The IMF Meets Commercial Banks: Sovereign Debt Restructuring between 1970 and 1989

Jérôme Sgard

The IMF Meets Commercial Banks:

Sovereign Debt Restructuring between 1970 and 1989

Jérôme Sgard

Sciences-Po / CERI

November 2011

jerome.sgard@sciences-po.fr

1. Introduction

Between 1982 and 1989, the International Monetary Fund (IMF) acted as a third party in a total of 210 debt restructurings between 41 debtor states and their creditors—official lenders from developed countries and hundreds of commercial banks. This experience of the Fund operating a quasi-bankruptcy procedure was all the more remarkable given that it never assumed such a role either in its early, post-1944 practice or in the ulterior periods.

Third-party intervention did not take the form of a classical adjudication, however. Instead, the Fund followed three different models simultaneously: (i) it provided neutral public goods (e.g., information, expertise, and an operating rule); (ii) as a crisis lender, it acted also as a broker and so entered into strategic interactions with banks and national governments; and (iii) it offered ex post enforcement guarantees (i.e., conditionality) as regards the debtor countries' economic policies. Note also that, contrary to a judge under most domestic bankruptcy laws, the IMF was not empowered to confirm a majority vote by creditors or to step in and impose a settlement, if they failed to agree. Hence, the whole process was directly confronted to serious problems of collective action: banks might fail to coordinate or might disagree with the debtor country; they could also hold off on making any decision in the expectation that the IMF (and/or other official agencies) would bail them out.

In place of adjudication, decision making took the form of a rule of distributed veto power: case after case, each party had to endorse explicitly a burden-sharing agreement that sought ex ante to balance the financial concessions made by banks, the policy commitments of debtor countries, and IMF lending. Thus, the Fund could block a debt accord that it considered to be nonviable from an economic perspective. In turn, the ad hoc representative committee of banks could veto a loan agreement between the IMF and a member country if, for example, the committee viewed the country's proposed economic adjustments as being insufficient to guarantee a proper level of debt service. And finally, of course, the country in question had to sign off on all arrangements. So even though the process did not actually mimic the operation of a court, third party contributions were decisive in structuring decision making and addressing issues of coordination, distributive equity as well as contractual recommitment.

This article analyzes how this regime was formed, how it evolved, and how the underlying collective action problems were actually solved. Toward that end, two main sources have been reviewed over a twenty years period: (i) the IMF's Executive Board deliberations on debt policy, which reflects how core member states envisaged the problem and tried to guide the organization; (ii) the specific contributions of the IMF Staff and its Managing Director, who heads the Fund. This approach seems to be particularly adequate in the case of an organization which internal expertise is considered as quite strong and which Staff has traditionally taken an active role in shaping policies and programs (Barnett and Newman, 2004). This overall approach then offers a detailed understanding of how the different stakeholders viewed the issues, what their policy preferences were, and how institutional innovation eventually came about.

The most striking finding that arises from this exploration is the highly informal and evolutionary character of the IMF's practice in this matter. There was first a prolonged trial-and-error period during the 1970s, a period in which the Fund's principals at best tacitly tolerated experimentation and the accumulation of know-how by the organization. In 1982, when Mexico opened the debt crisis of the 1980s, the Fund was therefore able to draw directly from those earlier experiments when assembling a more coherent and binding set of rules. This was also the moment when the governments of the United States and the other G7 countries explicitly endorsed the Fund's involvement in brokering deals and brought their unique political leverage to bear on the parties. Critically, their willingness to arm-twist the banks was instrumental in obtaining that they coordinate with the debtor countries.

This "Mexican jurisprudence" subsequently governed all debt restructuring until 1989, which in the case of bank debt totalled KK accords. Still, piecing together the exact rules of the game is not a entirely self-evident task, as they were never formalized in any international agreement, treaty, communiqué, or guidelines. Furthermore, *all* alternate and broader legal rules that could have governed or influenced debt renegotiations were systematically ignored or circumvented—a claim that holds equally for the clauses written into the initial bank loans, for national jurisdictions and their domestic bank regulations, for rules of international public law, and for the IMF's own Articles of Agreement. Even its internal bylaws were freely reinterpreted when convenient.

Lastly, informality and experimentation also applied with respect to the ex post monitoring of economic policies. IMF conditionality had been shaped, since the 1950s, as a high-power, bilateral arrangement with the Fund that was embedded in—and legitimized by—strong multilateral principles (Dell 1981, James 1998). From the late 1970s onward, conditionality was gradually leveraged in favour of private banks as well. As one might expect, mobilizing the Fund as a de facto private debt collector proved to be no less contentious than pressuring private banks into collective arrangements.

Sovereignty and private contracts

Randall Stone's (2008) concept of *conditional delegation* offers some analytical support at this point. Stone argues that there is, indeed, considerable 'agency slack' in the Fund as well as many informal rules that preserve certain power relationships; in contrast, formal rules embody the status quo among all stakeholders. Political consistency is thus maintained by, inter alia, the convergence of long-term interests and policy preferences among the IMF Staff, the Management, and the core member states. In Stone's view, this setup allows the US government to remove itself from day-to-day monitoring while reserving the option to resume direct command when its own interests are at stake. The evidence presented here suggests that this capacity to diverge from the status quo—and hence to innovate and shape new rules—is shared by the agent (i.e., the Management and Staff).

Nonetheless, the de facto suspension of the preexisting, more formal rules cannot be explained simply by agency slack or by divisions within the (collective) principal. That is, the broader political and institutional environment must also be taken into account.

From this perspective, the emergence of an ad hoc restructuring platform—as well as the leveraging of conditionality into a triangular interaction that included banks—are typical examples of what the legal critic and international lawyer Matti Koskenniemi calls *deformalization*: a process whereby the internal consistency of legal rules, and hence their grounding in coherent political or ethical principles, is debased by policy makers for the sake of expediency. In this way the law becomes a mere policy instrument or coordination device, not a guardian of rights or a keeper of broad rules of international political ordering.[1] In the present case, the notion of deformalization may help account for the existence of a regime that remained weakly institutionalized even as its regular working asked at the same time that many 'meta-rules', both domestic and multilateral, were relaxed. Weakening the meta-rules allowed for policy experimentation and innovation, albeit at the substantial cost of a reduced capacity to formalize and legitimize the new practices.

Specifically, it is argued here that the Fund's experience reflected the difficulty of adjusting the classical, post-1945 relationship between sovereign states and multilateral bodies to a world in which private agents were regaining independent access to the international economic scene. In the early 1970s, as commercial banks resumed their large-scale lending to developing countries, official agencies rapidly lost the control over international liquidity that they had maintained since the end of World War II. Soon they would be regularly confronted with the interests of private financiers, whose demands could be quite threatening during a payment crisis. The debt cycle of the 1970s and 1980s thus became the first occasion on which the IMF and its principals were forced to identify effective ways of interacting directly with market agents so that large volumes of debt contracts could be eventually restructured.

The problem is that intergovernmental organizations, such as the IMF, were never meant to interfere with private rights or to adjudicate a debtor's bankruptcy. Typically, citizens and firms bring contractual disputes to a domestic court or a private arbitration forum. With respect to trade issues, governments argue in front of a WTO dispute resolution panel whose decisions are then enforced domestically. On sovereign debt matters, there was no established rules and forum that could have guided negotiations and collective action. This was the context in which deformalization—which

[1] "By deformalization I mean a process whereby the law retreats solely to the provision of procedures or broadly defined directives to experts and decision-makers for the purpose of administering international problems by means of functionally-effective solutions" (Koskenniemi 2007). Petman (2011) applies this concept to the UN Security Council and the UN High Commissioner for Human Rights.

involved experimentation, bargaining, and raw power politics—eventually led to the Fund making decisions that paralleled those of a bankruptcy court though on an entirely different normative and political basis.

The paper proceeds as follows. Section 2 describes how it fits within the preexisting academic literature. Section 3 identifies the principal factors leading to the 1980s debt crisis and discusses how alternative institutional solutions were sidelined before the IMF emerged as the main forum for restructuring. Section 4 draws directly from the Fund's archives in order to identify the evolution of IMF strategy between 1970 and 1982.[2] Section 5 describes how the 1982 Mexican crisis was handled, and it analyzes the debt restructuring regime that was established thereby and that endured thereafter.[3] Section 6 discusses this regime in the context of deformalization and its justification, and Section 7 briefly accounts for the regime's eventual decline and fall. Section 8 concludes.

2. Related literature

Most of the academic literature on the debt crisis of the 1980s was actually produced at that time or immediately afterward. These contributions typically center on "macro" dimensions, whether they be economic and financial or political. Few authors have addressed the micro-level issues on which this article focuses: the issues of coordination and collective decision making.

A good entry point on the overall debt crisis is Cohen (1986), who proposes—on the basis of many interviews—an analytically informed account of the entire period extending from the 1970s oil shocks to the first post-1982 years. Kraft (1984) is also based on oral history, though his book focuses especially on the 1982 Mexican episode and is more narrative than analytical. Many macroeconomic contributions subsequently explore such issues as current account deficits, fiscal imbalances, the dynamics of debt stocks, and the so-called transfer problem. For example, Cline (1984) and Dale and Mattione (1984) are good primers, and both Cline (1993) and Dooley (1995) are good retrospectives. Some texts that cover the broader financial trends of that period also allocate one or two chapters to these events. Works in this vein include Helleiner (1996), James (1996), and Boughton (2001).

[2] The Fund's archives include the *Minutes* of the Fund's Executive Board meetings, where the representatives of member states (i.e., the Executive Directors) gather at least once a week to make or endorse the IMF's strategic decisions. They also include many *Staff Memoranda* that convey to the Board the collective experience, judgment, and proposals of the organization. Additional insights into the policy-making process are provided by internal *Office Memoranda*, which are typically not circulated to the Directors. Finally, the *Private Papers* of the successive Managing Directors can also be found in the Fund's archives. These archives are opened to the public after five, ten, or twenty years depending on how politically sensitive the contents are; some documents remain secret for even longer periods.

[3] Throughout this paper, the term "regime" is used pragmatically, much as in the standard definition given by Krasner: the "principles, norms, rules, and decision-making procedures around which actors' expectations converge" (1982); see also Stigal (1985). I also share the view of Kahler (1986), who argues that the debt restructuring regime established in 1982 was based on "fragments of [a] regime" that had emerged in the previous period.

In contrast, this literature is notably lacking in exploration of the dynamics of recontracting or the role of third-party arbitration. For instance, the early and influential papers of Eaton and Gersowitz (1981) and Eaton et al. (1981) model a government's decision to cease debt service as a trade-off between internal political benefits and reputation costs vis-à-vis foreign creditors. In effect, this representation of the sovereign debtor closely resembles the anomic state in the standard realist literature of International Relations: it acts in an international arena where rules and institutions are not expected to have much impact. The same pattern is observed by Bulow et al. (1988), who discuss recontracting but do not formalize an institutional setup that would help resolve the underlying collective action problems.

It is therefore significant that economic contributions have ignored the parallels between sovereign debt restructuring and domestic bankruptcy laws.[4] This failure is remarkable also because the literature on law and economics had already explored the domestic side of this comparison (Jackson 1986). In the 1980s there was also a substantial legal literature on international debt (e.g., Wood 1982, Mudge 1984, Buchheit 1986, Buchheit and Reisner 1988) that could have been mobilized. But it was not until the turn of the century that the parallels were fully examined (Bolton 2002, White 2002), in response to an IMF proposal to establish a full-fledged "bankruptcy court for sovereigns": a body that would have had the same function as the informal methods used in the 1980s but within a formal, statutory framework (IMF 2002).[5]

However, there are a few exceptions to this pattern of benign neglect concerning the microeconomic and institutional dimensions of debt renegotiations. Guttentag and Herring (1983) delved directly into the issue, but the extent of their information on actual practices was substantially less than what can now be gleaned from the IMF archives. With a perspective that draws more from political science, Lipson (1979, 1985a, 1985b), Wellons (1985), and Kahler (1986) explored the divisions among banks as well as their interactions with public regulators. Lipson in particular underscored how the larger financial institutions directly relied on their market power in seeking to control the risk that the smaller ones would opt-out of, or free ride on, a collective arrangement. And when that power was insufficient to the task, national bank regulators or central banks would step up the pressure. This is a critical insight that will be further explored here.

Power politics did actually into play in the debt game, sometimes with a strong flavor of hegemonic intervention. In 1982, core member states and the Fund explicitly assumed that decisive and coordinated action was needed in order to stabilize a world financial order that the individual parties (debtors and creditors alike) could not have stabilized if left to their own devices (Boughton 2001,

[4] Comparisons of this type were suggested by Kenen (1983), Rohatyn (1983), Weinert (1983), and Cohen (1989), but there was little analytical development along these lines. See also Oechsli (1981) for one work written from a legal viewpoint.
[5] Retrospective analyses of the restructuring model of the 1980s are rare, but see Hagan (2002) for a legal perspective as well as Rogoff and Zettelmeyer (2002).

Rhodes 2011). This supposition explains the willingness of national regulators to pressure banks into participating to the Fund's strategy. It was at these times that the Fund acted most clearly as an agent of the core member states (Broz and Hawes 2006, Stone 2008). On the other hand, there is no evidence that the IMF was "captured" by private banks (Gould 2003) or that such arrangements were a source of moral hazard due to the Fund's insuring banks against loan losses (Vaubel 1983). Rather, the Fund's success in imposing negotiated settlements should be understood as a response to the risk—well perceived at the time—that bailing out private agents could have adverse long term consequences (Sachs 1995, Eichengreen 2003).

Schematically, then, raw power politics were seen to be openly at work in the ex ante coordination of banks as well as in the ex post enforcement of conditionality. However, the rules that governed "burden sharing" and recontracting had to offer some guarantees of neutrality and equity lest the whole regime be considered unacceptable. As said, a debtor state or bank that felt badly treated could have rejected a given agreement; even they could have opted out of the regime entirely, as was actually threatened in the late 1980s. The third-party or "triadic" nature of debt resolution during this period was driven by these considerations (Stone Sweet 1999). The point is that this regime did not develop into a true judicial institution—in other words, one founded on an explicit devolution of authority, on formal rules of adjudication, and on credible commitments by the states to respect the regime's independence. It is significant that, during all these years, the Fund never adopted the strategy of legitimizing itself as an arbiter or trustee, i.e. a body which efficiency would rest ultimately on a self-standing notion of procedural integrity and the presumption of political independence (Alter 2008). That private banks entrusted large volumes of assets to this regime in spite of these structural weaknesses confirms indirectly that structural power relationships remained closely intertwined with quasi-judicial patterns.[6]

3. Historical background

From recycling to debt crisis

Developing countries reentered private capital markets during the 1970s, about a decade later than developed countries. This trend received a strong impetus after 1973, when the current account surpluses of oil-exporting countries were largely recycled to Mexico, Argentina, Yugoslavia, the Philippines, and so on. No less important was that private banks—and not multilateral organizations—

[6] Keohane et al. (2000) and Alter (2006) agree that international courts tend to be more independent when nonstate actors have access to them; in their view, this type of jurisdiction typically arises when states want to give strong commitments that private rights will be protected.

did most of the work, typically via syndicated loans.[7] This recycling set an altogether new course for the conditions under which developing countries would finance themselves, how they would address possible payment difficulties, and how the Fund might mediate on such occasions (IMF 1974).

An additional dimension is that the overall sustainability of private recycling was always a doubtful prospect. Contrary to widespread belief, the risks incurred by large accumulations of debt were well known at the time and did not remain unaddressed (Cohen 1986). Already by 1976–1977, for instance, US regulators were asking banks about their "country risk" procedures and about the adequacy of their equity capital to balance this new and rapidly growing class of risky assets. Yet because the bank-based recycling strategy had ostensibly been supported and monitored by the leading developed countries, the expectation was widespread that, if things turned sour, their governments would step in and cover possible losses—in other words, they would bail out the banks.[8]

From the late-1970s onward, the recurrence of debt restructurings increased in response to three main factors (Cline 1984, Boughton 2001, James 1996). First, after the 1979–1980 oil shock, many large developing countries began to accumulate debt at a more rapid pace. Second, the tightening of US monetary policy after 1979 led to a sharp increase in the cost of servicing debt, most of which had been contracted at flexible interest rates. Third, the world recession of 1980–1982 directly affected the capacity of these countries to generate export earnings at the very moment when their financial needs were sharply on the rise. Whereas only 10 countries had renegotiated their debt between 1975 and 1979, 20 countries concluded such arrangements during 1980–1982 (i.e., before the onset of the Mexican crisis in August 1982).[9] As financial tensions increased, they also spilled over from minor players (e.g., Zaïre, Jamaica, communist Poland) to the major players. In the weeks after the Mexican domino fell, it was followed by many others—starting with Argentina and Brazil. This is when the IMF first identified contagion as a serious threat (IMF 1983a).

Competition among forums

By that time, however, the interwar period's experience with debt restructuring had been essentially lost: there was no longer either a forum or an established set of rules to guide such operations. So the first step in accounting for how the IMF won a de facto monopoly in this matter is to examine how a

[7] On recycling, see Cohen (1986), James (1996, chapter 11), IMF (1973). A *loan syndication* is a collective lending operation, coordinated by a few lead banks, that raises funds from a large body of smaller financial institutions. After issuance, the agents' banks retain a number of fiduciary duties (e.g., the collection of interest payments) vis-à-vis participants. See Clarke and Farrar (1982), Mudge (1984), Buchheit (1986), Wood (2010).

[8] For example, US Secretary of the Treasury Michael Blumenthal declared in 1977 that "the lending policies of the private banks, which are performing a quasi-governmental intermediary function, must be far more intimately coordinated with the involvement of the International Monetary Fund and the other international financial institutions" (Blumenthal 1977).

[9] Summary tables on restructuring operations prior to 1982 can be found in IMF (1983f); for the post-1982 era, see IMF (1991).

variety of other institutional options were gradually sidelined. Four of them were actually tested before the Fund took over.

The first option, default, was seldom considered in practice. In that case, the parties would have followed what the initial debt contracts stipulated concerning renegotiations; and if a private agreement could not be obtained then the parties would have litigated—probably under different jurisdictions. Moreover, entry into such a procedure could be expected to trigger a "default event" on all debts owed by the country in question.[10] In many cases, banks would then have been required to post large loan-loss provisions or even declare themselves insolvent. In practice, this was a recipe for disaster.

The second option was for privately coordinated creditors to enter in direct negotiations with the government of the debtor country—that is, without any mediation (just as before 1914). Only one experiment of this sort was attempted, in 1976: at its own initiative, Peru negotiated both a financial agreement and an economic program with a consortium of American banks but without any input from the Fund in terms of information, expertise, or economic monitoring. After less than a year, the whole program collapsed and the banks declared that they would never again try to do the Fund's job; they were simply not equipped to enforce conditionality.[11] Of course, the whole episode was closely monitored by the IMF (1977d) and became part of its knowledge base.[12]

The third option was debt restructuring through an institutional forum designed by the United Nations Conference on Trade and Development (UNCTAD). This body, which is governed by a one-country, one-vote decision rule, was used during the 1970s by developing countries as a platform for demanding better trade and financial conditions. At the 1979 Conference in Tanzania, a resolution was adopted that called for the creation of a permanent "International Debt Commission" explicitly aimed at balancing social fairness and financial commitments; the possibility of deciding across-the-board debt write-offs was also mentioned (Zivkovic 2005). However, the developed countries immediately made clear that they would not follow suit, and this proposal barely registered with the Fund.

The last alternative was bailout, an option favored by many in the banking sector in the early 1980s. As financial distress in the less developed countries steadily increased, the banking community was awash with proposals for banks to (i) launch a mega-loan syndication on behalf of the Fund, (ii) use it to replenish the IMF's coffers, and then (iii) ask the Fund to bail them out from their excessive lending

[10] Mudge (1984) details how the agent banks that had coordinated the initial loan syndications were replaced by so-called Steering committees. On the creditors' side of the restructuring, see Buchheit (1988), Buchheit and Reisner (1988), and Hagan (2002). The only documented occurrence of litigation is the Allied Bank case (decided in New York in 1985), which concerned Costa Rica; see Rogoff and Zettelmeyer (2002).

[11] The Peruvian experience is discussed by Stallings (1979); see also Ballivean (1976) and the panel discussion in *Syracuse Journal of International Law and Commerce* (1978).

[12] A 1985 memo on the Peruvian program noted flatly: "It is clear that the monitoring effected [by the banks] came nowhere near the close scrutiny associated with the implementation of Fund-supported adjustment programs" (IMF 1985a).

to developing countries.[13] The eventual costs would admittedly have been borne by taxpayers, but it seems that this was a price worth paying. In practice this option was the true alternative to the Fund's negotiated approach, which by the end of 1982 was clearly intended as a response to moral hazard.

We now turn to the question of how, after sidelining alternative options, the IMF assembled ad hoc rules capable of resolving the collective action problems raised by defaults. Prior to 1982, the IMF had actually reviewed its debt policy in 1970–1971, 1977, and 1980–1981. On each occasion, Staff memos and the Minutes of Board meetings reflect the evolving nature of the problems and the emerging strategic options that were contemplated. They also show how the Fund tended to be proactive and experimental even as the member states favored orthodoxy and cautiousness.

4. How the IMF innovated

Coordination and Fund lending: The 1970–1971 review of debt policy

When the IMF discussed its first position papers on debt, in 1970–1971, it had already been party (since the late 1950s) to a number of restructurings, although on an occasional basis only and in the context of a division of labor within the World Bank that had not yet been settled.[14] Note that the sovereign debt market in earlier times bore few similarities to its subsequent incarnations. In the first place, lenders were either aid agencies or export guarantee institutions; hence almost all belonged to the public sector and so, in case of trouble, they were coordinated by the Paris Club.[15] In those days, financing problems were of a mostly short-term nature and took the form of accumulating arrears to these different agencies. The notion that a country might default across the board on all its debt was little more than a threat, not an actual occurrence, and systemic risk was never mentioned.

However, the issues that emerged from these operations shaped the Fund's early jurisprudence (IMF 1970, 1971a). First, debtors and creditors generally agreed that sequential bilateral negotiations would be too costly and would raise issues of fairness and/or intercreditor equity. A single coordination platform would then help the various parties communicate and jointly agree to settlements. Then, lenders definitely wanted a neutral and credible assessment of the debtor country's economic position so that the broad parameters of the negotiation could not be contested. Lastly, it became evident that a

[13] See, for example, Marmorstein (1978), Zolotas (1978), and Viénot (1980). Boughton (2001, pp. 291–292) suggests that, even within the Reagan administration, there was an "innate conviction" in August 1982 that a lender-of-last-resort operation was needed.
[14] On the Fund's pre-1970 experience with debt renegotiation, see de Vries (1966, pp. 593–603) and IMF (1976) as well as the 1964 and 1965 editions of the *Annual Reports*. On debt refinancing more generally during the 1950s and 1960s, see Bitterman (1973). At that time, contributions by the Fund or the World Bank were in fact substitutes: debtor countries would choose between them depending upon their past relationship which each organization.
[15] The Paris Club, created in 1956, coordinates public sector creditors (aid agencies, export guarantee institutions, etc); see Rieffel (1985).

multilateral agent could best prepare and monitor an economic program. These three core points—intercreditor equity, coordination, and expertise—were not especially problematic for the Fund, and neither did they call for much guidance by the member states. The US Executive Director casually noted at the time that such assistance by the Fund "where appropriate [...] was often extremely useful" (IMF 1971b)—a statement that was interpreted as a green light for wading more deeply into sovereign debt matters.

In fact, difficult policy dilemmas surfaced soon thereafter, when such disinterested, arm's-length contributions to settlements had to be integrated with IMF loans tied to tough economic programs—that is, conditionality. In retrospect, it was this conjunction that put the IMF on a trajectory that would, a decade later, establish it as a global broker thoroughly engaged in complex and sometimes muscular interactions with private financiers and national governments. Had the Fund provided only expertise and information then it would never have been brought to such a position.

In the early 1970s, advance signals of this bifurcation could be found in the alternative answers given to what was, a priori, a simple question: Should the IMF suspend lending when other creditors suffer arrears on either interest or capital payments, or should it instead ignore such conditions? The crux of the matter is that, by deciding to "lend into arrears", the IMF puts itself in a position quite independent of the interests and strategies of the other creditors. Conversely, "not lending into arrears" implies that the Fund's action is actually conditioned by developments that affect creditor banks; thus the IMF might be gradually drawn toward some form of coordination or negotiation with these lenders.

In 1970 the Executive Board decided that, as a matter of course, any accumulated arrears should be eliminated during the period of a Stand-By Arrangement (SBA). An SBA is the standard vehicle for IMF crisis lending, and at that time its typical duration was 18 to 24 months. Thus, reducing arrears would henceforth be included among the performance criteria (i.e., conditionality): as long as this criterion was respected, the Fund could lend to a country that was still in arrears. Yet with this procedure the IMF exposed itself to a serious threat that was actually spotted by the Staff and some Directors: lending to a country while also asking for a repayment of arrears could lead to the Fund's resources being used to support capital withdrawals rather than economic adjustment. In other words, because money is fungible, lending into arrears might lead to outright bailout of other investors—with all the consequences that would come to haunt the IMF in later decades: moral hazard followed by overlending and eventually more crises. It is therefore interesting that, in the still benign environment of the early 1970s, the Fund was already recommending a "balanced burden-sharing between creditors and active aid donors, avoiding any impression that new capital inflows would be largely offset by repayments to creditors" (IMF 1971a). Here, indeed, was the strategic bifurcation.

1977–1981: Banks enter the scene

The second phase in the evolution of IMF strategy came with the post–oil shocks "recycling" strategy. As commercial banks came to play a greater role in financing developing countries, they brought into debt matters their own specific interests, demands, and tenacity. Moreover, as large loan syndications became the preferred lending vehicle, many banks—small and large, international and local—became no less a part of the overall scheme as of the eventual payment problems.

Just as in the case of official lending agencies, the first point of contention to emerge between the banks and the IMF involved information and access to expert judgment. Since its creation, a core feature of the Fund's action had been its capacity to conduct ongoing, confidential exchanges with each member state on its current economic position (de Vries, 1969). Still, national governments were willing to share information, discuss their policies, and respond to the Fund's criticism or suggestions only because they believed that these exchanges would remain confidential. However, as soon as banks began to play a major role in international payments, the need for some adjustment in this policy became evident. As the Staff stated: "the issue remains that everything possible should be done to improve the flow of information to banks, so […] lessening the danger of abrupt and disruptive shifts of lending"; therefore, "continued attention must be given to studying what additional assistance can be provided by the Fund" (IMF 1977b).

Where should the dividing line be drawn between confidentiality and market efficiency? And who argued for what? On this point, a doctrine was soon established that endures to this day: the IMF would never, ever become a rating agency (IMF 1977b, 2004). Its mandate and its own capacity to bear on real-world financial evolution require that the Fund keep some of its own information confidential even though—from the perspective of private banks and that of the public sector—there may be a legitimate demand for that information. In other words, multilateral coordination was not to be dissolved by a unilateral drive for market efficiency. The former had its own legitimacy and distinct objectives. It was thus agreed that the IMF could disseminate statistics but would not publicize its judgment with respect to specific countries.

This being said, significant differences were observed between the Executive Directors on the one hand and, on the other hand, the Staff and (implicitly) the Management. Whereas member countries defended a fairly conservative and rule-based doctrine (which, perhaps not coincidentally, minimized monitoring costs), IMF officials were more inclined to support a relatively open approach with the banks. This preference was, at least in part, a response to the pressures to which the Fund was exposed: even after country-specific ratings were barred, creditor banks continued to look for "policy signals" that they could extract from the Fund. By the late 1970s, and especially after the failed 1976 Peruvian experiment, an SBA with the IMF became a de facto precondition to any restructuring. In other words, the Fund offered a focal point that coordinated the parties. As a consequence, however, banks kept coming and asking whether a previously arranged IMF program was still in operation, or whether the country in question still had the right to draw from the Fund (regardless of whether it *needed* to do so).

Again, the game-changing factor in the interaction with the banks proved to be Fund lending and the bargain over conditionality: once the IMF offers to lend at a time when all other creditors are seeking to withdraw, a classical Prisoners' Dilemma arises, which shapes the different strategic answers to the crisis. After the Executive Board's decision in 1970 on lending into arrears, each SBA became conditional on the debtor country establishing an economic program based on credible hypotheses about the future financing of the balance of payments. Of course, no such program could be devised without making some assumptions about future financial flows between the country and the banks that were lending the money. How could arrangements of this sort be made on an ex ante basis without some form of coordination? And how could the IMF ever lend under this rule without conveying its own judgment on the borrowing country's overall financial state and needs?

By the late 1970s this strategic problem was being solved, on a case-by-case basis, under the code name "parallel operations"—a term that wrongly suggests the banks and the IMF never met or communicated. In fact, meetings and exchanges of information were both extensive and recorded, and so allowed for de facto coordinated actions. For example, a 1977 internal memorandum mentions that, over one six-month period, the Staff received nearly 400 inquiries from about 80 international banks; although a majority of these inquiries involved such routine issues as data, in other cases "the contacts were initiated by banks to help determine their immediate decision on major lending proposals" (IMF 1977e). Minutes of bilateral meetings with banks are also common in the country files retained in the archives of area departments. Finally, the personal papers of the Managing Director include many references to meetings with the heads of large banks, including Citibank, Warburg, Lazard, and Kuhn Loeb.[16] The interest of private financial institutions in these meetings should not be overstated, however: while they welcomed exchanges of views and information, they were clearly restive vis-à-vis any direct intervention by the Fund in debt relationships.[17]

How the rules of the game evolved during these years would result indeed from the increasing difficulty of including banks in a cooperative strategy. The Staff mentioned, for instance, that during crises the banks could exercise "considerable bargaining power" that enabled them to capture all the resources lent by the Fund and thus to be bailed out. Other "occasions could arise in which the payments outlooks are so adverse that it will be difficult for banks whose interests may well be divergent to hold together in a common approach" (IMF 1977b). Debt restructurings therefore involved "formidable organizational problems for the banks", problems that called for "a massive

[16] See the Larosière Papers (IMF Archives, Box 19, File 3).
[17] This view is clearly reflected in the account of a series of meetings by US Treasury officials with large New York banks, in december 1977 (see US Treasury, 1997).

effort by lead banks to ensure coordination and cooperation among all creditor banks" (IMF 1980c). That is, if left to their own devices, banks would not always behave cooperatively.

The Fund's response to these problems was to adopt an increasingly proactive stance. Hence "the breaking of new ground": "procedures evolved and precedents were established" (IMF 1980d) that steadily increased the pressure on the banks. With hindsight, a critical development was that the Fund began, in some cases, to ask for "understandings at least on the maintenance of the existing level of individual bank exposure […]; in especially difficult circumstances, [banks should] provide for new financing flows to help offset the impact of outflows of interest payment[s]" (IMF 1980c). Said differently, debt settlements would not only require parallel progress but an exchange of commitments. How this exchange was actually secured was determined on a case-by-case approach. The Staff described for instance a difficult case in which it had

> indicated to [the banks] the level of bank financing which it considered crucial to the success of a reasonable adjustment effort. After a Fund arrangement […] had been worked out, but before it was brought to the Board, the staff participated in a meeting where the banks agreed in principle to provide a certain level of financing. After the arrangement was approved, the staff assumed an active, if informal, role in helping to ensure that the planned amount of assistance was in fact forthcoming, explaining to the banks that a shortfall would force a failure of the balance of payments test and might require explanation to the Fund Board. (IMF 1980c)

In this remarkable statement, the venom is in the tail: "a failure of the balance of payment test" means that, in fact, conditionality would be broken as a consequence of certain bank behavior; and "explanation to the Fund Board" should be decoded as implying that the overall program might therefore be suspended and disbursements halted. So if the banks free ride on the Fund's lending, then the Fund might as well retaliate and raise the stakes.

Other indications of future trends can be found in a contemporaneous review, and confirmation, of the Fund's policy on arrears (IMF 1980a, 1980b). Here the most interesting point lay in the Staff discussion of two possible methods for actually reducing arrears: (i) a gradual, across-the-board reduction on a pro rata basis; and (ii) the inclusion of arrears in a front-loaded debt restructuring agreement (IMF 1980a). Technically, this second option would have the considerable advantage of clearing all accounts at the outset; this would thus ensure that the Fund's resources could not end up repaying the arrears. In other words, the IMF's financial leverage would be maximized precisely because it would *not lend at all* into arrears, rather than lending conditionaly, i.e. under the umbrella of a Stand-By. Under this condition, its own loans would not become fungible at all with money flows between banks and the debtor country.

Here, then, were the two main trends that eventually converged in the 1982 "Mexican jurisprudence": banks would have to enter into binding, ex ante "understandings"; and the ever narrower limits under which the Fund would indeed lend into arrears would guarantee that its loans would contribute almost exclusively to the country's adjustment. The Fund assured that the banks would be indeed "bailed in" just because and its lending would be watertight.

Monitoring and guidance from the principals

What positions did the principals (i.e., the main member countries) defend during those years? And how, exactly, did they contribute to the ongoing debate on debt policy? A significant element of the answer to these questions is that, in practice, the Management and Staff never asked member states to formally extend the Fund's mandate, to grant it new powers or new tools, or even to confirm the extension of its portfolio of activities to debt matters. Their overall attitude is best summarized by a 1977 memo in which the Staff casually mentions that it would "regard any contribution it could make to the achievement of reasonable arrangements as worthwhile in the light of the consequences which would come from a failure to agree. The flow of bank loans is now so important to Fund members that major unresolved dispute[s] could cause a hesitation in new lending, leading to serious adjustment difficulties" (IMF 1977b).

In other words, the agent justifies its right to intervene on the grounds of possible dire consequences arising from coordination failures—not because its mandate is applicable or because the core member-states actually asked the IMF to step in. Moreover, this approach stands in sharp contrast to the position of the member's Executive Directors, whose overall tone when discussing the principle of "parallel operations" with banks, for instance, was clearly in favour of the status quo (i.e., multilateral orthodoxy). This was especially true of developing countries, who opposed a priori any interaction with private banks. For example, the Brazilian Executive Director declared in 1977 that "the staff should do nothing, either positively or negatively, to provoke or discourage such lending [by the banks] or it would […] be in the business of issuing certificates of creditworthiness or unworthiness" (IMF 1977c). The Indonesian Director then recalled that "the Fund was an organization of sovereign countries […]. It should be left to private entrepreneurs to assess the [investment] risks, receiving rewards for a correct appraisal or suffering losses for wrong judgements." The G7 countries, too, endorsed the conservative status quo in debt matters, as when the German Executive Director declared that "the Fund should avoid at all costs being drawn into debt negotiations between official lenders and debtor countries" (IMF 1977c).

In addition, the Minutes of the Board illustrate how divorced the Directors were from the issues raised by the increasing number of debt restructurings and by the underlying Prisoners' Dilemma. During the 1977 Board discussion on debt, the US representative mentioned for example that

> whether the concept of parallel financing could be further developed also appeared to be worth exploring. As for the role of the Fund in the debt renegotiation and servicing, it was a sphere of activity in which the institution should be alert to doing whatever it could and properly should do to find out whether there were additional ways in which it could facilitate the smooth operation of the monetary system. (IMF 1977c)

Indeed, it would be hard for even the most diligent agent to find any tangible guidance in such a statement. Another example is provided by a Board discussion in 1981, a time when the Fund had already asked banks to enter "understandings" as part of ex ante burden-sharing agreements. On that occasion, the US Alternate Executive Director noted that "he was concerned about the recent Fund practice […] of assuming that a specific amount of debt relief [by the banks] was involved in program proposals submitted to the Executive Board." However, it seems this representative had not thought the whole issue through: a few minutes later he argued that it "would be important to make certain that public resources were not used to finance reflows to banks".[18] Yet he did not propose a an alternate option that could deliver a burden-sharing accord that eliminated the bailout risk *without* entering into undue relations with the banks.

In summing up this discussion, Jacques de Larosière (the Fund's Managing Director) first politely agreed with the Executive Directors: they "have […] noted that it is difficult, and in the view of some perhaps not wise, for […] the Fund to impose on commercial banks a predetermined and detailed set of debt-rescheduling norms for each particular country." But he then brought the point home by stating that, "when it appears that the continuation of commercial or other private credit is an important element of the integral approach that the Fund has been developing, we shall do our best to see that the banks provide the expected amount of finance" (IMF 1981). What is most remarkable about this (then confidential) statement is the explicit recognition that, to some extent, strong-arm politics or even coercion might be needed for the Fund to implement its "integral approach". In fact, when speaking to its cautious principals, the Managing Director was much more straightforward than the Staff dared to be.

[18] See IMF 1981, also 1982a

5. The 1982–1989 regime: Burden sharing and conditionality

The Mexican crisis

In August 1982, Mexico did not actually default on its debt; rather, it declared itself unable either to refinance its maturing debt or to raise fresh funds. The story of how matters unfolded during the months that followed has already been told in detail.[19] The first step was to negotiate a so-called bridge loan with the Bank of International Settlements and its main member states, the G10 countries; this reduced the immediate pressure on Mexico and its creditor banks. Then, over several weeks and in a context rife with confusion, a Letter of Intent was negotiated between Mexico and the IMF while exploratory meetings were being held with the banks. What was new in these circumstances was not the nature but instead the magnitude of the collective action problem. More than 500 banks had to be involved in any agreement, and the financial stakes were huge: $8.2 billion was needed just to close the country's 1983 financing gap.

It was clear that either the government of the major creditor countries had to accept a mega-loan transferring the credit risk to multilaterals (i.e., to taxpayers) or the banks would have to contribute and thus be "bailed in". The threshold was reached on 18 November, when a meeting was held at the New York Federal Reserve Bank between the commercial banks and Larosière; on the basis of financing commitments made by the Fund ($1.3 billion) and the official lenders ($2 billion), he asked the banks to commit $5 billion. He then made clear that the proposal "would not be sent to the Board [for approval and disbursement of a Stand-By] if the coverage of the deficit gap were not known" (Federal Reserve Bank of New York 1982).

That same afternoon, Paul Volcker (then head of the Federal Reserve) stated that—provided American banks agreed with the Fund's demands—"new credits should not be subjected to supervisory criticism". In other words, banks would not have to augment their loan-loss reserves or reveal their possible underlying insolvency. All other creditor countries followed this line. Beyond expediency, the main rationale for this decision was the presumption that debtor countries suffered only from a liquidity problem that would eventually solve itself by virtue of, for example, economic adjustment and international recovery. That is to say, stalling for time was the most rational course of action to take.

However, the immediate challenge was to maintain coordination *among* the banks themselves—between (i) the largest institutions, which had lent the most to developing countries, though they also maintained a major stake in the continued expansion of international capital markets; and (ii) the local

[19] Boughton (2001, chapter 7) provides a comprehensive and nearly day-by-day account of the three-way negotiations involving the Fund, the Mexican authorities, and the banks between August 1982 and March 1983. Kraft (1984) is the other main reference. A detailed, hand-corrected chronology is also available in the Larosière Papers (IMF Archives, Box 50, File 3).

and regional banks, which were only marginally exposed to the debt crisis and thus had the incentive simply to absorb their losses and withdraw to their home market. This conflict of interest explains why, on 23 December, when the Executive Directors met to discuss the Mexican SBA, the lead banks had been able to obtain commitments only for $4.32 billion (against 5 billion that had been asked). Nonetheless, the Managing Director proposed approving the Stand-By Arrangement so that the whole operation could proceed. But he also carried a list that detailed how much each member country's banks still had to contribute: the Japanese were $92 million short; the Italians, $122 million; the Germans, $47 million; and so forth. He then "invited Executive Directors from countries whose commercial banks had not yet contributed their full share to consult with the authorities concerned on the best means of securing the additional funds" (IMF 1982b).

In short, if large banks were unable to coerce the smaller ones (via market power) then domestic regulators would step in. Whether such actions should be viewed as "coercion" or, more charitably, as "moral suasion" is a matter of judgment.[20] What was clear to many, however, was that this approach called for some institutional adjustments. In the words of the Belgian Executive Director, "the generalization of the method used by the Chairman in the present instance would depend on the supervising authorities in the various countries setting up appropriate arrangements" (IMF 1982b). With more irony, Jacques Polak (long-time Director of the Fund's Research Department who at this time was the Dutch Executive Director) could not resist the temptation "to compliment the US financial authorities for their willingness to assume duties with respect to banks which they would certainly have dismissed as totally inappropriate not long previously" (IMF 1982b).

Jurisprudence in 1982–1989: Underpinning the Stand-By Arrangements

The decision procedure that was hurriedly brought together in late 1982 was subsequently relied upon dozens of times until 1989, sometimes with the explicit intervention of national regulators and usually under the shadow of that possibility.[21] In essence, it consisted of three steps. First, the debtor country negotiated a macroeconomic program with an IMF Mission that visited the country. This program would eventually be sanctioned by a Letter of Intent to the IMF Managing Director that described the economic strategy and listed the main performance targets; the Fund's acceptance of the Letter signaled its seal of approval, which was backed by its economic expertise and unique access to strategic information. Second, the country entered into financial negotiations with the banks' steering committees, the so-called London Clubs; this would lead to debt rescheduling and, in general, some

[20] This dimension of the political economy of debt restructurings during the 1980s is often understated in the literature, although Lipson (1985a, 1985b) lays bare its essential elements. See also Crane (1984), Gibbs (1984), and Wellons (1985).

[21] For a retrospective of the successive steps in the debt strategy between 1982 and 1989, see Cline (1993, chapter 5), James (1996, chapter 12), and Boughton (2001, chapters 9–11).

"new money". Third, but not until that accord between country and banks had been concluded, the IMF Board would announce a Stand-By Arrangement and begin loan disbursements.

The Fund thus gained considerable leverage as a gatekeeper to the financial negotiation table. Even so, if the banks viewed the IMF as being too lenient with a given country (say, because of a "preferred pupil" status or pressure from a major member state), then they could simply veto the whole plan. And, obviously, the country in question still had to sign both agreements (i.e., one with the Fund and one with the banks). In other words, at the core of this quasi-bankruptcy rule was the right of each party to veto the eventual outcome. That hardly guaranteed that the overall process was fair from a broader social or ethical viewpoint; the argument presented here focuses on the collective action itself and the baroque ways in which it was organized.

Further down this road, it is significant, for instance, that no document was ever signed jointly by all three parties. In the first place, banks were represented by so-called steering committees, which in fact had no formal mandate or legal standing to enter into binding agreements. In practice, the debtor country chose each Steering committee's lead bank, which would then pick the other members itself. Moreover, individual creditor banks never endorsed the committee per se or its initiatives; instead, each bank would sign a separate agreement with the country and thus formalize, ex post, the terms previously arranged by the steering committee. Second, it should be remembered that, since the 1950s, Stand-By Arrangements had been shaped as a two-way exchange: the country would send a Letter of Intent and the Board would then announce its decision to extend a loan. Yet in these cases, too, no document is signed by both parties together. Third, the banks never met *officially* with the Fund, although many iterations of back-and-forth communications transpired; these exchanges naturally involved considerable flows of information and, more often than not, an element of brinksmanship.

However, the hodgepodge of rules just described is only half of the picture. The regular and predictable operation of the regime was not viable unless all preexisting laws, regulations, and contractual clauses that could have affected a debt renegotiation were effectively suspended or circumvented. Thus the other half of the picture includes the following elements.

(i) The avoidance of "regulatory criticism" by American banking regulations has already been noted, as has national regulators' being prepared to pressure individual banks if necessary.

(ii) The Executive Board of the IMF exhibited an extraordinary willingness for its own decisions on lending to be conditioned on the parallel agreement of an informal committee of private banks. This self-binding approach, however, was even not remotely founded in the IMF's Articles of Agreement or in any subsequent bylaws. In 1980 the Board had confirmed the 1970 doctrine whereby the IMF could lend into arrears (though only within the framework of an SBA). After 1982, this rule was almost always interpreted as requiring that arrears be included in a front-loaded financial agreement. Thus, in effect, the original stipulation was actually reversed, whereafter the Fund would *never* lend into arrears. Yet this change of doctrine was never formalized in any decisions or statements by the Board.

(iii) Each individual loan syndication included contingent clauses under which, in case of restructuring, the agent banks that had coordinated the initial lending operation were assigned specific responsibilities (Wood 2010). In practice, these lead banks never appeared at the negotiating table; their place was taken by the steering committees, which represented the hundreds or thousands of banks that had lent to each country (Mudge 1984, Lomax 1986). The main benefit of this approach was that it coordinated all creditor banks regardless of the initial syndicated loan(s) to which they had initially subscribed.

(iv) Except in a small number of cases, litigation by individual banks was avoided. This successful discouragement was a result of so-called sharing clauses, written into most syndication contracts, which requested banks that obtained payments to share these proceeds with other members of the syndicate. This stipulation was therefore more of a built-in defense against disruptive strategies than an ex post strategy of regulatory bypassing (Buchheit 1990).

(v) Finally, international law had, since the early twentieth century, been developing a doctrine on restructurings. That doctrine addressed the issues of sovereign immunity, hierarchy among creditors, and such principles of fairness as the *peri passu* clause. These principles were actually discussed by specialist lawyers in the 1970s and early 1980s (see *Syracuse Journal of International Law and Commerce* 1978, Wood 1982, *American Society of International Law Proceedings* 1983), but they never surfaced in discussions at the Fund or in its written statements. To the contrary, lawyers struggled to account for the Fund’s action which, they insisted, implied no notion of legal responsibility and so “carefully avoid[ed] reliance upon traditional legal remedies” (Carreau and Shaw 1995).

That last quotation should be contrasted with one from Joseph Gold, founder of the IMF’s legal doctrine. In a discussion of crisis lending he claimed that “our objective has been to set forth our understandings with members to the maximum extent within the four corners of the stand-by arrangement” (Gold 1968). Debt issues were not then being considered, but the general strategy seems not to have changed much during the two decades that followed. In its growing involvement as an active broker in debt restructurings, the Fund discovered that protecting its resources and maximizing its leverage required inviting the banks to stand within the “four corners of the Stand-By”, which provided the institutional backbone of the three-step decision rule.

6. Deformalization and its justification

How could an organization like the IMF ever act within such a weak formal framework? And how were its practices justified, or described in ways that referred at least minimally to its broad constitutional rules? Even a summary description of its actions must have drawn from an accepted vocabulary that would signal its reliance on a given set of operating principles. As far as international organizations are concerned, this is the first—if not the sole—criterion of legitimacy.

These issues were at stake when, in March 1983, the Fund made the first review of its experience since the Mexican quasi-default six months earlier. In four large surveys, the Staff described the conditions and lessons of the recent negotiations and welcomed the extent of "standardization" in how the restructurings were approached. The Staff then somewhat obliquely addressed the recent innovations: "In a few recent cases [i.e., Mexico, Argentina, Brazil and some others], the Fund has found it necessary to establish a close link between commercial bank debt restructuring arrangements and Fund-supported programs by requesting an explicit commitment from the banks regarding their lending posture" (IMF 1983a). Yet beyond this single statement there is no further explanation or formalization of these experiences. Rather than draw forward-looking policy conclusions or suggest how the Fund could find a legal basis for its recent actions, the Staff seized on a completely external argument: "the Fund has assumed a more direct coordinating role than has normally been the case" because of the need to preserve "the stable functioning of the international financial system" (IMF 1983b). Another paper, discussed at the same meeting, takes the same line and alludes to "possible systemic implications" (IMF 1983a); some Executive Directors also made similar arguments (IMF 1983c).[22]

This discursive strategy had a most significant corollary. Namely, the Fund would thereafter continue to repeat that the Mexican experiment had *not* created any precedent; it had merely been an exceptional foray into unknown territory. As the Staff wrote in March 1983, "it would not be appropriate to seek to formalize any general policy criteria concerning the precise role of the Fund in such situations." Instead, the priority should be to act "on an individual case-by-case basis, in close consultation with all parties concerned and keeping the Executive Directors fully informed of the possible alternative courses of action under consideration." The reason for adopting this maximal deformalization (Koskenniemi 2007) was put forward in a remarkably elliptic way: "It is recognized that this is an especially sensitive area and difficult decisions will be required regarding the extent and nature of the Fund's involvement" (IMF 1983b).

[22] The identification of imminent systemic risk by the IMF, US officials, and Wall Street banks has been one of the main lines of criticism against the 1982 strategy. See, for example, the contributions published in the *Cato Journal* by Weintraub (1983) and Smith (1984).

In other words, the Staff was asking for guidance from the principals. Yet the Executive Board refused to be that specific. When debating the Mexican program in December 1982, and during the March 1983 policy review, the Executive Board endorsed the Fund's recent action and applauded its Managing Director. For example, the US Executive Director commended the Fund and its management for addressing the recent crisis "with remarkable care and in an admirable fashion"; the UK director emphasized the "considerable skill" exhibited during crisis management (IMF 1983c). One after the other, the Directors followed suit with only minor variations in their balance of compliments and implicit touchiness regarding the Managing Director's recent action. If ever there was an example of delegation to a multilateral agent being affirmed ex post, this was it. However, the Directors did not offer much in the way of specific guidance. The US Director simply noted that it was important in each case for the Fund "to conclude that there is a reasonable degree of certainty that the program is viable from the point of view of financing" and hence that it "must always have reasonable confidence" concerning the contribution of banks (IMF 1983d). Other than that, it was merely remarked that a "continued cautious and careful approach will be necessary" and that it would be important to avoid "unnecessary rigid linkages that could put undue burdens or responsibilities on the Fund" (IMF 1983c). At the end of the day, the Managing Director accordingly (and rather tamely) concluded that "the relationship between Fund-supported programs and the debt relief […] should continue to be handled on a case-by-case basis" (IMF 1983e).

During the years that followed, this noncommital position was consistently defended even as the three-step decision procedure become standard practice and systemic risk receded. The whole strategy thus remained wrapped in euphemistic language. In its own writings, the Fund was asking the banks only for "reasonable assurances" in the framework of a "concerted lending" strategy—that is, "an organized and collective effort on the part of commercial banks, official creditors, and the Fund to secure commitments to close an *ex ante* financing gap for a member country" (IMF 1985b). Hence, the Fund would not "condition" its own action on such commitments; it would instead "have come to expect" them or have "indicated the Fund's support" and "encouraged the banks to commit themselves" (IMF 1984). It was quite clear, as well, that the occasional direct reliance on national bank regulators to put extra pressure on the banks would never be recognized: even a breakdown of these occasions has not been found. In other words, any suggestion of a coercive relation was systematically ruled out, and the notion that this regime was even remotely judicial in character, or that it shadowed a bankruptcy rule, was carefully shunned.[23]

[23] A 1984 memo authored by the Legal Department came close to a judicial interpretation of the Fund's role as a third-party dispute resolver, but in light of the extant of actual practices it reads like an afterthought: "a more active involvement of the Fund might be envisaged, for instance, in the determination of facts, the provision of technical analysis, and some move towards active conciliation and mediation" (IMF 198a). See also Gold (1972) on the Fund's more general resistance to legally sanctioning member states.

This does not mean, of course, that the Fund's officials and their principals were delusional. They knew very well what they were doing and, at least at the beginning of the crisis, they surely considered this procedure to be the best course of action. Hence, deformalization proved to be expedient from the short term perspective of crisis management and systemic risk containment. The point is that this strategy also raised acute problems of justification, legitimacy, and institutionalization. Hence, this rule remained directly dependent upon the continuing adhesion of all involved parties, therefore upon their underlying, rational trade-offs and the effect on them of power relationship. If the banks had been able to extract a bailout from the IMF, then the whole game would have played out much differently. This would have been true as well if debtor countries had colluded against developed countries and obtained for instance that the later took over part of their debt burden.

Here is the paradox which lies at the core of this debt restructuring regime. On the one hand, the principle that adjustment costs should be shared equitably mimicked the expected outcome of a bankruptcy procedure, which in practice was substituted by a rule of mutual veto. On the other hand, the stark divergence of interests between debtors and creditors could be managed, or endogenized, only as long as the IMF and its core member states had enough leverage over them. As soon as this leverage declined, the underlying trade-offs changed and the capacity to coordinate the parties and deliver debt settlements rapidly fell.

7. End of the regime

This shift was observed in practice after 1987. On the one hand, economic adjustment in debtor countries had been fairly consistent, although the rewards in terms of growth and access to capital markets were modest. Attempts to coordinate these countries politically were also being advocated, in particular by the so-called Group of Carthagena, in Latin America. On the other hand, the buildup of loan-loss reserves by banks and the expansion of secondary debt markets steadily increased each bank's room to maneuver.[24] The consequence was that containing wayward strategies by individual lenders became increasingly difficult at the same time that financial negotiations were becoming ever more complex. These trends put direct pressure on the IMF's self-binding commitment not to lend until such accords were reached: once it had accepted a Letter of Intent, therefore the principle of a Stand-by, it could not wait indefinitely before actually disbursing loan funds.

The first step away from the 1982 rules—a 1987 Bolivian restructuring—was therefore the subject of much commentary. Indeed, its annual review of debt strategy recognized that on future occasions "the

[24] Although a bank was not, strictly speaking, entitled to resell its participation in a loan syndicate, secondary exchanges became possible, and prevalent, after 1985. However, transaction costs were high and the legal status of such exchanges was never clarified; see Buchheit (1986) and Cline (1993). This trend was closely monitored by the Fund from the outset (IMF 1984).

Fund-supported program may become fully effective while relations between the country and the commercial banks remain unresolved [so that] external arrears to creditor banks would likely increase, which would have implications for the Fund arrangement" (IMF 1987). It is also remarkable that, as the Fund began to untie the knot that prohibited "lending into arrears", it did not follow its usual pragmatic or consequentialist line of arguments. Instead, the Staff grandly stated that the banks' equivocations "should not appear to prejudice the autonomy of the Fund in deciding its future relations with members, nor conflict with existing Executive Board guidelines" (IMF 1987). Furthermore, it also noted that since 1982 it had not been "intended that the Fund would, on an on-going basis, centrally guide the allocation of a substantial part of both private and official lending to developing countries. […] There is a need to ensure that the financial system is firmly embarked upon a course that leads towards […] a restoration of direct debtor/creditor relations" (IMF 1987).

This, for sure, was a description of the Fund's own actions that could not have been written in the years after the 1982 Mexican rescue. In fact, the IMF was now "re-formalizing" its discourse and action by explicitly calling for a return to the great rules: (i) only the Fund's Executive Board should be responsible for deciding when and how to lend; and (ii) the IMF should not interfere in the contractual relations between debtors and creditors. In practice, this implied shifting to a policy whereby the Fund might unilaterally lend into arrears.

It would take another two years before all the consequences of these evolutions would be fully recognized. But when the principle of full-fledged debt write-offs was finally accepted (with the March 1989 Brady Initiative), the "no lending into arrears" doctrine was immediately back on the table and then finally shelved. Hence the IMF was allowed to support countries that entered the long process of negotiating a Brady agreement (IMF 1989a, 1989b). As the Managing Director then said: "It is clearly the wish of this Board that the Fund discharges in full its central responsibilities in the debt strategy, but without interference in negotiations between debtors and creditors." Thus the Fund retained its option to "approve [an] arrangement outright", which meant that "an accumulation of arrears to banks may have to be tolerated" (IMF 1989c). The same day, a public communiqué formalized the decision that, from then on, the Fund could de-couple itself from the banks (IMF 1989d).

Yet in the longer run this shift in policy opened the door to an entirely new approach to crisis lending. Starting with Mexico's 1994–1995 payment crisis, the IMF intervened unilaterally and massively in order to contain any crisis of confidence—though without suspending market transactions or entering into formal agreements with investors. Stated differently, instead of shadowing a bankruptcy procedure, the Fund would now try to establish itself as a quasi–lender of last resort (Sachs 1995, Fischer 1999).

8. Conclusion

A detailed reading of the IMF Board Minutes and the Fund's Staff Memoranda offers a unique view of how, over the course of twenty years, a quasi-judicial rule for debt restructuring was assembled, operated, and eventually abandoned. Specifically, these archives document a collective process whereby a set of precedents was cobbled together that satisfied a pragmatic criterion of means–end efficiency while gaining adherence from both debtor and creditor states as well as from private investors. The most distinctive features of this regime were that it remained essentially ad hoc and called for a thorough process of deformalization; that is, all existing contingent regulations that might have borne on debt renegotiations first had to be ignored. Thus, the regime came to rest on a minimal degree of institutionalization and, symmetrically, on a mix of voluntary acceptance by the weaker parties and open pressure exercised by the stronger ones.

The paradox is that, in the final analysis, the overall sustainability of this regime rested on three features that could not be entirely legitimized. First, national authorities (specifically, banking regulators) were prepared to exert considerable pressure on private lenders. Second, the IMF's de facto economic conditionality was mobilized in support of the new commitments that the banks had received. Third, the Fund voluntarily committed itself to not lending to its own member states unless an informal gathering of commercial banks had agreed to follow suit.

These factors constituted the main force behind the success of the IMF Managing Director in avoiding a unilateral bailout of banks after 1982. This experience sheds a contrasting light on the extreme difficulties encountered since 1989 when attempting to "bail in" private investors during a period of crisis. It is clear that the modern, disintermediated global capital market makes matters far more difficult than they were in the old-style loan market of the 1970s and 1980s. It remains to be seen whether crisis managers today could arm-twist the banks, suspend existing rules across the board, and freely reinterpret the Fund's mandate and bylaws.

Bibliography

IMF Documents

IMF. 1970. *Payments Arrears in Current International Transactions*. Staff Memorandum SM/70/139. July 6, 9 pages.

IMF. 1971a. *Multilateral Debt Renegotiations – Experience of Fund Members*. Staff Memorandum SM/71/204. August 6.

IMF. 1971b. *Minutes of the Executive Board 71/114*. November 10, 1971, pp. 11-24.

IMF. 1973. Short-term Credits and External Debt Management: An Introductory Paper on the Extension of Banking Credits to Developing Countries. SM/73/166. July 11, 25 pages.

IMF. 1974. Multilateral Debt Renegotiations – Experience of Fund Members, 1971-74. Staff memorandum SM/ 74/228. 18 pages.

IMF. 1976. *Avoidance and Resolution of Debt Servicing Difficulties*. Staff Memorandum SM/76/202 corr. 2. September 27, 26 pages.

IMF. 1977a. The Fund's Relations with Commercial Banks. Office memorandum, Legal Department, 4 may.

IMF. 1977b. *Fund Relations with Commercial Banks*. Staff Memorandum SM/77/130, June 7. 7 pages.

IMF. 1977c. Minutes of the Executive Board, EBM 77/89 and EBM 77/90. June 22, pp. 3-14.

IMF. 1977d. *Peru – Mr Friedman's Visit and Meeting of Leading Commercial Banks*. Office Memorandum, August 18.

IMF 1977e. Staff contacts with commercial banks. Office Memorandum. September 20, 13 pages.

IMF. 1980a. Review of Fund Policies and Procedures on Payments Arrears. August 27. 14 pages. EBS/80/190.

IMF. 1980b. *Payment Arrears - Review of Fund Policies and Procedures*. EBM 80/153 and 80/154, October 17, am & pm., pp. 3-28, pp. 3-12.

IMF. 1980c. *External Indebtedness of Developing Countries*. Staff Memorandum SM/80/273. 24 décembre, 70 pages.

IMF. 1980d. Debt Restructuring by Commercial Banks – Recent Experience of Some Member Countries. Staff Memorandum to the Executive Board, SM/80/275. December 31.

IMF. 1981. *External Indebtedness of Developing Countries*. Executive Board Meeting 81/12 et 81/13, January 26, pp. 22-30 et . *Chairman's Summing Up*,

IMF. 1982a. External Payments Arrears of Fund Members, 1980-81. EBS/82/57, March 31, 18 pages.

IMF. 1982b. *Minutes of the Executive Board Meeting 82/167*, December 23. EBM 82/167 et 82/168, 38 et 35 pages.

IMF. 1983a. *Fund Policies and External Debt Servicing Problems*. Staff Memorandum to the Executive Board, SM/83/45. March 8. 50 pages.

IMF. 1983b. *Payments Difficulties Involving Debt to Commercial Banks*. Prepared by the Exchange and Trade Department. SM/83/47, March 9. 137 pages.

IMF. 1983c. *Minutes of the Executive Board Meeting*. EBM 83/57 and 83/58, April 6. 41 and 39 pages.

IMF. 1983d. Statement by Mr Erb on Fund Policies and External Debt Servicing Problems. EBM 83/57, April 6. 7 pages.

IMF. 1983e. The Chairman's Summing Up at the Conclusion of the Discussion on Fund Policies and External Debt Servicing Problems. Executive Board Seminar 83/58. April 6.

IMF 1983f. Recent Experience with Multilateral Debt Restructurings with Official Creditors and with International Banks. SM/83/227. November 7, 80 pages.

IMF. 1984. *The Role of the Fund in the Settlement of Disputes Between Members Relating to External Obligations*. Prepared by the Legal and the Exchange and Trade Relations Departments. SM/83/47. 24 april. 19 pages.

IMF. 1985a. Program Monitoring by Commercial Banks: the Experience of Peru. Office Memo, February 12. IMF Archives, Western Hemisphere Dept Fonds, Box 17, file 3

IMF. 1985b. The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors. EBS/85/173, July 23, 49 pages.

IMF. 1987. Implementation of the Debt Strategy – Current Issues. EBS/87/38. 20 février, 54 pages.

IMF. 1989a. Fund Involvement in the Debt Strategy – Further Considerations. EBS/89/96. May 12. 8 pages.

IMF. 1989b. Minutes of the Executive Board Meeting 89/61. EBM/89/61. May 23. 30 pages.

IMF. 1989c. *Summing Up by the Chairman – Fund Involvement in the Debt Strategy*. Executive Board Meeting 89/61. May 24.

IMF. 1989d. *Press Release n° 89/117*. May 24.

IMF 1991. Management of the Debt Situation. EBS/ 91/43, March 13. 36 pages.

IMF. 2002. The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations.. Prepared by the Legal and Policy Devlopment Reviews Departments. 27 novembre, 76 pages.

IMF. 2004. Signaling by the Fund – A Historical review. Policy Development and Review Departments. June 16, 42 pages.

Secondary Source

Alter, Karen. 2006. Private Litigants and the New International Courts, *Comparative Political Studies*, 39(1), pp. 22-49.

Alter, Karen. 2008. Agents or Trustees? International Courts in their Political Context. *European Journal of International Relations*. 14 (1), pp. 33-63

American Society of International Law Proceedings. 1983. Panel Discussion : Restructuring Sovereign Debt – Will There Be New International Law and Institutions ? 77, pp. 312-335.

Ballivean. 1976. What the Peru Experiment Means. *Institutional Investor*, October, page 145.

Barnett Michael, and Marhta Finmore. 2004. *Rules for the World, International Organizations in Global Politics*. Ithaca, Cornell University Press.

Bitterman, Henry J. 1973. *The Refunding of International Debt*. Durham, NC: Duke University Press, 250 pages.

Blumenthal, Michael. 1977. Towards International Equilibrium. International Monetary Conference, Tokyo, May 25. Reproduced in US Senate. 1977. *International Debt, Hearing before the Subcommittee on International finance*. August 29-30.

Bolton, Patrick. 2002. Towards a Statutory Approach to Sovereign Debt Restructuring, Lessons from corporate bankruptcy practice around the world. miméo, Princeton University, October, 47 pages.

Boughton, James M. 2001. *The Silent Revolution, the International Monetary Fund 1979-1989*. Washington: IMF. 1111 pages.

Broz, Lawrence J. and Michael Brewster Hawes. 2006. US domestic politics and International Monetary Fund policy. In Hawkins, Darren G. et al. (dirs). *Delegation and Agency in International Organizations*. Cambridge: Cambridge University Press. pp. 77-106.

Buchheit, Lee C. 1986. Legal issues in trading sovereign debt. *International Financial Law Review*. 5, pp. 17-21.

Buchheit, Lee C. 1988. Alternative techniques in sovereign debt restructuring. *University of Illinois Law Review*. 1988 (2), pp. 371-480.

Buccheit, Lee C. 1990. The Sharing clause as a litigation shield. *International Financial Law Review*, October, pp. 15-16.

Buchheit, Lee C. and Ralph Reisner. 1988. The effect of the sovereign debt restructuring process on inter-creditor relationships. *University of Illinois Law Review*. 1988 (2), pp. 493-517.

Bulow Jeremy, Kenneth Rogoff and Rudiger Dornbusch. 1988. The Buyback Boondoggle. *Brookings Papers on Economic Activity 2.*, pp. 675-704

Carreau, Dominique and Malcolm N. Shaw. 1995. *La dette extérieure/ The External Debt*. Dordrecht : Hague Academy of International Law/ Martinus Nijhoff, 774 pages.

Clarke, Leo and Stanley F. Farrar. 1982. Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers. *University of Illinois Law Review*. 1982 (1), pp. 229-249.

Cline, William R. 1984. *International Debt*. Washington: Institute of International Economics. 307 pages.

Cline, William R. 1993. *International Debt Reexamined*. Washington: Institute of International Economics. 533 pages.

Cohen, Benjamin J. 1986. *In Whose Interest? International Baking and American Foreign Policy*. New Haven: Yale University Press, 342 p.

Cohen, Benjamin J. 1989. A Global Chapter 11. *Foreign Policy*, 75.

Crane, Barbara B. 1984. Policy Coordination by Major Western Powers in Bargaining with the Third World Debt Relief and the Common Fund. *International Organization*. 38(3), pp. 399-428.

Dale, Richard and Richard P. Mattione. 1984. *Managing Global Debt*. Washington DC: Brookings.

Dell, Sidney. 1981. On Being Grandmotherly: The Evolution of IMF Conditionality. Princeton University, Essays in International Finance, n°144, 34p.

Dooley M. 1995. A Retrospective on the Debt Crisis., Working Paper 4963, 56p.

Eaton J., Gersowitz M. 1981. Debt with Potential Repudiation: Theoretical and Empirical Analysis. *Review of Economic Studies*, 48, avril, pp. 284-309.

Eaton J., Gersowitz M., Stiglitz J. 1981. The pure theory of country risk. *European Economic Review*, 30, juin, pp. 481-513.

Eichengreen, Barry. 2003. Restructuring Sovereign Debt. *Journal of Economic Perspectives*. 17 (4), Fall, pp. 75-98.

Federal Reserve Bank of New York. 1982. Meeting between IMF and commercial bankers. Office Memorandum [minutes], november 18, 13 pages.

Fischer S. 1999. On the Need for an International Lender of Last Resort. FMI, Washington, février.

Gibbs, Nancy P. 1984. A Regional Bank's Perspective. *Columbia Journal of Transnational Law*. 23, pp. 11-28

Gold, Joseph. 1968. *Mr Gold's Statement on Use of Fund's resources and Stand-By Arrangements*. Executive Board Meeting 68/123, August 14, 4 pages.

Gold, Joseph. 1972. The 'Sanctions' of the International Monetary Fund. *The American Journal of International Law*. 66 (5), pp. 737-762.

Gould, Erica R., 2003. Money Talks : Supplementary Financiers and International Monetary Fund Conditionality. *IO*, 57, Summer 2003, pp. 551-589.

Guttentag, Jack and Richard Herring. 1983. What happens when countries cannot pay their bank loans? The renegotiation process. *Journal of Comparative Business and Capital Market Law*. 5, pp. 209-231.

Hagan, Sean. 2002. Sovereign Debtors, Private Creditors, and the IMF. *Law and Business Review of the Americas*. 8, pp. 49-71.

Helleiner, Eric. 1996. *States and the Reemergence of Global Finance*. Ithaca: Cornell University Press. 243 p

Jackson, Thomas H. 1986. *The Logic and Limits of Bankruptcy Law.* Cambridge: Harvard University Press.

James, Harold. 1996. *International Monetary Cooperation since Bretton Woods*. Washigton and Oxford: IMF and Oxford University Press, p. 742

James Harold. 1998. From Grandmotherliness to Governance, The Evolution of IMF Conditionality. *Finance and Development*, 35 :4.

Kahler, Miles, ed. 1986. *The Politics of International Debt*. Ithaca: Cornell University Press.

Kenen, Peter B. 1983. A Bailout Plan for the Banks. *The New York Times*, March 6, section 3, p. 3.

Keohane, Robert O., Andrew Moravcsik, Anne-Marie Slaughter. 2000. Legalized Dispute Resolution: Interstate and Transnational. *International Organization*. 54 (3), pp. 457-488.

Koskenniemi, Martti. 2007. Constitutionalism as Mindset: Reflections on Kantian Themes About International Law and Globalization. *Theoretical Inquiry into Law.* 8(1), pp. 10-36.

Kraft, Joseph. 1984. *The Mexican Rescue*, New York: Group of Thirty.

Krasner, Steven. 1982. Structural Causes and Regime Consequences: Regimes as Intervening Variables. *Institutional Organization*. 36 (2), pp. 185-205.

Lipson, Charles. 1979. The IMF, Commercial Banks, and Third World Debts. In Aronson, Jonathan David, ed. *Debt and the Less Developed Countries*. Boulder, CL: Westview Press, pp. 317-333.

Lipson, Charles. 1985a. Bankers' Dilemmas: Private Cooperation in Rescheduling Sovereign Debts. *World Politics*. 38(1), pp. 200-225.

Lipson, Charles. 1985b. International debt and international institutions. In Miles Kahler, ed. *The Politics of International Debt. Ithaca*: Cornell University Press. pp. 219-243.

Lomax, David F. 1986. *The Developing Countries Debt Crisis*. London: Palgrave.

Marmorstein, Victoria A. 1978. Responding to the Call for Order in International Finance: Cooperation Between the International Monetary Fund and Commercial Banks. *Virginia Journal of International Law.* 18(3), pp. 445-483.

Mudge, Alfred. 1984. Sovereign Debt Restructure: A Perspective of Counsel to Agent Banks, Bank Advisory Groups and Servicing Banks. *Columbia Journal of Transnational Law*. 23, pp. 59-74.

Oechsli, Christopher G. 1981. Procedural Guidelines for Renegotiating LDC Debt: An Analogy to Chapter 11 of the US Bankruptcy Reform Act. *Virginia Journal of International Law*, 21(2), pp. 305-341.

Petman, Jarna. 2011. Deformalization of international organization law. Klabbers Jan and Asa Wallendahl, ed. *Research Handbook on the Law of International Organizations*. London: Edward Elgar, pp. 398-430.

Rhodes, William R. 2011. *Banker to the World: Leadership Lessons From the Front Lines of Global Finance*. New York: McGraw-Hill.

Rieffel A. 1985. *The role of the Paris Club in Managing Debt Problems*, Essays in International Finance n°161, Princeton University.

Rogoff, Kenneth and Zettelmeyer Jeromin. 2002. Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2002. Washington DC: IMFF, Working paper WP/02/133.

Rohatyn, Felix G. 1983. A Plan For Stretching Out Global Debt. *Business Week*, Feb? 28, p. 15-18

Sachs, J. 1995. Do we need an International Lender of Last Resort?. Frank D. Graham Lecture, Princeton University, april.

Smith, Fred L. 1984. The Politics of IMF Lending. *Cato Journal*. 4 (1), pp. 211-241

Stallings, Barbara. 1979. Peru and the US Banks: Privatization of Financial Relations. In Aronson, Jonathan David, ed. *Debt and the Less Developed Countries*. Boulder, CL: Westview Press, pp. 225-252.

Stigal, Duncan (1985). Coordination vs. Prisoners' Dilemma : Implications for International Cooperation and Regimes. 79 Am Pol Sci Rev 923.

Stone, Randall. 2008. The Scope of IMF Conditionality. *International Organization*. 62, pp. 589-620.

Stone Sweet, Alec. 1999. Judicialization and the Construction of Governance. *Comparative Political Studies*. 32(2), pp. 147-184.

Syracuse Journal of International Law and Commerce. 1978. Panel Discussion: Refinancing of Third World Debt. 5(2), pp. 270-297.

US Treasury. 1977. Meetings with New York banks. Inter-Office Memorandum, 23 december. 18 pages.

Vaubel Roland. 1983. The Moral Hazard of IMF Lending. *The World Economy*, 6:3, pp. 291-305

Viénot, Marc. 1980. Letter and Memorandum to Jacques de Larosière. Paris, Société Générale, December 16. Available in IMF Archives, Larosière Papers, Box 19/ File 3.

Vries, Margaret G de. 1976. *The International Monetary Fund, 1966-1971, volume I.* Washington: IMF.

Vries, Margaret G de. 1969. The consultation process. Horsefield, J. K. *The International Monetary Fund, 1945-1965*. Washington: IMF, pp. 229-248.

Weinert, Richard S. 1983. Banks and Bankruptcy. *Foreign Policy*. 50, Spring, pp. 138-149

Weintraub, Robert E. 1983. International Debt: Crisis and Challenges. *Cato Journal*, 4 (1), pp. 21-61.

Wellons, Philip A. 1985. International Debt: The Behaviour of Banks in a Politicized Environment. *International Organization*. 39(3), pp. 441-471.

White M. 2002. Sovereigns in Distress: Do they Need a Bankruptcy? *Brookings Papers on Economic Activity*, 2002 (1), pp. 287-320.

Wood, Philip R. 1982. Debt Priorities in Sovereign Insolvency. *International Financial Law Review*, 1(4), pp. 4-11.

Wood, Philip R. 2010. Essay: Sovereign Syndicated Bank Credits in the 1970s. *Law and Contemporary Problems*. 73 (7), pp. 8-28.

Zivkovic, Dusan. 2005. Debt Renegotiation Framework. Unctad, Paper prepared for the expert group on Debt Sustainability and Development Strategies. October, 18 pages.

Zolotas, Xenophon. 1978. A Proposal for a New Fund to Insure against Euromarket Defaults. *Euromoney*, April.