest, and the spill-over effects to other emerging markets. The U.S. administration, in particular, expressed concern that the crisis in Mexico could result in political instability in Mexico, and ultimately to an increase in immigration pressures. Moreover, the so-called "Tequila effect" began to spread throughout "emerging markets," depressing stocks, weakening currencies, and prompting other Latin nations to reconsider the pace of economic liberalization.

[59] Oppenheimer (1996), p. 219. For a detailed account, see Cameron (1995).

Even the U.S. and Canadian dollars came under pressure in the aftermath of the bailout. The market for Brady bonds fell on average by about 2.5 percent, thus adding to the debt problems of other debtor nations. In short, the grave implications of the Mexican crisis compelled policy makers to take drastic actions to avert a more serious disruption in global finance. The extraordinary measures required to confront the crisis exceeded the capacity of existing institutions and eventually led to a new bargaining game with new actors and issue-linkages.

The devaluation of the Mexican peso in December 1994 triggered a financial panic that required massive intervention. By the end of January 1995, President Bill Clinton had cobbled together a package of loan guarantees in excess of $50 billion. Massive state intervention was required to launch NAFTA, the centerpiece of market-led economic integration in Latin America.

It might be argued that the Mexican financial crisis threatened the stability of the global economy, especially emerging markets. However, the threat of a generalized systemic collapse was less significant than during the debt crisis that began in 1982. In spite of this, a far more costly bailout of the Mexican economy was engineered by the international financial community, led by the United States. The reason lies in the crucial importance of Mexico to the United States in the context of NAFTA, and the extent to which U.S. business interests were affected by the devaluation.[60]

The bailout revealed cracks in the international financial system: six European members of the IMF--Britain, Germany, Denmark, the Netherlands, Belgium, and Switzerland--abstained on the vote to provide $17 billion in loans to Mexico. They said the plan was pushed through too hastily (documents were received only an hour before the meeting to vote on the package), and without regard for the IMF's other obligations or problems of moral hazard.[61] U.S. officials noted that the speed of the markets had outstripped the ability of bureaucratic agencies like the Fund to respond.

The emergency bailout, combined with Mexico's domestic adjustment measures, only addressed part of the problem. Under the terms of the bailout package assembled by the United States, Mexico will receive $20 billion in loans with up to ten year maturities through the Treasury's Exchange Stabilization Fund. The Federal Reserve agreed to provide short-term bridge financing of up to $6 billion. The other industrialized nations would provide an additional $10 billion in credit through the Bank for International Settlements (BIS).

President Clinton's pressure on the BIS to contribute to the Mexican bailout was not openly resisted, but the enthusiasm of European central bankers was minimal. The International Monetary Fund extended $17.8 billion in credit. Of this, $7.8 billion (300 percent of Mexico's IMF quota) were made immediately available. The remaining $10 billion were set aside to be provided to the extent that the government central banks in the BIS fall short of their $10 billion target. Overall, the IMF provided 688 percent of the quota for which Mexico was eligible, the largest ever financing package approved by the Fund. In fact, the total bailout packages includes money that is far from secure. Most of the real, hard money is from the U.S., which is why it can set the lending conditions. It is unlikely that any further money could come from outside the NAFTA partners.[62]

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[60] An official in the Mexican Ministry of Foreign Affairs suggested that the generosity of the bailout set out a signal that the crisis was more serious than it really was. Interview, Mexico City (1995).
[61] The New York Times, 3 February 1995, p. A1, A6.
[62] Thanks are due to Lawrence Whitehead for these observations.

Clinton's bailout was unpopular domestically and would not pass the Republicans and Democrats in Congress, some of whom wondered why similar steps were not taken to bailout Orange County or U.S. workers in distress. The measure had to be taken using executive powers to spend through the exchange stabilization funds of the U.S. Treasury and by strong-arming the IMF. Clinton was able to achieve this by linking the crisis to U.S. security and leadership in the global economy.

U.S. Secretary of the Treasury, Robert Rubin said that the release of fresh funds demonstrated that Mexico was fully complying with the conditions of the bailout. The first $10 billion would come from the U.S. between February and June 1995, as long as Mexico complied with targets. The remainder would be made available, as necessary. By August 1995, Mexico's reserves had climbed back to $15.7 billion; $26 billion in Tesobonos had been paid off, leaving only $3.1 billion due; and the Mexican government had shifted back to issuing peso-denominated bonds.

The bailout package imposed strict conditionality measures on monetary and fiscal policy as well as foreign borrowing. Loan guarantees were backed by oil revenues held as collateral by the Federal Reserve Bank of New York. Mexico has to buy back the pesos it has exchanged for dollars with the United States at 2.25 percent or more over Treasury bill rates of varying maturities.[63] The terms included the unusual accounting practice that every withdrawal of funds would have to be approved in advance by the U.S. Treasury, which would oversee how all the money was spent. The Mexican government also set up a fund, backed by the World Bank, to ensure that local banks met the minimum capitalization levels required by regulators--again, a form of socialized

[63] The Economist, 25 February 1995, p. 79.

risk. The United States executive arranged the financial package for Mexico because it believed that Mexican financial stability was in the interests of the U.S. economy. A financial meltdown in Mexico could have repercussions throughout the "emerging markets" of Latin America and Eastern Europe and could ultimately result in a loss of jobs at home. Nevertheless, the idea of bailing out a foreign country was unacceptable to members of the Congress, many of whom accused the President of being too concerned for wealthy investors and speculators.

In short, as in the previous cases we have examined, the U.S. took the lead in coping with the debt problem in Mexico. In this case, it did so without much support from Europeans and others who saw the problem as one that did not threaten international financial system and thus one that they could ignore.

V. THE 1997-8 ASIAN CRISIS

The recent Asian crisis once again demonstrates the crucial role of the United States in international debt negotiations. In the following three cases, the U.S. played quite distinct roles commensurate with its strategic, political, and economic objectives. In Thailand, the U.S. was noticeable by its absence; in Korean and Indonesia, the U.S. played a very active role. Once again, the efforts by the IMF, while initially supported by the U.S., proved to be inadequate or inappropriate for the task at hand.

Thailand

Before the Thai baht began to falter in June 1997, few analysts foresaw its financial crisis. In December 1996, the IMF's report, Thailand: The Road to Sustained Growth, raised no concerns. As late as April 1997, Thailand's sovereign risk rating was a straight A. Although Thailand did have a relatively high current account deficit of about 8% of GDP, most saw this as benign. After June 1997, however, analysts rushed to explain Thailand's vulnerability. Morris Goldstein of the Institute for International Economics, for example, pointed to financial-sector weaknesses in Thailand as the cause of its currency crisis. Specifically, he argued that the Thai economy had experienced a credit boom stoked by large net capital inflows, most of it directed to real estate and equities. "This overextension and concentration of credit left the ASEAN 4 [Thailand, Indonesia, Malaysia, and the Philippines] vulnerable to a shift in credit conditions."[64]

In Thailand, that vulnerability was heightened because of the Thai Central Bank's policy of pegging the baht to the U.S. dollar, which encouraged Thai banks and firms to borrow in foreign currency at short maturities for often imprudent ventures. As a result, after the baht came under attack, U.S. Deputy Treasury Secretary Lawrence Summers estimated that "nonperforming loans in the Thai banking sector may be around twenty percent of GDP."[65] The Economist estimated that by July, the central Thai bank was spending $2.6 billion a month to keep the financial system going.[66]

By April 1997, when speculative pressures against the baht began building, the IMF and the U.S. government were openly urging the Thai government to force banks to declare their bad debts and begin to clean the financial system up. Even after it was forced to announce a managed float of the baht in early July, which devalued the baht by about twenty percent, Thailand refused to apply new economic measures or to openly seek IMF assistance. For their part, however, the IMF and the United States did not treat Thailand's currency crisis as a serious problem. In July, when the baht lost twenty

[64] Goldstein (1998), p. 1.

percent of its value, Daniel Tarullo, the U.S. administration's top international economic advisor recalled that "there were no crisis meetings and certainly no sense that this was the start of an economic crisis that might roll around the world."[67] As a result, although the IMF urged action on Thailand, it did not press Thailand strongly enough to produce change. Fred Bergsten, director of the Institute for International Economics, argues that the international monetary regime's early warning system failed to prevent exactly the kind of crisis it was created to prevent. "The IMF and the Group of Seven countries should have really put the heat on the Thais." [68]

Thailand finally requested IMF assistance in August 1997, and on August 20, it signed a letter of intent with the IMF in Tokyo. The IMF authorized $17 billion to rescue the Thai economy. The IMF itself contributed $4 billion, the Asian Development Bank $2.7 billion, Southeast Asian countries $3.5 billion, and Japan $4 billion. In keeping with the IMF's mission, Thailand agreed to a series of reforms, economic and financial, in return for funds. These can broadly be grouped into six policies areas:[69] (1) fiscal policy contraction; (2) bank closures, with the IMF immediately identifying 58 out of 91 Thai finance institutions to be suspended and subsequently ordering 56 of these be liquidated; (3) enforcement of capital adequacy standards; (4) tight domestic credit to defend the exchange rate; (5) agreement to fully repay debt; and (6) liberalization reforms including tariff reduction, reducing barriers for foreign investment, and reducing monopoly powers.

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[65] New York Times, August 14, 1997, p. 1.
[66] The Economist, November 15, 1997.
[67] New York Times, July 5, 1998, p. 1
[68] New York Times, August 19, 1997, p. 1.
[69] See Sachs and Radelet (1998) for a complete discussion.

In contrast to other Asian nations in crisis, however, after the ineffective Chavalit government gave way, Thailand eagerly enacted IMF reforms. IMF officials quickly and repeatedly praised Thailand for enacting reforms and closely following the fund's program, holding it up as a model for other countries. Yet the IMF's medicine only exacerbated financial troubles and businessmen in Thailand, including a former foreign minister, only saw a gloomy future. "We're going down and we don't know when we'll reach the bottom."[70] The abrupt announcements of bank closures only served to inflame the panic instead of instill confidence and added to the on-going liquidity squeeze, making it more difficult for existing banks to continue normal lending operations.[71] Credit all but dried up. As a result, private investment has fallen 11.9% from March 1997.

While official currency reserves are slowly recovering, close to US$27 billion, the country still has a limited ability to service creditors. Bankers predict that a sudden call on loans will precipitate the financial system's collapse. Thailand remains mired in a deep recession that most analysts predict will last through 1999. In its fourth letter of intent with the IMF, the Thai government predicted that the economy will shrink 5.5% in 1998, with investment falling 24%.[72] National unemployment has doubled to include 2 million people, and the government expects 800,000 more people will lose their jobs by the end of the year. Manufacturing production has fallen 21% since the June 1997. As of June 1998, the stock index continues to flounder at an 11 year low, and the baht has lost 37% of the value since June 1997. The Thai consumer price index rose 10.7% and wholesale price index jumped 20.7% in June 1998, the biggest increase in a decade.

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[70] Financial Times, July 1, 1998, p. 23.

IMF officials have acknowledged their error, and in November, officials restructured the loan agreement with Thailand, offering more comprehensive financial restructuring plans to go along with bank closures in an attempt to restore confidence in the financial sector and increase financial solvency.[73] The IMF has also eased requirements to allow for a 1999 budget deficit of 3% of gross domestic product.

In early 1997, U.S. officials had joined with the IMF in pushing the Thai government to clean up its financial system, particularly its nonpeforming loans. By August, however, the United States had dropped out of the process, and during the loan negotiations, the United States was conspicuous by its absence. In stark contrast to Japan, the U.S. directly contributed no funds to the bailout, and U.S. administration officials remained silent on developments in Thailand. The U.S. inaction was widely criticized in Asia, and the Thais themselves were shocked and angered at what they saw as the failure of a long-time ally to come to their aid.

The U.S. decision not to participate in the original IMF bailout was motivated by several factors: (1) U.S. officials were angry that Thailand had defied earlier U.S. and IMF advice to reform its economic and financial practices; (2) The United States may not have fully realized the gravity of the situation since the official IMF assessment was still that Thailand was fundamentally strong economically. As late as the November APEC summit meeting, President Clinton was describing the Thai and Malaysian currency crises as "a few small glitches in the road;"[74] (3) There was no shortage of available financing since Japan, whose banks were the most exposed by the currency

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[71] Bresnan (1998), p. 4.
[72] Asia Pulse, July 1, 1998.
[73] Fischer (1998), p. 103.
[74] The New York Times, July 5, 1998, p. 1

meltdown, was very willing to provide funds; (4) the post-Cold War context has meant the United States is less concerned about communist threats in Asia and thus less willing to help strategic allies such as Thailand. "The Vietnam-era military alliance of the United States with Thailand had been substantially attenuated by Thailand's failure to agree to the pre-positioning of military materiel off-shore in Thai waters in support of U.S. forces in the Persian Gulf;"[75] and (5) the Clinton administration feared a domestic political backlash from key isolationist members of Congress already aroused by perceived waste in United Nations peacekeeping costs, and so did not want to fight for funding.

The United States strategy appeared to backfire almost immediately, as the currency crisis continued to spread beyond Thailand, quickly moving to the larger economies of Indonesia and Korea. Despite the IMF's intervention, the financial crisis, largely driven by currency speculation, continued to spread to beyond Thailand to the Philippines, Malaysia, Indonesia, and most importantly, Korea. The IMF eventually promised the Philippines $1.1 billion in aid, Indonesia up to $40 billion, and Korea up to $60 billion. By the time Korea requested IMF assistance in December 1997, the United States government changed strategy with respect to Thailand.

As in the Cold War, the U.S. has now come to view Thailand as a bulwark, though this time against spreading financial problems and not communism. The U.S. has principally been concerned that uneven implementation of IMF conditions in Indonesia not lead Thailand and particularly Korea to similarly resist. The United States began playing a direct role in the Thai economic problems in early 1998. In March 1998,

[75] Bresnan (1998), p. 3.

President Clinton officially welcomed Thai Prime Minister Chuan to Washington. The U.S. administration used the meeting to re-establish connections with Thailand and soothe Thai feelings over the U.S inaction in the summer of 1997. The United States also used the opportunity to announce $1.7 billion of aid to Thailand, through the U.S. Export-Import Bank, the Trade Development Agency, and the Overseas Private Investment Corporation (OPIC).[76] The administration also launched a major program to help Thai students in the U.S., through the State Department, USIA, and the INS to allow Thai students to work as well as study in the U.S.

The United States has given this aid as encouragement for Thailand to continue implementing IMF conditions and undertake reform, and as a tangible reminder that the U.S. stands alongside the IMF and its goals. In a July 1998 visit to Thailand, U.S. Treasury Secretary Robert Rubin proclaimed, "The U.S. stands with you as you face this challenge… Though this will be a hard path to follow… failure to implement reform would lead to far worse conditions and far longer duress."[77] Once again, as in other cases of debt resolution, the U.S. has been brought into the debt rescheduling process.

South Korea

Ever since its take-off in the 1960s, the Korean economy has been displaying remarkable macroeconomic performance. Despite the slowdown in annual GDP growth, the economy recorded 5.9% growth in 1997 while keeping unemployment and inflation down to 2.6% and 4.4% respectively. The 1997 economic crisis was first foreshadowed by the falling unit-prices of semi-conductors, which squeezed corporate profits. The

[76] White House Press Briefing, March 11, 1997.

decline in export prices was then exacerbated by bankruptcies of major conglomerates, such as the default of Hanbo Steel Corporation in January of 1997.

Historically, Korea had been quick to adjust to currency overvaluation, but this time—despite added pressure from the 1994 depreciation of the Chinese yuan and the 1995 depreciation of the Japanese yen—Korea failed to act.[78] As of mid-1997, Japanese banks had about $23 billion in loans and other credits to South Korea, European banks had $36 billion, and U.S. banks had extended $10 billion of credit to South Korea. In October, the South Korean won began to slump rapidly in value. Soon after, the Dow Jones plunged 554 points in response to Asian economic difficulties. In November, Korea turned to the IMF, and on December 4, 1997, the IMF approved a $21 billion loan for South Korea, part of a bailout package that will total nearly $60 billion. Two days later, the Central Bank of Korea announced that it had received $5.22 billion.

By late December 1997, Korea's reserves were almost gone, shrinking at a rate of $1 billion a day. The U.S. government and the IMF recognized that the original strategy had failed and agreed to accelerate $10 billion of the committed loans as a bridge to prevent a default. More important, the U.S. Federal Reserve and other major central banks called in the leading commercial banks and urged them to create a coordinated program of short-term loan rollovers and longer-term debt restructuring. The banks agreed to roll over the loans coming due immediately, and the crisis was averted.[79] Despite the rollover, Korea still had to pay off about 10 percent of the due loans on December 31, leaving only $9 billion in foreign currency reserves.[80]

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[77] Business Day, July 1, 1998, p. 2.
[78] Chang (1998), p. 9.
[79] Feldstein (1998).
[80] New York Times, January 5, 1998, p. 10.

Despite initial resistance from smaller international lenders in a replay of the 1980s debt crisis, global lenders agreed in January 1998 to roll over Korea's maturing obligations for 90 days, easing worries about default on some $40 billion in debt due by March 31.[81] This conflict between banks was most apparent among U.S. commercial and investment bankers, who had been spearheading private sector involvement in the Korean bailout. With billions of dollars in outstanding loans to Korean banks, U.S. banks had a large stake in the bailout's success or failure. But beyond protecting their own investments, bankers also tried to position themselves to capture a share of the profits that would accompany the management of any transactions to resolve the crisis, such as straightforward loans or bond issues, or a more complicated conversion of private-bank debt into government-backed bonds.[82] These potential profits are no small matter, which perhaps in part explains the Korean government's subsequent efforts to independently secure as much as $35 billion in new financing. Korea's move to sell bonds on its own, interfered with foreign banks' efforts to lead the repackaging of Korea's almost $40 billion in short-term debt.[83]

In early January, about $34 billion of Korea's $92 billion in short-term debt was owed by Korean commercial banks, with $25 billion of that due by the end of March.[84] On January 8, 1998, the IMF and South Korea agreed to a 90-day rollover of short-term debt. Soon thereafter, U.S. Treasury Secretary Robert E. Rubin urged international lenders to join the 90-day rollover in order to facilitate the resolution of the crisis.

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[81] Mr. Rhodes helped to persuade banks around the world to roll over short-term loans to Korean banks. His message to international commercial bankers: "Let's stop the hemorrhaging and buy time to get the country back to the international financial markets." Wall Street Journal, January 9, 1998, p. 10 and The Sacramento Bee, January 2, 1998, p. A1.
[82] Wall Street Journal, January 2, 1998, p. 5.
[83] New York Times, January 5, 1998, p. 1.

IMF rescheduling efforts were aimed more at debts owed by banks than at debts owed by private borrowers, in part because bank debts constituted the bulk of short-term obligations, but also because of the role bank failures can play in fueling financial panic. Thus, the failure of corporations that dwarfed many banks was still seen as preferable than the failure of any large Korean bank. As the Wall Street Journal noted, the IMF also sought to avoid cushioning industrial conglomerates from the consequences of their excessive borrowing.[85]

Martin Feldstein argues that the IMF may have encouraged future bad lending by taking control of the situation without waiting for lenders and borrowers to begin direct negotiations with each other.[86] Chang also criticizes the IMF's haste in deciding to accelerate financial liberalization. Given the poor state of financial regulation, it was not at all obvious that loosening the reins further would open up the market for more able financial institutions. On the contrary, the institutions ready to take advantage of such openings were many of the same ones that had made poor loans to badly-managed Korean institutions![87]

By mid-January, the IMF had eased up its macroeconomic targets for Korea: the inflation target was raised from five to nine percent; the monetary growth target was raised from nine to 14 percent; the budget surplus requirement was dropped; and the capital adequacy standard was delayed, allowing Korean banks to continue to make loans.[88] Clearly the IMF's initial conditions had been overly ambitious.

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[84] Wall Street Journal, January 5, 1998, p. A16.
[85] Wall Street Journal, January 5, 1998, p. A16.
[86] Feldstein (1998).
[87] Chang (1998), p. 14.
[88] Chang (1998), p. 13.

According to You Jong Keun, a top economic adviser to South Korean President-elect Kim Dae Jung, "international banks 'are trying to get as much as they can in this deal, but they are also under pressure to take some kind of haircut.'"[89] But given the pressure for international banks to take a hit on their loans to Korea, as well as the worldwide losses already incurred by stock investors in Korean companies, the Korean government tried to negotiate an interest rate below the market rate.[90] Lenders were asking that the new loans carry an interest rate of 7 percentage points to 8 percentage points over LIBOR. With over 100 creditor banks having extended loans to Korean banks, negotiating an interest rate far below the market rate presented its own problems. Since the debt swap was voluntary, the government had to pay sufficient interest to entice banks to participate in the exchange. Otherwise, the liquidity crisis would continue.[91] The banks ended up with less than 3 percentage points above it.[92] The Korean government publicly challenged such interest rates and has continued to fight for lower rates.[93]

On January 28, international creditor banks and the South Korean government announced a plan to exchange $24 billion of short-term debt for new loans maturing in one, two, and three years. The agreement restructured only loans that made to Korean banks, leaving billions of dollars in loans to private Korean companies not yet restructured.[94] To the extent that the debt maturities were increased, the lenders have had to wait for their money.

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[89] Wall Street Journal, January 26, 1998, p. A12.
[90] Wall Street Journal, January 26, 1998, p. A12.
[91] Wall Street Journal, January 26, 1998, p. A12.
[92] Orange Country Register, January 30, 1998, p. C3.
[93] Wall Street Journal, January 19, 1998, p. A11.
[94] Orange Country Register, January 30, 1998, p. C3.

On January 30, the Korean stock market re-opened after a three-day holiday and stocks rose more than seven percent. On another positive note, Seoul's usable reserves then totaled $12.4 billion, up from $8.9 billion at the end of last year. The government said that it wanted at least $40 billion in reserves by the end of 1998.[95] In February, the Ministry of Finance and Economy announced the closure of one-third of the country's 30 merchant banks due to their thinly capitalized condition and previous excessive borrowing. By one estimate, the 30 merchant banks lent at least six trillion won ($3.6 billion) to six big conglomerates that filed for court protection from creditors last year; shareholder equity in the banks was only two-thirds that amount. The banks also lent heavily to Indonesia, and owed foreign creditors about $20 billion.[96] A government-backed "bridge bank" was created to assume the failed institutions' assets and liabilities.[97]

More recently, Korea has been making considerable progress towards recovery. Capital inflow from a recent bond offering, IMF bail-out funds and central bank loans to overseas branches of local banks has boosted Korea's usable foreign exchange reserves reached $30.3 billion (as of April 1998).[98] Corporate reforms by the banking sector are leading to possible elimination of large companies.[99] Furthermore, the government is steadily pursuing restructuring of the financial sector by promoting mergers, such as the one between Hana and Boram banks.[100] After providing the crucial initial momentum, the U.S failed to provide significant leadership as its funding for IMF encountered

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[95] Los Angeles Times, March 3, 1998, p. D-1.
[96] Wall Street Journal, February 2, 1998, p. A16.
[97] Wall Street Journal, February 2, 1998, p. A16.
[98] Business Times (Singapore), April 21, 1998, p. 6.
[99] Korea Herald, May 8, 1998, B2.
[100] Korea Herald, July 16, 1998, B6.

protracted delays in Congress. Indeed, the rapid depletion of the regular IMF reserves resulting from the loans to Asia and Russia forced the organization to resort to its emergency reserves.[101]

Indonesia

Until recently, Indonesia had been lauded by the World Bank for avoiding the worse symptoms of the Dutch disease (excessive reliance on natural gas or raw material exports), which had sabotaged development in many other third world countries. The charismatic-authoritarian Suharto regime governed over an ethnically and geographically fragmented society and the world's fourth largest population. Under Suharto, government-business relations became increasingly ruled by corruption and nepotism. Yet at moments of economic crisis, such as in the mid-1960s and during the oil boom-bust cycles in the 1973-1980s, Suharto had chosen to follow the advice of Western-trained economists. In the current Asian crisis, he has behaved otherwise.

By mid-1998, the rupiah has dropped from 2400 one year ago to its current level of over 14000. Consequently, the dollar value of foreign debt has soared. Inflation and unemployment have skyrocketed, while foreign trade is at a standstill, and companies listed on stockmarket are technically bankrupt. Economic predictions for the year 1998 are for real GDP to decline by 10%, inflation to increase to 80%, and the government budget deficit is estimated at 8.5% for the coming year, which will be wholly financed by foreign borrowings.[102]

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[101] Boston Globe, July 14, 1998, D1.
[102] Washington Post, June 26, 1998, p. A23.

The respective roles of the IMF and the U.S. in Indonesia's macroeconomic and debt crisis can be examined in three periods. Each period is marked by a breakdown of a prior agreement, and the eventual resumption of talk between the Indonesian government and the IMF and U.S. officials. As the economic crisis in Indonesia deepened, the United States increased its involvement, particularly in defending IMF's policies against critics and exerting political pressure on Suharto. President Habibie and the IMF have recently entered the fourth agreement, which is best understood as a political decision by the Clinton administration to tie the rescue plan to political improvement as well as usual compliance with IMF economic targets.

The first IMF letter of intent addressed to the IMF by the government of Indonesia on October 31, 1997 was not publicly disclosed. It is known that the agreement was sketchy, hastily put together, and included demands for bank closures and government budget reduction. Harvard economist Jeffrey Sachs criticized the IMF's approach, arguing that East Asian countries are quite unlike Latin American, Africa, and other historical cases of countries needing IMF intervention to impose spending and credit discipline.[103] The IMF later partially accepted the criticism, and permitted the Indonesian government to run a budget deficit. In January, Suharto announced a budget without any of IMF's austerity measures. The stockmarket in Jakarta crashed, and on January 27 the government declared what amounted to a moratorium on all Indonesian corporate debt. Suharto's attitude of denying the exigencies of the crisis effectively destroyed the first agreement.

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[103] New York Times, November 3, 1997, Op-Ed.

With the specter of regional market contagion becoming a real threat after October 1997, the U.S. reversed its early position of non-commitment regarding Thailand, and presented a "second line of defense" of $3 billlion in support of the IMF plan.[104] U.S. Treasury officials were careful to portray the U.S. and IMF as playing reversed roles from the Mexican case, where the U.S. led the rescue effort. Although at this point Indonesia was seen as fundamentally strong, the U.S. had gotten out in front of the IMF in defense of its geopolitical stake in containing the effects of the "contagion."

It had also become increasingly evident that the IMF program would not work in troubled Asian economies without American participation. Economically, a large sum of money was needed. Early on in the crisis, the U.S. had spurned Japan's plan for an independent Asian monetary fund of $100 billion, and consequently the U.S. had to assume the burden in the Indonesian rescue. Aside from this financial commitment, the U.S. policy remained largely inchoate and indistinct from the IMF position. A summit meeting of President Clinton and President Suharto in Vancouver in November hardly dealt with the crisis, with Clinton's attention mainly lingering over issues of human rights.[105]

Under pressure from abroad, Suharto signed a new letter of intent on January 15. The "50-Point Program" was surprisingly detailed and extensive in its demands, and highly incendiary for the structural reforms that would cut down on the wealth and power of the Suharto family. However, Suharto soon proved the skeptics right by indicating his desire to remain in power, picking Habibie as the Vice-President, a man with no power base and predilection for big government and expensive projects. The IMF agreement

[104] Bresnan (1998), p. 2.

was economically sabotaged in February when Suharto began toying with the notion of a currency board, which would fix the value to the rupiah to the dollar at a rate of 5,000-5,500.[106] The IMF and U.S. reacted strongly. On March 6, IMF suspended a scheduled $3 billion infusion. Five days later, Suharto was reelected to a seventh five-year term, and formed a cabinet of close supporters with little competence and experience in economic reform, including his daughter Tutut as the minister of social affairs in charge of overseeing relief.[107]

The U.S. continued to support the IMF position. In response to Suharto's so-called "IMF-Plus" plan with the currency board, Clinton sent former vice-president Walter Mondale to Indonesia in an effort to "get through" to Suharto the importance of abiding by the IMF plan. Domestic critics and officials quickly became restless, perceiving Suharto to be playing a game of brinkmanship with the IMF in order to obtain better terms than those accepted by South Korea and Thailand -- under the assumption that Indonesia was too important for the international community and the U.S. to abandon.[108]

Secretary of Treasury, Robert Rubin, emerged as a staunch defender of the IMF. He supported the IMF's decision to withhold additional funds, arguing that money could not solve the deep problems of excessive credit extension, monopolies, protective tariffs, and wasteful infrastructure projects.[109]

The 3rd round of talks between the IMF and Indonesia focused on two issues: restructuring of the domestic banking industry; and resolving the problem of the foreign

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[105] "Economy in 1998" www.indonesiatoday.com/a3/j6/y1jan98.html.
[106] The Economist, March 7, 1998, pp. 42-3.
[107] Bresnan (1998), p. 15.
[108] The Economist, April 11, 1998, p. 29.

debt of Indonesia's private corporations. Several sources reported that repayment was to be handled in ways similar to the framework of Mexico's Ficorca Plan 1983, in which foreign banks offered companies extended periods to repay their loans.[110] The Indonesian economy had reached such crisis proportions that Suharto had few choices but to accept extensive terms similar to those stipulated in the second agreement, in addition to compliance measures on the monitoring and disbursement of money. In light of the desperate economic conditions, some spending allowances were made for the provision of basic necessities and humanitarian aid.

An agreement was reached on the second week of April 1998. However, riots on the eve of implementation of price increase put an abrupt end to IMF's effort to recreate an atmosphere of credibility. Consequently, the Indonesia crisis has become predominantly one of political crisis, in which the U.S. was able and eager to seek resolution with international economic assistance as the ultimate reward.

As law and order fell apart on the street of Medan, the State Department began to assert the paramount interest of the U.S. in preventing a return of praetorian politics. However, debates on the floor of the House of Representative on whether the IMF was exceeding its reach and unwisely extending its obsolescent role in the Indonesian case brought doubts about whether the U.S. could or should supply the financial backing for IMF programs in Asia.[111] Criticisms came from right and left: Republicans demanded the withdrawal of IMF intervention to permit the market to punish investors, while Democrats urged the addition of political conditions to the IMF agenda.

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[109] Www.pbs.org/newshour/bb/asia/jan-june98/indonesia_3-10.html
[110] The Economist, 4/11/98, p. 29.
[111] Washington Post, June 17, 1998, p. A06.

Interest groups seem less influential than geopolitical considerations, perhaps because the principal American economic interest in Indonesia was in the production of oil and natural gas, which continued uninterrupted.[112] American banks were not major creditors in Indonesia, holding only 7.8% of Indonesian corporate debt (vs. 39% by Japanese banks).[113]

Toward the end of May 1998, newly appointed President Habibie agreed to hold an election in 1999, and tried to persuade Hubert Neiss of the IMF to resume the bailout program. Neiss met opposition leaders, and solicited their approval for the IMF program.[114] The 4th IMF plan called for new budgetary targets, an exchange rate target of 10,000 rupiah to the dollar, tightened grip on credit, restructuring of corporate debt, banking reforms and restructuring, provisions for basic necessities. Furthermore it is estimated that an additional $3-4 billion is needed to support the $43 billion set aside for stabilization in the April 10th agreement.[115] Additional loans were promised by the World Bank ($1 billion), the Asian Developmental Bank, and Japan.

On June 4, a major agreement with the international banks was worked out to stretch out debt payments by Indonesian business, with a 3-year grace period and payment of debt over 5 years.[116] The dollar value of the Indonesian private debt totaled over $80 billion. The daunting tasks of restructuring of the banking industry approach those faced by the Eastern European countries and Mexico in 1990s, as independent

[112] Bresnan (1998), p. 20.
[113] Bresnan (1998), p. 20.
[114] Washington Post, May 29, 1998, p. A29.
[115] Wall Street Journal, June 26, 1998, p. A12.
[116] Washington Post, June 5, 1998, p. D02.

accountants called in by IBRA (Indonesian Bank Restructuring Agency) find Indonesian banks in worse shape than thought.[117]

Changing political perceptions of the Clinton administration provided the impetus for reaching the 4th Agreement. Specifically the agreement reflects a tentative judgement in Washington that Indonesia appears to be stabilizing politically, now that Habibie has proposed holding election next year and started releasing prisoners. Furthermore it conforms to the administration's view that ties the rescue plan to political improvements such as human rights, broad political inclusion, and selection of pro-reform cabinet members.[118] It remains to be seen how much weight compliance with IMF economic targets carry relative to these political gains.

Secretary of State Albright's speech on June 16 was typical of the emerging American position of tying political improvements to continuation of bailout. She announced the American decision to resume support for international lending to Indonesia, the approval of $1 billion in short-term financing through the U.S. Export-Import Bank for the U.S. exports to Indonesia, and further humanitarian assistance of $65 million. In the same speech she urged Asian leaders to emulate Kim Dae Jung in carrying out political reform based on democratic principles. As she put it, "the lesson for Indonesia is that democracies are better able to adjust to change than regimes that are autocratic."[119]

Why is the U.S. carrying so large (and increasing) a share of the political burden in pressuring Jakarta? Three main reasons are readily identifiable. First, a stable and cooperative Indonesia represents a paramount strategic interest for the United States in

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[117] Wall Street Journal, June 26, 1998, p. A17.

view of its strategic position and large population. Second, there was a clear risk of "contagion" in the region and a less certain risk of adverse effects on the U.S. economy. Third, despite criticisms from prominent economists, there is considerable support from the mainstream for IMF policies.

CONCLUSION

This paper has focused on debt rescheduling efforts involving primarily Mexico and other Latin American countries in the 1930s and 1940s, the 1980s, the 1995 peso crisis, and the more recent Asian crises with an eye to understanding the role of creditor governments and international institutions in resolving crises. I have suggested that when left to their own devices in the earlier period, bondholders and debtors took an inordinate amount of time to reach an accord. Indeed, accords were often only reached with significant U.S. participation or linkages to international institution loans, with the former leading to a debtor favorable settlement as in Mexico and the latter leading to quite an unfavorable agreement as in the case of Peru.

In the 1980s, the initial efforts by the U.S. and IMF, while forestalling a financial crisis, led to a long drawn out period of rollovers, jumbo loans, and the like, resulting in high costs for Latin American debtors. Debt negotiations during this period only came to an end with the U.S.-promoted Brady Plan that called for significant writedowns in debt. While the IMF came to endorse this strategy, it did not take any initiative in deviating from its traditional approach.

[118] Washington Post, May 22, 1998, p. A42.
[119] Dailynews.yahoo.com/headlines/ap/…/albright_asia_text2_1.html, p.2.

The more recent cases of the 1995 Mexican peso crisis and the Asian crises are marked once again by heavy U.S. involvement. In the peso crisis, significant U.S. guarantees enabled the Mexicans to once again attract capital and put their economy on a sounder footing. The Asian crises have yet to be resolved, but the initial IMF errors and U.S. endorsement of the bulk of the IMF's actions do not signal that much has been learned from previous efforts to cope with debt crises. It remains to be seen if the U.S. and IMF will once again play a more balanced role in resolving this current crisis as they did in the 1980s following severe political problems in Latin America.

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