2 THE EVOLUTION OF DEBT CRISES: ORIGINS, MANAGEMENT AND POLICY LESSONS

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2.1 INTRODUCTION

The 1997–9 Asian debt crisis has raised our interest in studying the origin and resolution of debt crises in comparative perspective. It is particularly important for scholars and policy-makers to see how problems have been handled in other situations now that alternative schemes to reform international institutions, regulate financial intermediaries and improve debtor policies and the like are being considered.

This chapter discusses the origins of major debt crises since the 1820s and the ensuing debt-rescheduling processes between borrowers and creditors.[1] In examining this history, I identify four different cycles of lending, default and rescheduling, namely the 1820s to the 1860s, the 1870s to the First World War, the 1920s to the 1960s, and the 1970s to the 1990s. The analysis in section 2.2 follows what I term an epochal division, and emphasizes the following characteristics of the creditor–debtor relationship: (1) the distribution of capabilities in the four different periods; (2) the different types of lender and debtor involved; and (3) the presence or absence of international regimes as a constraint on actors' behaviour.

Section 2.3 considers the issue of debt crisis management. It focuses on Latin American debt-rescheduling efforts in the 1930s and 1940s, the 1980s, the 1994 Mexican peso crisis and the Asian crises in 1997–9. Section 2.4

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[1] In discussing the origins of debt crises, I employ an approach that builds on and refines works by earlier scholars, who argue that the occurrence and resolution of debt crises are best explained by a focus on cycles of lending to and retrenchment by creditor countries. For example, both Carlos Marichal (1989) and Christian Suter (1992) suggest that fluctuations in lending cycles related to the world economy, rather than to individual policy choices of states, account for debt crises. See also Suter, Stamm and Pfister (1990). On cycles more generally, see Kindleberger (1978).

discusses the lessons to be learned from these efforts at orderly debt work-outs. In particular, I argue 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, frequent intervention by the United States and other creditor governments – including less common but crucial actions by it and others throughout the twentieth century – have been decisive in resolving debt crises. An analysis of the Latin American experience and the more recent Asian crises suggests that calls for debtors and lenders to be left to work out their own problems, and also the prevalent view that the IMF has been doing an adequate job in managing debt crises, are misguided.

2.2 ORIGINS OF DEBT CRISES

The 1820s–1860s

The world economy in the 1820s was dominated by the British. They and the French were the two major powers at the time.[2] Lending in this period occurred through bond flotations led by merchant banking houses in the London and Paris financial markets. Initially, only a few major banking houses were involved in the lending business, with Baring Brothers and N. M. Rothschild among the most important. Later on, other, less reputable lenders, including mercantile firms, saw profitable opportunities in the bond market and jumped into the market for Latin American flotations (Jenks 1927/1973: 48). These actors were intermediaries who profited on transactions, but generally they did not suffer direct losses when loans fell into default. Because bankers were held more accountable to investors and needed to protect their reputations, they were more inclined to make good loans.

On the debtor side, newly established Latin American states sought financing for two major expenses: paying for their wars of liberation and covering current government costs. Because these objectives did little to increase debt-servicing capabilities, debt repayment was unlikely. The borrowers often seemed relatively unconcerned with the damage to their credit rating that default would incur.

The 1870s to 1914

The international financial system at this time was characterized by overwhelming British dominance. Lenders had succeeded in organizing bondholders' associations in Britain, France and Belgium. These associations improved bondholders' ability to negotiate; they also effectively suppressed efforts by speculators

[2] Portions of the historical discussion for the nineteenth and twentieth centuries are based on Aggarwal (1996).

and issuing bankers to represent them, eliminating middlemen who did not always keep bondholders' best interests in mind. Regarding borrowers' motivations, countries increasingly borrowed for infrastructural development (railway expenditures constituted over 40% of invested debt), although many still sought to finance current government expenditure.[3]

The 1920s–1960s

International finance during this period saw rapid lending in the 1920s followed by default in the 1930s and rescheduling efforts that lasted into the 1960s. American investment in Latin America grew dramatically. US capital flowed overwhelmingly into public coffers: as much as 80% of American funds went towards the purchase of publicly floated bonds. By 1930, 14 of 20 Latin American countries had floated new bonds. As in the previous two epochs, bondholders held their investments directly and formed private bodies to coordinate actions aimed at regaining their investments when defaults occurred.

After the First World War, additional countries joined the sovereign-borrowing bandwagon. Most capital flowed from the United States, the new centre of international finance, to Europe, especially Germany, and to Latin America and Canada (as before the war). Instead of financing development projects such as railways, foreign capital bolstered reserves, balanced government deficits and financed current expenditures (Fishlow 1985: 419–20),

Lending fluctuated considerably during this period, with major declines in 1921, 1923, 1926 and 1928. The last severe drop, in 1928 (owing to the diversion of funds to the US stock market and the ensuing Depression), crushed the servicing prospects of both European and Latin American borrowers. By 1933, twelve Latin American countries and nine European countries suspended at least part of their debt servicing, and efforts to reschedule defaulted debts which began in the 1940s continued until the early 1960s

The 1970s–1990s

The onset of debt problems in the 1980s was similar to those of previous epochs.[4] Growing trade and increasingly available private funding from flush banks encouraged countries to borrow. An important departure from earlier times, however, was the development of new financial markets and mechanisms,

[3] Fishlow (1985) argues that historically, debtors can be divided by the uses to which they put funds: development or current revenue. In the first category were Australia and most of the Latin American countries; in the second were most eastern European and Middle Eastern countries.
[4] For a good discussion of parallels in this regard, see Marichal (1989: 233).

which accelerated the lending drive. These mechanisms included the eurocurrency market and the advent of loan syndication.

During the 1960s, most lending to the developing countries came from public institutions such as the World Bank and the Inter-American Development Bank, as well as from creditor governments. But after the 1973 oil crisis, international banks became flush as oil-producing countries poured their money into them, expanding the funds available in the Euromarket for recycling the vast inflow of funds. Newly creditworthy developing countries in Latin America, Asia and eastern Europe faced serious balance of payments problems as their oil bills increased. As governments found economic adjustment to be politically unpopular, the international banks provided a welcome source of capital.

Lending in the 1970s was accelerated by an incentive system created through the loan syndication process. Although banks lent on their own account, they could often garner large fees with less risk through the arrangement of loans involving large numbers of banks. These so-called lead banks, with regional and smaller banks in tow, searched far and wide for lending opportunities and found a ready market in places such as Latin America. Countries in that region had a high demand for funds to finance their public sector. The lending system entailed recycling funds from OPEC countries to banks to developing borrowers, who then sold goods to developed countries, allowing them to pay for their oil imports. It worked smoothly at first. But as countries faced pending loan repayments, they turned increasingly to shorter-term borrowing, aggravating the need for continued access to capital.[5] At the same time, the aggregate amount of loans skyrocketed.

By 1981, the crisis began to develop. Faced with strong inflationary pressures, the United States pursued tight monetary policies. These 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 debtors. Then 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 high oil prices before 1981, placed severe strain on their ability to service their debts. For oil exporters such as Mexico, the effect of an oil price plunge in 1981, higher interest rates and worsening export prospects proved lethal. Poland and Argentina were the first to seek bank rescheduling in 1981, and were followed by Mexico, Brazil, Argentina and other major debtors. By 1983, over 25 countries were in arrears.

[5] In Latin America, short-term debt as a proportion of imports grew from 26% in 1975 to 65% in 1981. Inter-American Development Bank (1984: 16).

The Mexican peso crisis of 1994

Between 1984 and 1994, Mexico absorbed more than $94 billion in capital inflows.[6] Meanwhile, domestic savings declined from 22% to 16% of its GDP between 1988 and 1994.[7] Worse still, the Mexican economy was virtually stagnant. The annual increase in GDP declined from 4.5% in 1990 to 0.4% in 1993. Powerful recessionary pressures had begun to manifest themselves in 1993, when per capita income fell for the first time since 1988 (Lustig 1995: 375).

By 1994, Mexico had few options. As US interest rates rose, Mexico found it harder to attract foreign capital. One solution would have been tighter monetary policies, to cut imports and improve Mexico's current account balance. However, as Jaime Ros notes, this option probably would have led to a crisis in the banking sector and a recession similar to that of 1995, with one difference: the exchange rate would have remained overvalued (Ros 1995: 46).

The other solution would have been to devalue the peso. This option was ruled out because of the desire to retain credibility and confidence among investors, especially foreign investors. Thus, when major institutional investors such as Fidelity Latin American began to refuse to buy peso-denominated Federal Treasury Certificates, or Cetes, Mexico relied on dollar-denominated Treasury Bonds (Tesobonos) and less on Cetes. This turned out to be a crucial policy error.

The over-reliance on Tesobonos increased the risk the government shouldered relative to foreign investors in its effort to maintain Mexico's attractiveness as a place to invest. Whereas the value of Cetes issued by Mexico decreased from $26.1 billion in 1993 to $7.5 billion in 1994, the value of Tesobonos increased from $1.2 billion in 1993 to $17.8 billion in 1994 (Sachs et al. 1995: Table 9). The combination of growing Tesobono obligations and declining international reserves was a major cause of the loss of investor confidence. This loss of confidence was reinforced by a series of political and economic shocks that culminated in the depletion of Mexico's hard currency reserves and the devaluation of the peso.

Origins of the 1990s Asian crisis: Thailand and South Korea

Before its currency the baht began to falter in June 1997, few analysts foresaw Thailand's financial crisis.[8] In December 1996, the IMF's report *Thailand: The*

[6] This section draws heavily on Cameron and Aggarwal (1996).
[7] According to the Federal Reserve Bank of the United States, Mexican investors increased their deposits in US banks from $12.6 billion to $16.8 billion in 1994 – in spite of a massive withdrawal of over $6 billion from US institutions by the Bank of Mexico. See 'Fuga de 4,200 mdd a EU en enero-febrero', *La Jornada*, 11 July 1995. Figures on savings from President Zedillo's 1995 address to the nation, reported in 'La ciudadanía, motor del avance político: Zedillo', *La Jornada*, 2 September 1995. All other figures are from the Department of Finance (Canada) (1995).
[8] This section draws on Aggarwal (2000).

Road to Sustained Growth raised no concerns. As late as April 1997, Thailand's sovereign risk rating was a straight A. After June 1997, however, analysts rushed to explain its 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 which were directed towards real estate and equities. 'This over-extension and concentration of credit left the ASEAN 4 [Thailand, Indonesia, Malaysia and the Philippines] vulnerable to a shift in credit conditions' (Goldstein 1998: 1).

In Thailand, that vulnerability was heightened because of the Thai Central Bank's policy of pegging the baht to the dollar, which encouraged Thai banks and firms to borrow in foreign currency at short maturities for often imprudent ventures. Non-performing loans in the Thai banking sector were estimated to be about 20% of GDP at the time of the crisis.[9]

As in Thailand, the macroeconomic performance of the South Korean economy was sound before the crisis. 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. Historically, South 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 – South Korea failed to act (Chang 1998: 9).

The main characteristic of South Korea's financial crisis was that, in contrast to the bulk of debt incurred by Latin American countries in the late 1970s and early 1980s before the 1982 crisis, nearly all of its foreign debt was owed by private South Korean institutions. The public sector owed only $18.1 billion of the total. South Korea's 1997 year-end debt totalled $154.4 billion, excluding financial institution debt, according to IMF calculations; of this, $68.4 billion was short term (of less than a one-year maturity) (IMF 1998: 31). If all debt were included, the total short-term debt was $112.2 billion, and long-term debt was $136.3 billion, for a total of $248.5 billion.[10] (By contrast, of Mexico's total debt of $81 billion at the end of 1981, before the onset of the debt crisis, about $59 billion was public debt.[11]) As of mid-1997, Japanese banks had about $23 billion in loans and other credits to South Korea; European banks had $36 billion; and US banks had extended $10 billion of short-term credit to South Korea.

The 1997 economic crisis was first foreshadowed by the falling unit prices of semi-conductors, which squeezed corporate profits. The decline in export prices

[9] *New York Times*, 14 August 1997: 1.
[10] Korea's Economic Reform Progress Report', 2 October 1998, press release by the South Korean Ministry of Finance.
[11] *Commercio Exterior*, 9 September 1992: 852.

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

Debt forgiveness? The origins of the HIPC initiative

In the context of global economic relations, the heavily indebted poor countries (HIPC) initiative marked an official recognition by international financial institutions and the advanced industrial countries that existing programmes for improving the financial situation of the heavily indebted poor countries were not working. The emergence of the HIPC initiative was an acknowledgment that fiscal austerity and economic openness alone would not allow those countries to escape the crushing burden of their obligations to rich-world creditors. Significant debt cancellation would be necessary.

The advent of the HIPC initiative was a result of a long struggle among debtors, creditors, international financial institutions and, eventually, NGOs to cope with unsustainable debt.[12] The debt crisis in the early 1980s focused attention on the debt burdens of several middle-sized countries; but it was not until the late 1980s that serious attempts were made to confront the ever-worsening financial situation of the poorest debtor countries. The Paris Club creditors announced successive measures in the late 1980s and early to mid-1990s – the Toronto Terms in 1988, the London Terms in 1991, the Naples Terms in 1994–5 and the Lyon Terms in 1996 – to inject some flexibility and relief into poor-country debt rescheduling.

Nevertheless, the structural adjustment framework under which poor countries had obligations to their creditors – in particular, the international financial institutions – failed to free these countries from the 'debt trap'. In fact, even star performers such as Uganda were sinking under the weight of debt-servicing burdens. However, the influence and pressure of NGOs convinced a group of small European countries, then the World Bank and finally the IMF and the larger creditors that something had to be done. Under the aegis of a World Bank study, the HIPC initiative was created to manage the escape of the poorest countries from the debt trap.

2.3 COMPARING DEBT CRISIS MANAGEMENT

The conventional wisdom about the historical record of debt rescheduling has been summarized succinctly by Barry Eichengreen and Albert Fishlow (1996). The resolution of debt crises during the era of bond finance in the 1930s was characterized, they argue, by minimal government intervention. In the 1980s

[12] See Fogarty, Chapter 11 in this volume.

by contrast, they suggest that Lending and coordination of debt restructuring by the IMF arguably prevented the crisis from spreading further. In examining the 1994–5 Mexican crisis, they find that intervention took place less through 'multilaterals like the IMF as through the leadership of the United States' (Eichengreen and Fishlow 1996: 4). 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 1994–5, Eichengreen and Fishlow discuss American interests in preventing economic collapse, with consequent problems of immigration and a 'perceived failure of the US-promoted model of liberalization and privatization' (Eichengreen and Fishlow 1996: 36).

Is this assessment of the history of intervention in debt rescheduling accurate? In the subsections that follow, I shall show that the United States was much more involved in earlier debt resolution efforts than Eichengreen and Fishlow (1996) have indicated For example, in the defaults of the 1930s the United States generally did not intervene directly to help bondholders. Yet most Latin American rescheduling negotiations also did not conclude in the 1930s. Indeed, debt rescheduling only began in earnest and was concluded in the 1940s and 1950s. And in the case of two major debtors, Mexico and Peru, the US attitude proved critical, with differing US considerations and actions leading to a highly favourable accord for Mexico but to an equally unfavourable agreement for Peru.[13] The evidence also does not support the view that in the 1980s the IMF played the highly positive role Eichengreen and Fishlow indicate. In fact, 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 write-downs, that the crisis that affected nearly all Latin American countries in the 1980s and many others as well moved towards resolution.

The 1820s–1860s

Although there are similarities in the timing of borrowing and in the patterns of default during this first epoch, the same cannot be said for the patterns of debt rescheduling. With respect to rescheduling, we see much less consistency across cases, whether we focus on structural variables or on economic cycles. The timing of rescheduling varied considerably: Chile came to an agreement in 1842, and reschedulings by other Latin American states occurred in the 1850s, 1860s and 1870s. A final resolution of the continent's defaults arrived only with the Mexican agreement of 1888.[14]

[13] In the case of Peru, as I have shown, strong pressure by the British government contributed to the less favourable terms of debt settlement. See Aggarwal (1996).
[14] For a description of the differences in the timing of outcomes, see Marichal (1989: 58–61).

The outcomes of debt agreements depended on factors such as the political stability of the countries, their financial resources and the demands of their creditors. In the absence of formal international rules and procedures on rescheduling, this epoch also saw pressure by the French, British and American governments on debtor countries. The harshest measures were taken by the French, with the installation of Maximilian as Emperor of Mexico in the early 1860s.

The 1870s–1920s

As in the first epoch, the resolution of debt crises varied considerably in terms of measures taken, such as sales of assets (the Egyptian case), write-downs of debt and variation in the timing of the actual settlements (running from 1879 to the 1890s). For this era, cyclical factors, although highly significant, are less powerful explanations of default than for the first era. With respect to rescheduling, the Council on Foreign Bondholders played an active role in many negotiations, but we still see considerable variations in outcomes, particularly in terms of the role of creditor governments in the negotiations. In short, individual variations in the position of the key actors in this epoch are important in explaining rescheduling outcomes.

Mexico and Peru in the 1920s–1950s

Whereas most countries went into default in the 1930s, Mexico had been in default since 1913. Various efforts to come to an agreement with bondholders failed before the 1920s. In 1922, negotiations resumed between the Mexican finance minister Adolfo de la Huerta and the International Committee of Bankers of Mexico (ICBM) (formed in 1919). A number of issues hampered these negotiations. The Mexican government insisted that any debt settlement include a new loan. 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, de la Huerta signed a new debt accord in June 1922, consolidating Mexico's foreign and railway debts and certain internal obligations held by foreigners. But President Obregón refused to ratify the agreement, stating that he was sceptical about the 'good faith and sincerity' of the committee (Turlington 1930: 294). Only after realizing that recognition from the United States would not be forthcoming without a debt agreement did he reluctantly sign the debt accords in August 1922. Following this accord and the Bucareli Conference that led to

additional treaties of interest to the United States, Washington extended formal recognition to the Obregón government in August 1923.

Despite this new agreement, Mexico was in default again for most of the 1930s. Additional agreements in 1925 and 1930 had failed to generate significant debt repayments; and for the most part, the United States showed little interest in debt negotiations during this time. It was only with the onset of the Second World War and a renewed US interest in Mexico that Mexican debt problems were finally solved, by a United States–Mexico agreement in 1941.[15] Besides settling Mexico's agrarian and oil claims, the United States agreed to a trade treaty; it also agreed 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 in the light of its broader objectives was 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 either to take it or to accept nothing. The oil companies took it.[16] Similar US government pressure led to an agreement in November 1942 between the ICBM and Mexico, with terms favourable to the latter.[17] 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 unsecured debt bonds. Over $500 million in direct government debt (principal and interest) would be paid by $50 million in debt service.[18]

Pressure from creditor governments also played an important role in settling the Peruvian debt crisis of the 1930s. Throughout the decade, negotiations dragged on between the bondholders and Peru without sign of resolution. As in the Mexican case, with the onset of the Second World War the US government began to take a more active interest. With an eye on security concerns, it was reluctant to push the 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 aeroplanes from the German airline Lufthansa; in March 1941, it closed Transocean, a German shipping group (Carey 1964: 106–7).

By the early 1950s, however, the Peruvian Bondholders Council had convinced the World Bank to help it block new loans to Peru. Peru conceded by offering to pay back interest on the bonds and the principal in full (SD 823.10/8-1351). As some disagreement continued concerning the date from which back interest would be calculated, the British government acted on behalf of its

[15] For a good discussion of the terms of the United States–Mexico agreement, see Cline (1953: 248–9). For other discussions, see Cronon (1960) and Wood (1961).
[16] For discussion of these negotiations, see Cronon (1960), Wood (1961) and Krasner (1978).
[17] Wynne (1951: 97–8); *The Economist*, 5 December 1942: 709.
[18] Idem.

bondholders and increased its pressure. When it appeared that the World Bank was considering 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'(SD 823.10/9-1351). In the end, strong pressure from the British government and international institutions meant that the Peruvians had little choice but to agree to terms considerably more onerous than those Mexico had negotiated in 1942.

The 1980s

American banks occupied a more important role in this epoch than in earlier ones: they accounted for 35.7% of total international lending to Argentina, Brazil and Mexico, the major borrowers in Latin America in the early 1980s before the crisis. Moreover, much of this debt was concentrated in the hands of a few large North American creditors, so that their perspective on rescheduling had a disproportionately large impact on negotiations. The European banking community, on the other hand, played a more significant role in financing eastern Europe.

In more recent years, the IMF has become an arbiter of creditworthiness on private markets, and private lenders have sought to link further lending to its approval. As we shall see in the examination of our cases, it has also played a key role in monitoring debt-rescheduling agreements.[19] 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 write-down. Indeed, the IMF's strategy of continuous roll-overs 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 United States also undertook very similar actions in other Latin American countries. As we shall see, it was an active participant from the start, and enlisted the IMF to help in debt rescheduling. The effect of initial US 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.

In 1982, after the Mexican government first requested help with its debt obligations, the Federal Reserve called a group of central bank deputies to an emergency meeting at the Bank for International Settlements (BIS) in Basle. 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

[19] For a discussion of the role of the IMF in the debt crisis, see Aggarwal (1987).

released in three phases, with disbursement of the first part hinging on the negotiation results between Mexico and the IMF over austerity measures (Kraft 1984: 18). The US government and the IMF also pressured commercial banks to participate in a loan to Mexico, leading to a new agreement in December 1982 with rather generous terms for Mexico.

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 service its debt fully. On the whole, the United States during this time appeared willing to nudge the banks and Mexico towards continued cooperation but remained unwilling to promote major reduction in debt actively. Despite growing political problems in Mexico, the IMF continued to insist on Mexican adherence to an adjustment programme. It still saw itself as the stabilizer of the international financial system and the arbiter of debt negotiations between banks and debtor countries.

Signs of a new US attitude came in October 1988, following the Brazilian debt moratorium of 1987 and serious political instability in Mexico after 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.[20] Nonetheless, Mexico's problems continued to worsen, prompting US Secretary of the Treasury Nicholas Brady to propose in March 1989 a new approach to handling the debt crisis.[21] This action placed the United States firmly behind the process of debt reduction. Brady proposed that debt reduction and/or debt-service reduction should 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; it viewed excess debt and net transfer of resources as stifling economic recovery in countries that could otherwise serve as important export markets. The IMF's managing director Michel Camdessus also endorsed Brady's proposal (*IMF Survey* 1989a: 91).

Following the Brady initiative, in May 1989 the IMF and Mexico agreed to a three-year extended arrangement, including debt reduction and an immediate disbursement of funds from the Compensatory and Contingency Financing Facility (CCFF).[22] Despite US endorsement of debt reduction, however, the

[20] *The Economist*, 22 October 1988: 70.
[21] *The Economist*, 18 March 1989: 110.
[22] Of the SDR3,250.7 million package, SDR2,797.2 million were from the EFF (Extended Fund Facility) and SDR453.3 million were 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; damaged crops, which necessitated increases of Mexico's main cereal imports; and higher prices of those imports caused serious damage to the trade balance. See *IMF Survey* (1989*b*: 175).

banks were reluctant to make concessions to Mexico. By late 1989, strong intervention by the US 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 yielding an annual savings of approximately $1.3 billion for Mexico.[23]

The negotiations in the 1980s indicate that the United States and other creditor countries, rather than the IMF, proved to be the decisive actors. Creditor governments initially supported the roll-over and jumbo loan approach to debt rescheduling, which ultimately proved futile, and 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 favoured the banks. Only as dissent increased in Latin America and provoked strategic concerns and domestic criticisms within the United States did the US government pursue debt reduction. Although the IMF ultimately endorsed this approach, it did not take any initiative during the 1980s to fundamentally alter the course of debt negotiations. As we shall now see, the underlying pattern of the US role would be repeated in the 1994 peso crisis.

The Mexican peso crisis of 1994

It can be argued that the financial crisis in Mexico threatened the stability of the global economy, especially of emerging markets. However, the threat of a systemic collapse was less significant than during the debt crisis of 1982. Nonetheless, a far more costly bailout of the Mexican economy was engineered by the international financial community, led by the United States. The reason for this lay in the crucial importance of Mexico to the United States in the context of the North American Free Trade Agreement (NAFTA) and the extent to which US business interests were affected by the Mexican devaluation.[24]

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

[23] *The Economist*, 29 July 1989: 65–6. For a discussion of the Mexican agreement, see Aggarwal (1996).
[24] An official in the Mexican Ministry of Foreign Affairs suggested that the generosity of the bailout sent out a signal that the crisis was more serious than it really was. Interview, Mexico City, March 1995.

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. $7.8 billion, 300% of Mexico's IMF quota, was made immediately available. The remaining $10 billion was set aside, to be provided to the extent that the central banks in the BIS fell short of their $10 billion target. Overall, the IMF provided 688% of the quota for which Mexico was eligible, the largest financing package ever approved by it (IMF 1995). In fact, the total bailout package included money that was far from secure. Most of the real, hard money came from the US, which therefore set the lending conditions. It is unlikely that any further money could have come from outside the NAFTA partners.

The bailout package imposed strict conditionality measures on Mexico's monetary and fiscal policy and foreign borrowing. Loan guarantees were backed by oil revenues, held as collateral by the Federal Reserve Bank of New York. Mexico had to buy back the pesos it had exchanged for dollars with the United States at 2.25% or more over Treasury bill rates of varying maturities.[25] The terms included the unusual accounting practice in which every withdrawal of funds had to be approved in advance by the US Treasury, which oversaw 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 risk.

The 1990s Asian crisis: resolving debt problems in Thailand and South Korea

Thailand

Despite earlier pressures from the IMF and the US government for financial sector reforms, Thailand did not request IMF assistance until August 1997. Bangkok then received a rescue package of $17 billion, in return for its commitment to reforms in six policy areas:[26] (1) fiscal policy contraction; (2) bank closures, with the IMF immediately identifying 58 of 91 Thai financial institutions to be suspended and subsequently ordering 56 of them to be liquidated; (3) enforcement of capital adequacy standards; (4) tight domestic credit to defend the exchange rate; (5) agreement to repay debt fully; and (6) liberalization reforms including tariff reduction, reducing barriers to foreign investment and reducing monopoly powers. The United States was conspicuously absent from the loan negotiations. In stark contrast to Japan, it failed to contribute funds directly to the bailout.

[25] 'Band-aid', *The Economist*, 25 February 1995: 79.
[26] See Radelet and Sachs (1998) for a complete discussion.

The IMF's medicine only exacerbated Thailand's financial troubles, however. The abrupt announcement of bank closures increased the panic rather than instilled confidence; it added to the liquidity squeeze, making it more difficult for existing banks to continue normal lending operations (Bresnan 1998: 4). Credit all but dried up, and private investment fell rapidly after March 1997. IMF officials acknowledged their error. In November 1997, they 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 (Fischer 1998: 103). The IMF also eased the conditions of the rescue package, and allowed for a 1999 budget deficit of 3% of gross domestic product.

Despite the IMF's intervention, the financial crisis, driven largely by currency speculation, continued to spread beyosnd Thailand to the Philippines, Malaysia, Indonesia and, most importantly, South Korea. It eventually promised the Philippines $1.1 billion in aid, Indonesia up to $40 billion and South Korea up to $60 billion. By the time South Korea requested the IMF's assistance, in December 1997, the United States government had changed strategy with respect to Thailand. It had mainly been concerned that uneven implementation of IMF conditions in Indonesia might cause Thailand, and particularly South Korea, to resist similar programmes. In March 1998, President Clinton offered $1.7 billion of aid as encouragement for Thailand to continue implementing the IMF's conditions and undertake reform and as a tangible reminder that the United States supported the IMF and its goals. Once again, as in other cases of debt resolution, it was brought into the debt-rescheduling process.

South Korea

In October 1997, the South Korean currency, the won, began to slump rapidly in value. The Bank of Korea repeatedly attempted to defend its value. On 17 November 1997, however, South Korea abandoned its defence of the battered won. In making this decision, 'officials hinted broadly that economic factors had less to do with abandoning the line than political ones. A Bank of Korea official told Reuters the central bank was simply following a decision by the Ministry of Finance and Economy.'[27]

Once the crisis began, South Korea's then steadfast determination to avoid asking for help from the IMF both shaped its position and deepened the crisis. The incoming Finance Minister Lim Chang-Yuel tried to stay away from IMF by pushing financial support measures, which were too little, too late. On 21 November, the South Korean government announced that it was seeking help

[27] *International Herald Tribune*, 18 November 1997: 17.

from the IMF, but troubles persisted concerning the terms.[28] A two-week delay in signing an agreement worsened the crisis. But on 4 December, South Korean officials and Michel Camdessus signed a letter of intent covering an international accord to provide South Korea a $57-billion bailout package,[29] of which the IMF committed $21 billion. Two days later, the Central Bank of Korea announced that it had received $5.22 billion.

This bailout effort failed to stem the tide. South Korea's continuing resistance to the IMF agreement manifested itself in the presidential election that took place on 18 December: people voted for the candidate who was most critical of the IMF reform bailout – Kim Dae Jung.[30] By late December 1997, South Korea's reserves were almost gone, shrinking at a rate of $1 billion a day. On 24 December, the United States and other G-7 governments, as well as the IMF, recognized that the original strategy had failed; they agreed to accelerate $10 billion of the committed loans as a bridge to prevent default. Of greater significance, however, was the decision by the US Federal Reserve, the Bank of England, the Bundesbank and other major central banks to urge leading commercial banks to create a coordinated programme of short-term loan roll-overs and longer-term debt restructuring.[31] At this point, South Korea had approximately $100 billion outstanding in short-term debt, of which about $15 billion was due at the end of December and another $15 billion at the end of January 1998.

As in previous debt crises in other countries, the different levels of exposure to the country influenced cooperation among banks in managing the crisis in South Korea.[32] Major banks with large exposures could gain by transforming their debt into loans with higher interest, and they spearheaded the effort to coordinate their actions by meeting early on in the crisis. Smaller banks, by contrast, continued to resist. To some extent, even the large banks felt heavily pressured by the IMF and governments. For example, 'leading Dutch banks ABN AMRO and ING said they have agreed to roll over South Korean debt following a request from the International Monetary Fund, but on the condition that other G-10 nations as well as Australia and New Zealand do the same (Roubini 1998a).'

On 24 December 1997, six major US banks – J.P. Morgan, Bankers Trust, Bank of America, the Bank of New York, Chase Manhattan and Citicorp – met and released a joint statement on their intention to provide supplemental funding to South Korea.[33] On 29 December, major American, European and Japanese

[28] *New York Times*, 2 December 1997: A1.
[29] *Los Angeles Times*, 4 December 1997: D1.
[30] *Financial Times*, 19 December 1997: 20.
[31] *Euromoney*, 15 March 1998.
[32] See Aggarwal (1987) on coordination problems among banks.
[33] *New York Times*, 25 December 1997: A1.

banks reached an eleventh-hour informal agreement to roll over the short-term debts coming due on December 31, but for varying times.[34] Although the major banks' effort was initially resisted by smaller banks, which preferred to exit from South Korea completely rather than incurring more costs,[35] the latter agreed on 5 January 1998 to roll over all of Korea's maturing obligations until 31 March, easing worries about default on some $40 billion of debt.[36] This agreement was officially signed on 16 January 1998. Despite the roll-over, South Korea still had to pay off about 10% of the due loans on 31 December 1997, leaving only $9 billion in foreign currency reserves.[37]

At the inception of the debt crisis, much of the discussion was about managing the short-term debts coming due in 30, 60 and 90 days. While private international creditor banks were discussing the issue of rolling over short-term debts, the South Korean government needed to decide on a long-term financing strategy. Unfortunately, although it was working hard with foreign banks to avoid a formal moratorium, it had to work against South Korea's declining credit rating, because Moody's claimed that the forced roll-over of interbank credits was equivalent to a default.[38]

Various plans to ensure a longer-term rescheduling were vetted. One plan, masterminded by J. P. Morgan in cooperation with Citicorp and Chase Manhattan, called for South Korea to offer $25 billion in bonds. $10 billion of the bonds would be sold for cash, to bolster Korea's waning foreign exchange reserves, and the remainder would be issued through a Dutch auction to foreign lenders who wished to take them in place of their short-term loans to South Korea (Roubini 1998b). The plan initially called for a swap portion of $15 billion, but some non-US banks complained that 'the liberal use of South Korean government-backed bonds would dilute their hard-earned and close relationships with Korean clients'.[39] A second idea came from a meeting between the Bank of Korea governor Lee Kyung-Shick and Société Générale, the French bank designated to represent all French commercial banks, on 9 January 1998 to discuss the future of South Korea's short-term debt.[40] Société Générale proposed converting some outstanding South Korean debt into floating rate notes

[34] *Financial Times*, 31 December 1997: 4; *Euromoney,* 15 March 1998.
[35] *New York Times*, 3 January 1998: D3.
[36] Citicorp Vice Chairman William Rhodes helped to persuade banks around the world to roll over short-term loans to South Korean banks. His message to international commercial bankers was 'Let's stop the hemorrhaging and buy time to get the country back to the international financial markets.' *Wall Street Journal*, 9 January 1998: 10; *The Sacramento Bee*, 2 January 1998: A1.
[37] *New York Times*, 5 January 1998: 10.
[38] *Financial Times*, 13 January 1998: 5.
[39] *Dow Jones International News*, 15 January 1998.
[40] *The Scotsman*, 9 January 1998: 28.

after that debt was rolled over, thus addressing South Korea's concern about the high price it might be forced to pay in order to obtain funds.[41] Another proposal, which the South Korean government also did not choose, was supported by bankers at Goldman, Sachs & Co. and Salomon Smith Barney. This would have made available $5 billion in syndicated loans, to bolster foreign exchange reserves, followed by a bond offering of $9 or $10 billion. The bond offering under this proposal would not have turned the debts into bonds; it would have been up to the banks to renegotiate (Roubini 1998c).

In the end, the price of new funds seemed to have mattered to the South Korean government: it chose the Société Générale model of long-term financing. Negotiations continued during January 1998. According to You Jong Keun, a top economic adviser to the 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".'[42] Lenders asked that the new loans carry an interest rate of 7–8% over LIBOR (London Interbank Offering Rate).[43] Meanwhile, Société Générale had proposed that the interest be pegged at 4% above LIBOR.[44] But given the pressure for international banks to share in the costs of rescheduling, and also the worldwide losses already incurred by stock investors in South Korean companies, the South Korean government tried to negotiate an interest rate below the market rate.[45]

At the end of January 1998, the South Korean government and its global creditors agreed on the debt-exchange method of financing. Under the Société Générale plan, about $24 billion of South Korea's short-term bank debt was to be exchanged for government-guaranteed loans with maturities of one, two or three years and bearing a floating exchange rate of 2.25%, 2.5% and 2.75% over the six-month LIBOR respectively.[46] Of the $24 billion, the South Korean government pledged to guarantee $20 billion. More than 200 international banks were involved, and the negotiations with the South Korean government were led by the Bank of America, the Bank of Nova Scotia, the Bank of Tokyo-Mitsubishi, Chase Manhattan Bank, Citibank, Commerzbank, Deutsche Bank, HSBC Holdings, J.P. Morgan, Sanwa bank, SBC Warburg Dillon Read, Société Générale and Westdeutsche Landesbank.[47]

In 1999, capital inflow, IMF bailout funds and import contraction boosted South Korea's trade surplus and usable foreign exchange reserves.[48] A government-

[41] *Dow Jones International News*, 21 and 23 January 1998.
[42] *Wall Street Journal*, 26 January 1998: A12.
[43] *The Daily Yomiuri*, 25 January 1998: 1.
[44] Idem.
[45] *Wall Street Journal*, 26 January 1998: A12.
[46] *FT Asia Intelligence Wire*, 30 January 1998.
[47] *Dow Jones International News*, 28 January 1998.
[48] *Business Times* (Singapore), 21 April 1998, 6; also (World Bank 1999).

led programme in financial sector reforms, especially corporate debt and operational restructuring, affected half of the 72 financial entities, including the largest South Korean banks and conglomerates (World Bank 1999). Since then, the South Korean economy has continued to recover, although many concerns remain about the fragility of the recovery and the financial solvency of major companies.

HIPC and the emergence of debt forgiveness

The debt situation of the world's poorest countries raises a different question for this analysis: will similar trends of leadership and debt resolution occur with respect to a group of countries that are essentially marginal to the interests of the key actors? The debt situation of these countries poses no real risk to systemic stability, and the advent of debt reduction has occurred not in reaction to a catalytic event but in response to external political pressure on the key actors. Thus the HIPC case *is* qualitatively different in that the context and the actors are different from the cases discussed above.

The contextual difference between the HIPC case and the cases above is that the poorest countries' debt situation presents no immediate risk to any of the principal actors other than the HIPCs themselves. Lending to these countries comes from a variety of sources – private banks, Paris Club creditors and, most importantly, the IMF and the World Bank – none of which is overexposed in these (mainly African) countries. Therefore, the difficulties that these countries have experienced with IMF-backed structural adjustment programmes and the growing dilemma of the debt trap (in even the most successful performers, such as Uganda) does not threaten the broader interests of creditors. Thus, many creditors were content to undertake periodic rescheduling while continuing to collect interest on their loans. The emergence of the HIPC initiatives (see the chapters in this volume by Brigitte Granville and Edward Fogarty) was not a creditor reaction to systemic crisis but a creditor recognition that these debtors would not be able to escape from the debt trap. Creditors worried that these countries might eventually default en masse, with the inevitable result of complete non-payment of both interest and principal. In other words, the HIPC initiatives were a reaction to a potential future crisis, not one already underway.

The HIPC initiatives cannot be considered simply as a case of enlightened self-interest among creditors, however. Their advent is even more a story of the growing effectiveness of international NGOs in framing debt as a moral issue and bringing it onto the international agenda. In this sense, NGOs are a completely new type of actor in debt-resolution processes, and can affect considerably the dynamics of international bargaining. By applying increasing pressure as poor-country debt issues remain unresolved, NGOs such as Jubilee 2000, Oxfam and others have increased the costs of private and multilateral

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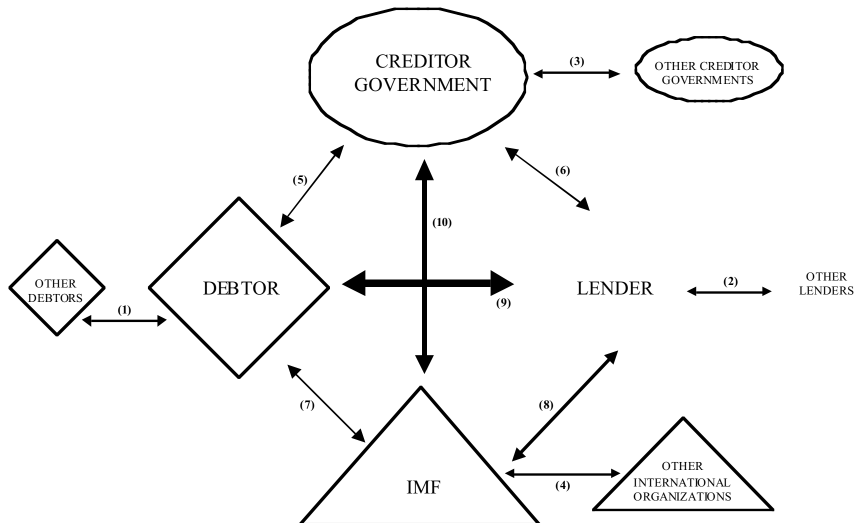
banks' inability to work together to negotiate with debtor governments. On the other hand, NGOs have acted as (unsolicited) advocates of debtors, in essence representing a 'united front' for a group of countries that otherwise cannot make a commitment to collaborate on their own. With pressure to resolve poor-country debt increasing while creditors' ability to achieve satisfactory long-term solutions remains inadequate, it is not surprising that HIPC1 and HIPC2 have been undertaken by creditors *before* the debt situation of these countries threatens the stability of the international financial system.

2.4 LESSONS ON THE ROLE OF CREDITOR GOVERNMENTS

To draw policy lessons about how better to resolve debt crises, it is important to understand the nature of the bargaining among various parties involved and the problems each party faces. Figure 2.1 illustrates 10 possible bargaining relationships. Among similar actors, there is interaction among (1) debtors, (2) lenders, (3) creditor governments and (4) international organizations. In addition, there are six remaining interaction possibilities among pairs of different types of actor. Although we could analyse each of these relationships, we need not examine each in detail in order to understand the basics of debt-rescheduling negotiations.

When a crisis begins, there are strong incentives on the part of banks to stop lending and on the part of debtors to stop paying. Cooperation in principle

Figure 2.1: The actors and their potential bargaining relationships in debt rescheduling



Source: Aggarwal (1996: Ch. 2)

could be better for both, but cooperation means active adjustment and the bearing of costs. Banks realize that they cannot afford to do this alone *vis-à-vis* debtors, but they have problems cooperating among themselves. First, each wants the others to bear the burden, and this is complicated by the large number of actors involved. Second, different levels of involvement among banks also lead to problems for cooperation. Bank exposures vary by capital outlay, timing, maturity, type of loan and borrower. Some banks make short-term loans; others make longer-term ones. Some loan to private firms, others to the state.

Debtors also face different collective action problems in forming a united front against creditors. Both their competition for continued funds from banks and the lack of an authority to enforce cooperation (that is, to guard against cheating) have blocked the formation of debtor cartels. At the same time, important domestic differences in ability to undertake economic adjustment coupled with variations in size and debt burden, generate different levels of interest in and commitment to cooperation.

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.[49]

Difficulties in cooperation between banks and debtors have contributed to a larger role for creditor governments and international organizations. Historically, debtors and lenders have often attempted to involve creditor governments (CGs) in negotiations by linking debt to security or trade issues. When debtors have succeeded in linking debt to CGs' national interest, these governments have at times provided financial aid and 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.[51] Private lenders have often called on their governments to enforce the 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 negotiations of their own volition, to meet their own strategic, political or economic objectives.[52]

[49] Lipson (1985) examines bank efforts to unite in the 1980s. Aggarwal (1987) analyses the differential success of banks and debtors in uniting.

[50] 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.

[51] 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.

How do CGs decide whether or not to intervene? I argue that three considerations are important: strategic security concerns, financial concerns and political concerns.[52] With respect to security interests, these depend on factors such as (1) the types of political alliance CGs have with other major powers; (2) the number of competing major powers in the system; (3) the importance of international financial institutions; and (4) 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 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 the US government's interests in its own banks.

With respect to CGs' financial concerns, 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 those 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; the second influences the CG's level of interest in taking the lead in rescheduling matters.

Finally, with respect to political issues and to their relationship with debtors, CGs are concerned with the impact of debt rescheduling on their trade relations, political alliances and ideological concerns and with possible spillovers to areas such as immigration. Severe economic adjustment programmes 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 US 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 programmes on governments' stability.

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 states without being directly associated with their promotion.

[52] A more precise analysis of intervention calculations by creditor governments can be found in Aggarwal (1996: Chapter 3).

Although intervention in debt crises by creditor governments and international organizations has helped to overcome the problems of cooperation between debtors and creditors, this intervention has been the subject of great controversy. In the Mexican crisis, for instance, there were concerns that the bailout package would send the wrong signal to private markets and developing countries.

Many were worried that the peso bailout would create a problem of moral hazard that might discourage responsible fiscal management in countries such as Russia. Similarly in the Asian crisis, Martin Feldstein (1998) argues, 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.

Despite such controversies, historical evidence suggests that in the 19th and early 20th centuries, bondholders and debtors took an inordinate amount of time to reach an accord when left to their own devices. Indeed, accords were often reached only with significant US participation or by way of linkages to loans from international institutions, the former leading to a debtor-favourable settlement, as in Mexico, and the latter leading to an unfavourable agreement, as in the case of Peru.

In the 1980s, initial efforts by the United States and the IMF to resolve debt crises and forestalled a financial crisis led to a protracted period of roll-overs, jumbo loans and the like, resulting in high costs for Latin American debtors. Debt negotiations came to an end only with the Brady Plan, which called for significant write-downs in debt. Although the IMF came to endorse this strategy, it did not take any initiative that deviated from its traditional approach.

The more recent cases of the 1994 Mexican peso crisis and the Asian crises were characterized yet again by heavy US involvement. In the peso crisis, significant US guarantees enabled the Mexicans to attract capital again and put their economy on a sounder footing. The Asian crises have not been fully resolved, and the IMF's initial errors and the United States' endorsement of the bulk of its actions do not signal that much has been learned from previous efforts to cope with debt crises. Meanwhile, the emergence of the HIPC initiatives may be an example of a collective action problem solved by debtors – or rather by the NGOs on behalf of the debtors – to the effect that creditors have had to go along with (some) debt reduction, and not just debt rescheduling. However, it remains to be seen whether the relative power of US, European and Japanese creditors will reassert itself (and to what end) in the resolution of HIPC debt.

2.5 CONCLUSION

This chapter has attempted to show how the origins of debt crises have historically been linked to the cycles of lending and retrenchment in the international economy. My analysis of these cycles has focused not only on lenders and borrowers

but also on systemic factors such as the distribution of capabilities and the role of creditor governments. In discussing the role of CGs, I have sought to discuss their different concerns and motivations in intervening in debt crises.

The historical case studies, including the most recent Asian crises, have highlighted the important role of CGs, especially the United States, in debt crisis management. Strong US interests and pressures, if present, have been crucial in facilitating negotiations and agreements in most cases. Intervention by CGs may also significantly shape the outcomes of debt resolutions, as I have shown in the cases of Mexico and Peru in the 1930s and 1940s.

In my view, understanding the motivation of the United States and other creditor countries more generally helps us to consider questions of appropriate international institutional mechanisms that might facilitate the management of future international debt crises. Effective and speedy resolutions of such crises require not only the involvement of international institutions but also the active participation of CGs, especially the United States.

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