How the IMF did it–sovereign debt restructuring between 1970 and 1989

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Key points

- Between 1982 and 1989, the International Monetary Fund (IMF) acted as a third-party in a total of 109 debt restructurings between 41 debtor states and their creditor banks.
- At the core of these restructurings was the old Stand-By Arrangement (SBA), ie the standard IMF instrument for conditional lending to member-countries.
- The SBA was thus transformed into a three-way, voluntary arrangement that de facto rested on a rule of mutual veto.
- This self-sustained, though largely ad hoc procedure depended on the systematic ignoring of all hard-law or contract-based rules that could have shaped the debt restructurings.
- This article analyses: (i) how this regime emerged through trial and error during the 1970s; and (ii) how it was implemented, accounted for and justified after the 1982 Mexican crisis.

1. Introduction

The saga of Argentina's debt renegotiations since the 2001 default, followed by the chaotic experience of Greece after 2010, has reminded us how difficult it is to build a sustainable, well-accepted procedure for restructuring sovereign debts. Despite decades, if not centuries of experience, policy makers lack a solid body of principles and guidelines so that, again and again, each time this market is in crisis they are haunted by the same dilemmas. The first one is typically over who may declare that a country's debt should be restructured, and by which criteria. Next come many more difficult questions about the place or jurisdiction where a settlement may take place, coordination and decision-making among the parties, or the link between a financial settlement and the monitoring of the debtor country's policy commitments.

Since the mid-1990s this debate has increasingly focused on one subpart of this broad range of issues, namely decision-making among creditors. After the option of a specialized supra-national court was rejected in 2003,[1] most contributions have focused on whether, and how, different contingent clauses written in the initial debt contracts may guide the parties if and when a restructuring becomes necessary. This discussion first revolved around the issue of the Collective Action Clause[2] and later moved to the *pari*

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1 Krueger Anne, 'New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking' (1 April 2002) IIE, Washington DC; Patrick Bolton, 'Towards a Statutory Approach to Sovereign Debt Restructuring: Lessons from Corporate Bankruptcy Practice Around the World' (2003) *IMF Staff Papers*, 50 (special issue).

2 Mitu Gulati and Mark Weidemaier, 'A People's History of Collective Action Clauses' (2013) 5 Virginia Journal of International Law 1–95.

passu clause, especially in the wake of the decisions rendered by New York courts and the US Supreme Court in 2013 and 2014 on the Argentine case.[3] These most recent evolutions are striking because they seem to prohibit any majority-based decision rule among creditors, even though since the Middle Ages domestic bankruptcy statutes have almost always endorsed this non-contractual, coercive principle. The underlying trend is however broader: there is arguably no period in modern history when the renegotiation of sovereign debts has been so strongly structured by a rather narrow contractual language. Even during the first global era, before 1914, when no multilateral agency interfered in restructurings, these operations were more ad hoc and took place farther away from the national courts of justice.

The contrast is also very strong when comparing current practices with those observed during the debt crisis of the 1980s, which are the object of the present article. While today we observe at best a fledgling and contested regime, the rules that were adopted immediately after the Mexican quasi-default of August 1982 proved remarkably stable and predictable: until 1989 they governed a total of 109 restructurings between 41 debtor states and hundreds of creditor banks. Of course this episode is first remembered today for the long lapse in time (seven years) before creditor countries accepted the principle of large write-offs, instead of simple debt service rescheduling. But here is a problem of substance, not one of procedure. Process in fact worked fine, at least in relative terms, though how this stability was obtained is now largely and curiously forgotten. Here is indeed a lesson that was neither entirely drawn, nor handed over.

The key feature of this procedure was a veto-based decision rule. In case after case, each party had to endorse explicitly a so-called burden-sharing agreement that sought to balance on an *ex ante* basis the financial concessions made by banks, the policy commitments of the debtor country and the International Monetary Fund (IMF or the Fund) lending. The voluntary dimension that was enshrined in this decision rule was a response to the absence of a proper jurisdictional authority that would have allowed the Fund or another authority to adjudicate cases. Still, creditors were coordinated, economic costs and losses were shared, debt contracts were rewritten, and economic policies generally changed course. Moreover, the burden-sharing agreement endowed these accords with a measure of perceived distributive fairness, hence of legitimacy: they could be opposed to third parties, like bank shareholders, electors or representatives of key Member States on the Fund's Board. Lastly, the multilateral character of this regime ensured that a degree of 'comparability of treatment' (in IMF-speak) would apply across cases.

Another remarkable trait of these rules is that they were never formalized in any international agreement, treaty, communiqué or guidelines. Restructuring operations were exclusively founded on bylaws that had been formulated internally by the Fund before being de facto adopted by creditor banks and debtor countries. All alternate hard law regulations or contractual clauses that could have governed or influenced debt renegotiations were systematically ignored or circumvented; even the IMF's own statutes, the 1944 Articles of

3 Mark C Weidemaier, 'Sovereign Debt after *NML v Argentina*' (2013) 8(2) CMLJ 121–22.

Agreement, were freely reinterpreted when convenient. An ultra soft law mechanism thus ousted all better established authorities that could have legitimately claimed jurisdiction.

The veto rule and widespread informality together beg the question of how the overall procedure was structured and what exact role the IMF played in it. Did it work as the proxy of a court or an arbitration tribunal? Or was the neutral and technical character of its many contributions only a shield, with the actual game boiling down to a more or less sophisticated mix of bargaining and brokering? In this case, outcomes would have been shaped in fact by the brutal political economic forces that are typically unleashed by sovereign defaults. But then what about the rule of mutual veto? Why would the parties have adhered to such a demanding rule, if in fact power struggles ruled the day?

The best way to explore this experiment is to start with the nitty-gritty of how debt restructurings and macroeconomic programmes were actually discussed and articulated in relation to each other. The Fund's archives reveal how experimentation, bargaining and raw power politics delivered this ad-hoc *assemblage* set of rules according to which cases were then processed. We can then recount how the post-1982 procedure resulted in practice from a decade-long process of trial and error, that built in turn on the rules and usages that the Fund had developed since the 1950s. The same archival sources show however that this regime always rested on a constellation of interests and power relationships whose gradual decline after 1987 directly affected its capacity to deliver settlements. Once the banks and the countries involved had recovered from the initial economic shock, the capacity to arm-twist them into the IMF negotiating rooms rapidly declined. Political economic contingencies thus threatened, constrained and shaped altogether the procedure that governed renegotiations.

The next section briefly summarizes the existing literature on the debt crisis of the 1980s. Sections 3 and 4 then analyse how the regime that emerged in 1982 resulted from a long process of trial and error that began in 1970 before being shaped by the tensions that rapidly surrounded the post-oil shocks, the so-called recycling strategy. Section 5 then moves on to the specific crisis of the 1980s and how the Fund addressed it, and section 6 analyses how these rules were described and justified in spite of their soft, lightly formalized character. Section 7 is a conclusion.

2. What the literature says

The regime for sovereign debt restructuring that was built and operated by the Fund during the 1980s stands out indeed from practically all other experiences. Before 1914, these operations resulted generally from direct negotiations between debtor countries, issuing banks and bondholders' associations, without intervention by any third-party, multilateral or not; in the worst cases, gunboats would be sent, but this measure was seen as an exception to the rule.[4] Later, the League of Nations intervened repeatedly in these

4 Edwin Borchardt, *State Insolvency and Foreign Bondholders* (Beard Books 1951); Marc Flandreau, 'Sovereign States, Bondholders Committees, and the London Stock Exchange in the Nineteenth Century (1827–68): New Facts and Old Fictions' (2013) 29(4) Oxford Review of Economic Policy 668–96.

matters, just as the IMF since 1995, but both proved unable to build a well-accepted, stable set of rules.[5] Critically, all attempts at establishing some kind of bankruptcy court or arbitration panel for sovereign debts failed miserably: first during the pre-1914 era at The Hague,[6] then in the late 1930s in Geneva[7] and finally in the early 2000s in Washington.[8] Against this background, the recent experiences of Argentina and Greece remain as examples of how 'not' to address sovereign insolvency.[9] These repeated failures ultimately reflect the fact that a multilateral forum is not a natural jurisdiction for solving debt disputes, neither between private parties, nor between states and private investors. In fact, national governments have never conceded the authority to adjudicate their debt problems to any such body.

One important reason why so little is known about the workings of the 1970s and 1980s regime is that most social scientists who have studied this episode have shared a similar disregard for its legal and procedural dimensions. The pattern applies whether they have focused on the international politics of the debt crisis,[10] on the broader long-term history of international finance[11] or on the macroeconomics of over-indebtedness and balance of payment adjustment.[12] This lapse also extends to later publications, like Reinhart and Rogoff,[13] or Das and others,[14] which cover a lot of ground in matters of sovereign debt without adding much on the specifics of the 1980s cycle. The main exceptions to this broad rule are Cohen,[15] who is still a good primer on the early part of the crisis, Lipson[16] and Guttentag and Herring.[17] However, the extent of the information available to them was substantially less than what is now available, so that they do not

5 Barry Eichengreen and Peter H Lindert (eds), *The International Debt Crisis in Historical Perspective* (MIT Press 1989); Udaibir S Das, Michael G Papaioannou and Christoph Trebesch, 'Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts' (2012) IMF, Working Paper WP/12/203.

6 Mallarmé, André, *L'Arbitrage Vénézuélien devant la Cour de la Haye (1903-1904)* (Pedone 1906); Mark C Weidemaier, 'Contracting for State Interventions: The Origins of Sovereign Debt Arbitration' (2010) 73 Law and Contemporary Problems 335–55.

7 League of Nations, *Report of the Committee for the Study of International Loan Contracts* (League of Nations 1939).

8 IMF, 'The Design of the Sovereign Debt Restructuring Mechanism – Further Considerations' (27 November 2002) Prepared by the Legal and Policy Development Reviews Departments; Michelle White, 'Sovereigns in Distress: Do They Need a Bankruptcy?' (2002) 2002(1) Brookings Papers on Economic Activity 287–320.

9 Philip R Lane, 'The European Sovereign Debt Crisis' (2012) 26(3) The Journal of Economic Perspectives 49–67. Weidemaier (n 3).

10 Stephan Haggard and Robert R Kaufman (eds), *The Politics of Economic Adjustment* (Princeton University Press 1992); Eric Helleiner, *States and the Reemergence of Global Finance* (Cornell University Press 1996); Rawi Abdelal, *Capital Rules, the Construction of Global Finance* (Harvard University Press 2007).

11 Harold James, *International Monetary Cooperation since Bretton Woods* (IMF and Oxford University Press 1996); James M Boughton, *The Silent Revolution, the International Monetary Fund 1979–1989* (IMF 2001).

12 Richard Dale and Richard P Mattione, *Managing Global Debt* (Brookings 1984); William R Cline, *International Debt Reexamined* (Institute of International Economics 1993); Michael P Dooley, 'A Retrospective on the Debt Crisis' (1995) NBER Working Paper 4963.

13 Carmen M Reinhart and Kenneth Rogoff, *This Time is Different. Eight Centuries of Financial Folly* (Princeton University Press 2009).

14 Das and others (n 5).

15 Cohen (*In whose Interests? International Banking and American Foreign Policy* (Yale University Press 1986)).

16 Charles Lipson, 'Bankers' Dilemmas: Private Cooperation in Rescheduling Sovereign Debts' (1985) 38(1) World Politics 200–25; Charles Lipson, 'International Debt and International Institutions' in Miles Kahler (ed), *The Politics of International Debt* (Cornell University Press 1985) 219–43.

17 Guttentag and Herring (Disaster Myopia in International Banking. Essays in International Finance 164, 46p).

entirely reconstruct the link between the macro-side of the crisis and the micro-level legal and contractual dimensions of restructuring operations.

In order to better identify the rules that shaped the restructuring procedure and endowed it with remarkable predictability, one should thus look first at the legal literature, like Horn,[18] Buchheit,[19] MacCallum,[20] Gold[21] or Hagan.[22] Beyond these, the key sources are the Fund's own publications and archives. The present article is based as suggested, in particular on a systematic exploration of: (i) the Minutes of the Executive Board meetings, which reflect how Member States (represented by Executive Directors) discussed debt issues and tried to guide the organization; (ii) the various proposals and appraisals made by the staff, which capitalize the internal expertise of the Fund;[23] and lastly (iii) a stream of reports and publications by the Fund's Legal Department which tracks its jurisprudence on conditional lending, primarily the Stand-By Arrangement (SBA).

3. How the game started

Taking control of the playing field

There was nothing inevitable about the emergence of the IMF as the main forum for dealing with sovereign debt problems in the 1970s. As its 1944 Articles of Agreements did not envisage any such role, first the Executive Board had to agree that the absence of a formal mandate was not an excuse to stay put, a decision which in fact raised little resistance from the principals.[24] As the American Executive Director casually noted at a Board meeting, in April 1971, relying on the expertise of the Fund 'where appropriate . . . was often extremely useful'[25]—a statement that could well be interpreted as a green light for wading more deeply into sovereign debt matters. However, the IMF could just as well have anticipated on Milton Friedman's advice to stop lending and provide only expertise, information and goodwill.[26] Whether this tack would have led to countries with debt

18 Norbert Horn, 'The Restructuring of International Loans and the International Debt Crisis' (1984) 12(10) International Business Lawyer 400–409.

19 Lee C Buchheit, 'Legal Issues in Trading Sovereign Debt' (1986) 5 International Financial Law Review 17–21; Lee C Buchheit, 'Alternative Techniques in Sovereign Debt Restructuring' (1988) 1988(2) University of Illinois Law Review 371–400.

20 Robert K MacCallum, 'Sovereign Debt Restucturing: The Rights and Duties of Commercial Banks *inter sese*' (1987) 1987(2) Columbia Business Law Review 425–57.

21 Joseph Gold, 'Mexico and the Development of the Practice of the International Monetary Fund' (1988) 16(10) World Development 1127–42.

22 Sean Hagan, 'Sovereign Debtors, Private Creditors, and the IMF' (2002) 8 Law and Business Review of the Americas 49–71.

23 The Staff's archives are mostly made of (i) 'Staff Memoranda' that convey to the Board the collective experience, judgement and proposals of the organization; (ii) internal 'Office Memoranda', which reflect the internal policy debates and are typically not circulated to the Directors; and (iii) 'Private Papers' of the successive Managing Directors, which are the key intermediary between the Staff and the Directors. These archives are opened to the public after 5, 10 or 20 years depending on how politically sensitive the contents are.

24 On the Fund's pre-1970 experience with debt renegotiation, see the 1964 and 1965 editions of the *Annual Reports,* James (n 11), Helleiner (n 10). Also see Margaret G de Vries, *The International Monetary Fund, 1966-1971* (IMF 1976) vol I, 593–603; IMF, 'Avoidance and Resolution of Debt Servicing Difficulties' (27 September 1976) Staff Memorandum SM/76/202 corr 2; Henry J Bittermann, *The Refunding of International Debt* (Duke University Press 1973).

25 IMF (21 and 23 April 1971) Minutes of the Executive Board Meeting, 71/33 and 71/34.

26 'If the IMF were out of the picture . . . the banks would arrange their own rescheduling of debts, as they do with domestic borrowers in trouble.' Milton Friedman, 'No More Money for the IMF' *Newsweek* (3 November 1983).

problems to a less controversial presence is not clear: later during the same decade, banks began to use the Fund's pronouncements as a source of risk assessment, and even started to ask for its private judgement on the evolving situation in given countries—whether a programme was on track or drifting.[27] The Board soon judged that this role might seriously limit its discretion and capacity to adjust its judgements when bargaining with countries' governments.[28] More generally, it was clearly agreed upon that the Fund should never mimic a rating agency or become the operator of a system of traffic lights for international capital markets.

The decision to enter the debt restructuring business also implied the de facto rejection of alternate institutional options. The first, outright default, was seldom considered in practice. In that case, the parties would have followed the initial debt contracts' provisions for renegotiation, and if a private agreement could not be obtained then the parties would have litigated—probably under different jurisdictions.[29] Moreover, in many cases, a 'default event' on one class of debt or another would have extended to all other contracts, after which most creditors would have been forced to post large loan-loss provisions or even declare themselves insolvent. In practice, this was a recipe for disaster.

A second option was for privately coordinated creditors to enter in direct negotiations with the government of the debtor country—without any mediation, somewhat 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 programme 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 programme 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.[30] Of course, the episode was closely monitored by the IMF and became part of its knowledge base.[31]

A third option was to restructure debt through the United Nations Conference on Trade and Development (UNCTAD). This body, 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 its 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

27 Gold (n 21).

28 IMF (22 June 1977) Minutes of the Executive Board, EBM 77/89 and EBM 77/90; IMF, Policy Development and Review Departments, *Signaling by the Fund – A Historical Review* (IMF 2004).

29 The only well-known occurrence of litigation is the 1985 Allied Bank case; see Kenneth Rogoff and Jeromin Zettelmeyer, 'Early Ideas on Sovereign Bankruptcy Reorganization: A Survey' (2002) Working paper WP/02/ 57, IMF, Washington DC.

30 Barbara Stallings, 'Peru and the US Banks: Privatization of Financial Relations' in Jonathan David Aronson (ed), *Debt and the Less Developed Countries* (Westview Press 1979); AO Adede, 'Panel Discussion: Refinancing of Third World Debt' (1978) 5(2) Syracuse Journal of International Law and Commerce 235–67; Ballivean, 'What the Peru Experiment Means' *Institutional Investor* (October 1976).

31 'It is clear that the monitoring effected [by the banks in Peru] came nowhere near the close scrutiny associated with the implementation of Fund-supported adjustment programs.' IMF 'Program Monitoring by Commercial Banks: the Experience of Peru' (12 February 1985) Office Memorandum to the Managing Director; IMF, 'External Indebtedness of Developing Countries' (24 December 1980) Staff Memorandum SM/80/273.

possibility of deciding for across-the-\board debt write-offs was also mentioned.[32] But the developed countries immediately made clear that they were not in agreement, and this proposal barely registered with the Fund. Clearly, the Fund was protected by its close relationship to the financial administrations of its key Member States—after all, it is their creature.

The 'four corners' of the SBAs

Once it had been agreed that addressing debt problems was actually 'appropriate' for the IMF, the next step was to design a strategy to deal with restructurings and make them easier to settle. The tool the Fund immediately mobilized was the Stand By Arrangement (SBA), ie the standard vehicle for conditional lending which it had been developing through trial and error since the early 1950s. Significantly, the founder of the IMF's legal doctrine, Joseph Gold, had often insisted when addressing Fund officials that the SBA should be envisaged neither as a contract nor as an international treaty. In both cases, he argued, sanction of a failure to comply would have taken a sharp 'censorious' character, which was deemed unhelpful or even disruptive.[33] The threat of sanction or even expulsion was not an option, Gold argued, because the Fund should always aim at keeping communication lines open so as to allow for a resumption of negotiations and to make a new accord as easy as possible to obtain. Said differently, the priority is 'consultation and collaboration'[34]—a dyadic approach that may suggest pragmatism, but also hints at bargaining and arm-twisting.

Rather than as a (private law) contract or a (public law) international treaty, the SBA was thus shaped as a shallower 'exchange transaction', made of two 'parallel declarations':[35] a 'Letter of Intent' is first sent by the country's authorities to the Fund's Managing Director, and the Executive Board then gives access to a stated amount of refundable cash which 'stands by' in the Fund's accounts until the country draws on it. This two-track exchange explains why no document ever carries the signatures of both parties at the same time, even though hard bargaining does happen and commitments are entered into. Three significant features further highlight the original, self-sustained legal character of the SBA. First, Gold is adamant that SBAs should not interact with the domestic legal order of the member-countries, which is why the Fund never asks that they be voted into law by national Parliaments. Then, the interpretation of the Letter of Intent (ie the economic programme) on an *ex post* basis is never left to a third-party or arbitration procedure: the Fund has always preferred discretionary bilateral 'consultations' between the two parties. Lastly, Gold has admitted that, during at least the first

32 Dusan Zivkovic, 'Debt Renegotiation Framework' (October 2005) Paper Prepared for the Expert Group on Debt Sustainability and Development Strategies, UNCTAD <vi.unctad.org/debt/debt/m3/documents/zivkovic.PDF> accessed 7 January 2016.

33 Robert C Effros, 'A Tribute to Sir Joseph Gold' (2002) 8 Law and Business Review of the Americas 9–33; Joseph Gold, *The Stand-By Arrangements of the International Monetary Fund, a Commentary on Their Formal, Legal, and Financial Aspects* (IMF 1970).

34 Joseph Gold, 'The Law and Practice of the International Monetary Fund with Respect to 'Stand-By Arrangements'' (1963) 12(1) ICLQ 1–30; Joseph Gold, *Interpretation by the Fund, Pamphlet Series No 11* (IMF 1968) 68 p.

35 Gold, 'The Law and Practice', *The Rule of Law in the International Monetary Fund, law and Practice. Pamphlet Series 32* (IMF 1980); Gold (1980).

decade or practice, the experimental and evolutionary character of the SBA implied that the formal, legal link with the Article of Agreement was a source of concern.[36]

Bringing all these elements together, Gold once summed up in graphic terms this self-contained approach by stating (in an internal presentation at the Fund) 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'.[37] What Gold may not have anticipated at the time was the sheer flexibility of this squared legal framework: quite soon after the IMF started addressing sovereign debt crises, it discovered that the best way to handle them was to invite the banks to come in and deal jointly with the Fund and the debtor country within the framework of the SBA. Therefore all parties would be able to rely upon tested rules for bargaining and decision-making as well as on the practice of *ex post* conditionality monitoring. In other words, the structure of the SBA and the related expertise that the IMF had accumulated since the 1950s provided after 1970 a platform where the three parties could bargain and exchange credible commitments.

Not lending into arrears

Technically, banks and their debt baggage entered the four corners of the SBA via one rather narrow door. When a country with a debt problem called for help, the IMF had to consider, among many other policy issues, how to address the arrears to lenders (interests and capital) that had accumulated before that moment. Should the Fund ignore these arrears and therefore act without regard for the commercial banks and more generally for the evolution of the international credit markets? In this case, the Fund may as well 'lend into arrears', ie while ignoring arrears entirely. The Fund converged rapidly, however, towards the opposite, pro-active stance and so it was decided in 1970 that reducing arrears, typically during the duration of a SBA, could be part of a programme and hence of conditionality. As long as the country remained faithful to its commitments in this respect (as on the more traditional macroeconomic targets), the Fund could keep lending to it.[38]

In practice, the prohibition to 'lend into arrears', hence the obligation to coordinate one way or another with banks, remained until 1989 a key plank of the Fund's doctrine. Under this rule, no loan could be made available as long as an agreement on arrears was missing (such as rescheduling or capitalization) but also, by extension, as long as a settlement on the general debt problem had not been reached; this settlement might thus include as well the rescheduling of amortizations, grace periods or eventually debt write-offs. The catch, from a legal perspective, is that any assumption regarding arrears, hence debt more generally, inevitably affected how the 'financing gap' of the country (ie current

36 This uncertainty was resolved with the 1968 *Guidelines on Conditionality*, which formalized the doctrine that had emerged since 1953 in the form of a decision taken by the Executive Board. See Gold, 'The Law and Practice' (n 34).

37 Joseph Gold, 'Mr Gold's Statement on Use of Fund's Resources and Stand-By Arrangements' (14 August 1968) Executive Board Meeting 68/123.

38 'In general, the understanding [between Fund and country] should provide for the elimination of the payments arrears within the period of the stand-by arrangement.' IMF, Executive Board Decision n° 3153-(70/95) (26 October 1970). See also IMF, 'Payments Arrears in Current International Transactions' (6 July 1970) Staff Memorandum SM/70/139.

balance plus amortizations) would be covered over the duration of the SBA. And this arrangement had to be stated *ex ante* in the Letter of Intent if the Executive Board was to extend a stand-by loan. Thus the policy towards arrears became in practice the conduit that brought the general issue of debt restructuring into the squared structure of the SBA. Macroeconomic conditionality, financial concessions by the banks and multilateral support from the IMF had to become part of a 'burden sharing' accord that would be de facto written into the terms of the stand-by loan.

4. Commercial banks enter the scene: 1977–1982

The run-up to the 1982 crisis

Making this broad rule work was not easy. A full decade of trial and error was needed, where the main external driving force was the post-oil-shocks 'recycling' strategy: the process through which the current account surpluses of oil-exporting countries were largely re-lent to countries like Mexico, Argentina, Brazil or Yugoslavia. Critically, private banks did most of the work and relied on large loan syndications as their preferred lending vehicle: many banks small and large, international and local, became a part of the overall scheme and of the eventual payment problems.[39]

In practice, as soon as the Fund had made lending conditional upon the repayment of arrears, the first problem to address was that its loans might end up supporting capital and interests outflows, rather than supporting economic adjustment. In other words, the IMF would indirectly though visibly bail out private creditors, with all the consequences that would come to haunt it in later decades: moral hazard followed by over-lending and eventually more crises. Remarkably, in the still benign environment of the early 1970s, the Fund staff already recommended 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'.[40] This threat became steadily more serious as the debt problems grew and as the banks' voice became louder inside the four corners of the SBA. Said differently, the IMF was confronted with a standard Prisoner's Dilemma: unless it succeeded in coordinating the parties *ex ante* and in enforcing *ex post* the terms of their agreement, it would lose any capacity to control how its own resources were used. And the greater the tensions on debt sustainability, the more difficult it would be to solve this dilemma.

Until the late 1970s, the solution that was adopted took the form of a two-track approach: at the same time when the country was negotiating a SBA with the Fund, it

39 IMF, 'Multilateral Debt Renegotiations – Experience of Fund Members, 1971-74' (1974) Staff Memorandum SM/ 74/228; IMF (n 24). On recycling, see Benjamin J Cohen, 'A Global Chapter 11' (1989) 75 Foreign Policy 109–27, ch 11; James (n 11) ch 11; IMF, 'Short-term Credits and External Debt Management: An Introductory Paper on the Extension of Banking Credits to Developing Countries' (11 July 1973) SM/73/166. 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. See Leo Clarke and Stanley F Farrar, 'Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers' [1982] University of Illinois Law Review 229–249; James R Silkenat, 'Eurodollar Borrowing by Developing States: Terms and Negotiating Problems' (1979) 20 Harvard International Law Journal 98, 89–102; Philip R Wood, 'Essay: Sovereign Syndicated Bank Credits in the 1970s' (2010) 73(7) Law and Contemporary Problems 8–28.

40 IMF (n 25).

would bargain with the banks on arrears specifically, and on debt more generally. This approach came to be known under the codename 'parallel operations' though, for sure, they called for substantial exchanges of information and signals between banks and Fund.[41] By the end of decade, however, financial distress increased further as a consequence of the second, 1979–1980 oil shock, the tightening of US monetary policy after 1979, and the world recession of 1980–1982. Whereas only 10 countries had renegotiated their debt between 1975 and 1979, 20 countries concluded such arrangements between January 1980 and August 1982. A second problem of collective action, this time among banks, then increased further the challenge for the IMF. Already by 1977, the Fund staff noted that banks could occasionally exercise 'considerable bargaining power', but that the main risk was stalemate: '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'.[42] In 1980, the staff further underlined that debt restructurings now involved 'formidable organizational problems for the banks. The banks generally acknowledge that their interests are best served by avoiding default (. . .) but individual banks have considerable incentives to attempt to reduce exposure to the country concerned'; this situation therefore imposed 'a massive effort by lead banks to ensure coordination and cooperation among all creditor banks'.[43] As the stakes became higher, agreement thus became more difficult to obtain and the risk increased that the Fund would eventually fail to control the use of its own resources, once disbursed. As a consequence, the doctrine of 'parallel lending' evolved towards a more binding relationship.

In late 1980, the Fund staff described in an internal report a recent landmark 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'.[44] In other words, in order to reach a viable settlement, the two negotiations could no longer unfold on two separate though parallel routes. The three parties had to meet, and the Fund would not be just a silent observer, or benevolent mediator. The same internal report then continues: '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.'[45] In this most

41 A 1977 Office memorandum mentions for instance that, over a six-month period, the staff had received nearly 400 inquiries from banks, among which a number were actually 'initiated by banks to help determine their immediate decision on major lending proposals' (Staff contacts with Commercial Banks. Office Memorandum to the Managing Director. IMF, 20 September 1977). Minutes of bilateral meetings with banks are also common in the country files retained in the archives of area departments.

42 IMF, 'Fund Relations with Commercial Banks' (7 June 1977) Staff Memorandum SM/77/130.

43 IMF, 'External Indebtedness of Developing Countries' (n 31).

44 IMF, 'Review of Fund Policies and Procedures on Payments Arrears' (27 August 1980) EBS/80/190.

45 IMF, 'Debt Restructuring by Commercial Banks – Recent Experience of Some Member Countries' (31 December 1980) Staff Memorandum SM/80/275.

remarkable statement, the venom is in the tail: 'a failure of the balance of payment test' meant that conditionality would be broken as a consequence of uncooperative bank behaviour, and the 'explanation to the Fund Board' implied that the overall programme might therefore be suspended and disbursements halted. In sum, if the banks free ride on the Fund's lending, then the Fund might well retaliate and raise the stakes. This was no longer a world where ships sailed on parallel lines and exchanged cryptic signals.[46]

The other significant bifurcation before the Mexican watershed appears in a 1980 review of policies on arrears, where the Fund staff softly suggested that, in the case of large restructurings, interest arrears might be capitalized upfront and immediately made part of the total stock of debt.[47] This proposition was presented as one option among others, but its strategic implications were straightforward: in this case, the banks would not only have to accept an extension over time of interest repayments, they would have to contribute to easing the financial and liquidity position of the debtor country from the very first day the programme was adopted. This is indeed what happened after 1982. And this new twist implied a new interpretation of the rule of 'not lending into arrears': no payment at all on interest arrears would be written into the SBA, because they would be entirely absorbed by banks as de facto new debt.

Guidance from the principals

During this long process of experimentation, the Fund's staff in Washington, its missions in debtor countries and the officials in contact with commercial banks never ceased to design and discuss alternative strategies for addressing sovereign debt crises. Moreover, this was not seen as a minor issue to be left to second-rank officials. Tellingly, from early 1980 onwards the personal papers of the Managing Director, Jacques de Larosière, include many references to meetings (and dinners) with the heads of large banks, like Citibank, Warburg, Lazard or Kuhn Loeb.[48] Clearly, the bankers welcomed informal exchanges of views, including on the 'possible solutions to the major funding problems which many developing countries are likely to face in the eighties'.[49] All parties saw these meetings as new practice, a point that is alluded to in a letter of thanks to Larosière that noted in passing that 'direct contact with the commercial banks is difficult for you politically'.[50]

The fact that the IMF as a whole remained alert to the growing tensions in the international financial system stands, however, in sharp contrast with the positions of the Executive Directors. The representatives of member-countries typically backpedalled when discussing the ongoing experimentation, defending multilateral orthodoxy and

46 In turn these decisions were founded only on the clause in the Articles of Agreement that establishes the Board as the sole interpreter of those Articles. See Gold, *Interpretation by the Fund* (n 34); John W Head, 'Law and Policy in International Financial Institutions: The Changing Role of Law in the IMF and the Multilateral Development Banks' (2007–2008) 17 Kansas Journal of Law and Public Policy 194–229.

47 IMF, 'Review of Fund Policies and Procedures' (n 44).

48 IMF Archives, Larosière Papers (Box 19, File 3).

49 ibid, letter from Mr van der Wyck, from Warburg, to Larosière, dated 7 January 1980.

50 ibid, private letter to Larosière, dated 10 January 1980.

clear-cut rules of interaction with banks. Developing countries in particular were most adamant on this point, like Brazil for instance, whose Executive Director said most clearly at a 1977 Board meeting 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'.[51] The Indonesian Director added, '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 judgments'. The German Executive Director, always ready to defend a principled position in financial matters, declared 'the Fund should avoid at all costs being drawn into debt negotiations between official lenders and debtor countries'.[52]

Again in 1981, at a time when the Fund had already started to ask banks to enter into 'understandings', the US Alternate Director underlined 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, 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'.[53] Yet he did not propose an option that could eliminate the bailout risk without entering into undue relations with the banks.

In summing up the discussion that same day, Jacques de Larosière 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: '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'.[54] What is most striking in this (then confidential) statement is the recognition that some 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.

5. 1982–1987: from crisis to routine

In August 1982, Mexico did not default on its debt in the exact legal sense of the 'default event' that is a suspension of debt service. Rather, it declared itself unable either to refinance its maturing debt or to raise fresh funds, and thus asked for help. The story of how matters unfolded during the following months has already been told in detail and needs only be briefly summarized here.[55] The first step was to negotiate a so-called bridge loan with the Bank of International Settlements and its main Member States, the G10

51 IMF (22 June 1977) (n 28).

52 ibid.

53 External Indebtedness of Developing Countries. Executive Board Meeting 81/12 et 81/13, January 26.

54 IMF, 'External Indebtedness of Developing Countries' (26 January 1981) Executive Board Meeting 81/12 et 81/13.

55 Boughton (n 11) ch 7, provides a comprehensive and nearly day-by-day account of the negotiations between August 1982 and March 1983. Kraft (n 54) is the other main reference. A detailed, hand-corrected chronology of this period is also available in the IMF Archives, Larosière Papers (Box 50, File 3). See also Alvarez ('The Mexican Debt Crisis Redux: International Interbank Markets

countries;[56] this measure reduced the immediate pressure so that over several weeks an economic programme was negotiated between Mexico and the IMF while exploratory meetings were held with the banks. What was new in these circumstances was not the nature of the collective action problem raised by the threat of an outright default: as said previously, neither the lead banks nor the IMF were in unknown territory. But what was entirely unfamiliar was the magnitude of the problem: some 530 banks now had to be party to any agreement made, and with a country that clearly had much more economic and geopolitical leverage than, say, Zaïre or Jamaica. The financial stakes were proportional: $8.2 billion ($16.8 billion in 2015 dollars) was needed just to close Mexico's financing gap till the end of 1983.

It soon became clear to all parties that either the banks would be 'bailed in' via some burden-sharing agreement, or the burden would be transferred to multilaterals and to major creditor countries, that is, banks would be 'bailed out'. In practice, the banking community was awash with proposals for banks to (i) launch a mega-loan syndication on behalf of the Fund; (ii) use the money to replenish the IMF's coffers; and (iii) ask the Fund to bail them out from their excessive lending to developing countries. The eventual costs would admittedly have been borne by taxpayers, but for many it was a price worth paying.[57]

The threshold was reached on 18 November, when a meeting was held at the New York Federal Reserve Bank between the commercial banks and the Managing Director of the Fund, Jacques de Larosière. On the basis of financing commitments made by the Fund ($1.2 billion) and the official lenders ($2 billion), he asked the banks to commit the balance of $5 billion. He then added that the proposed Mexican SBA 'would not be sent to the Board [for approval and disbursement] if the coverage of the deficit gap were not known'; that is, if no binding understanding was obtained from the banks as a whole.[58] Said differently, he attempted in full daylight to arm-twist the international banking community. That same afternoon, however, Paul Volcker (then head of the Federal Reserve) stated that as long as American banks agreed with the Fund's demands, 'new credits should not be subjected to supervisory criticism'.[59] Banks would not have to augment their loan-loss reserves or reveal their possible underlying insolvency,[60] making this negotiation a two-way game.

and Financial Crisis' (1977–1982) 22(1) Financial History Review 79–105) for an analytical narrative of the run-up to August 1982 from the perspective of Mexican interbank relationships.

56 Established in 1962, the G10 group includes Belgium, Canada, France, Italy, Japan, The Netherlands, the UK and the USA. Switzerland joined the group in 1964.

57 Victoria A Marmorstein, 'Responding to the Call for Order in International Finance: Cooperation Between the International Monetary Fund and Commercial Banks' (1978) 18(3) Virginia Journal of International Law 445–483; Xenophon Zolotas, 'A Proposal for a New Fund to Ensure against Euromarket Defaults' *Euromoney* (April 1978) 77–84; Marc Viénot, 'Letter and Memorandum to Jacques de Larosière', Société Générale, Paris, 16 December 1980. Available in IMF Archives (n 48). Boughton states that, even within the Reagan administration, there was an 'innate conviction' in August 1982 that some bailout operation was inevitable. Boughton (n 11) 291–292.

58 Federal Reserve Bank of New York, 1982.

59 Joseph Kraft, *The Mexican Rescue* (Group of Thirty 1984).

60 This practice would continue during the following years and was also followed by the national regulators from other creditor countries: 'Bank supervisory authorities generally have shown considerable flexibility as regard new money packages. They have been prepared to acquiesce in the circumvention of lending limits, and to accept only gradual dilution of banks' exposure to the major borrowers.' IMF, 'The Impact of Banking Regulations on Lending to Developing Countries' (11 December 1984) Office Memorandum to the Managing Director.

During the following weeks the main challenge was to maintain coordination among the banks themselves: between (i) the largest institutions, which had lent the most to developing countries, and which also maintained a major stake in the continued expansion of international capital markets; and (ii) the local 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 would mark the political economy of the debt crisis until 1989.[61]

On 23 December, when the Fund Executive Directors met to discuss the Mexican loan, the lead banks had been able to obtain commitments for only \$4.32 billion (of the \$5 billion requested). The Managing Director proposed that the operation proceed, but he also came with a list that detailed how much each member-country's banks still had to contribute: the Japanese banks 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'.[62]

In short, if large banks were unable to coerce the smaller ones to step up (via market power), then national domestic regulators would step in: a domestic, hierarchical relation would be mobilized in support of international coordination. Whether this strategy should be viewed as coercion or more charitably as moral suasion is a matter of judgment.[63] More important is the illustration proposed here of how national regimes of regulated finance typical of post-1945 settlements became instrumental in addressing an international crisis, via a multilateral agency. Governments de facto intervened into private property rights at the domestic level in order to support a multilateral response to the crisis. Of course, the Fund's Board did not miss the extraordinary character of this method: in the words of the Belgian Executive Director, 'the generalization of the method used by the Chairman in this instance would depend on the supervising authorities in the various countries setting up appropriate arrangements'.[64] With some irony, Jacques Polak, the Dutch Executive Director (and long-time Director of the Fund's Research Department), 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'.[65]

61 The two 1985 contributions by Lipson (n 16) and Guttentag and Herring (n 17) comment on the relationships between banks. See also on this Barbara B Crane, 'Policy Coordination by Major Western Powers in Bargaining with the Third World Debt Relief and the Common Fund' (1984) 38 (3) International Organization 399–428; Philip A Wellons, 'International Debt: The Behaviour of Banks in a Politicized Environment' (1985) 39(3) International Organization 441–71; and MacCallum (n 20); see also Nancy P Gibbs, 'A Regional Bank's Perspective' (1984) 23 Columbia Journal of Transnational Law 11–28; IMF, 'Regional Banks' Attitude to Debt Restructurings and New Money Packages' (29 February 1984) Office Memorandum to the Managing Director (draft version).

62 IMF (23 December 1982) Minutes of the Executive Board Meeting 82/167 and 82/168.

63 Buchheit adds that restructurings were obtained 'through various methods of moral suasion, although the reluctant bank recipient of such attention may find these suasive overtures to be uncomfortably blunt'. Lee C Buccheit, 'The Changing Tactics of Sovereign Debt Restructuring' (1987) International Financial Law Review 35–39; Hagan (n 22), from the Fund Legal Department, writes even more directly that 'during the 1980s . . . the process of securing a contribution from the private sector would be a coercive one'.

64 IMF (n 62).

65 ibid.

6. Deformalization and justification

The decision-making process assembled in late 1982 and confirmed in early 1983 to address the case of Mexico was relied upon 109 times by 1989, sometimes with the explicit intervention of national regulators and more often under the shadow of that possibility.[66] First, the debtor country negotiated a macroeconomic programme with a visiting IMF mission. In most cases this programme was sanctioned by a Letter of Intent to the IMF Managing Director, which described the economic strategy and how the financing gap would be covered; the sending of the Letter signalled the Fund's seal of approval and its implicit commitment to extend a loan. Secondly, the country negotiated a debt restructuring accord with the banks' advisory committee, the so-called London Club; this accord typically included a frontloaded capitalization of arrears, a rescheduling of capital amortization and some 'new money'. Lastly, once this financial settlement had been reached, the IMF Board would formally announce a Stand-By loan and allow disbursements.

The old bilateral 'exchange transaction' that had been developed since the 1950s had now been transformed into a three-party transaction structured by a rule of mutual veto. If for instance the banks considered the economic program as too weak, they could indeed reject the whole package; and, similarly, the Imf could reject a financial settlement which they considered as insufficient. Hence, debt restructuring remained a voluntary decision, not a jurisdictional one. Furthermore, the new process extended over time the bond between the three parties, thanks primarily to the enforcement guarantees that came with policy monitoring by the Fund. The ad hoc, non-contractual machinery that had been built around the SBA was thus instrumental in allowing the parties to commit themselves anew, after the first contracts had failed. This new process was obtained despite the fact that neither the banks nor the debtor country ever formally delegated authority over their contractual engagements to the IMF.

Expediency

Until 1987 success rested on one further condition: outside the squared framework of the SBA, all pre-existing statutes, laws, regulations, guidelines or contractual clauses that could have affected debt renegotiations were de facto suspended, circumvented or put on hold; if not, the fragile envelope of the SBA might have been punctured by this harder legal material and soon torn to pieces. This condition first applied to international public law, specifically to the elements of a doctrine on restructuring that had developed since the early twentieth century: for example, on issues of sovereign immunity, hierarchy among creditors or the *pari passu* clause. These principles were discussed by international lawyers in the 1970s and early 1980s,[67] but they never surfaced in discussions at the Fund

66 This figure excludes 18 accords signed between 1989 and 1994 under the Brady Initiative. Summary tables can be found in IMF, 'Management of the Debt Situation' (13 March 1991) Executive Board Seminar EBS/91/43. Descriptions of the successive steps in the debt strategy between 1982 and 1989 can be found in Cline (n 12) ch 5, James (n 11), ch 12 and Boughton (n 11) chs 9–11.

67 Adede (n 30); Wood (n 39); 'Panel Discussion: Restructuring Sovereign Debt – Will There Be New International Law and Institutions?' (1983) 77 American Society of International Law Proceedings 312–17; George Weisz, Nancy E Schwartzkopf and

or in its written statements so that lawyers struggled to account for the Fund's actions, which they insisted implied no notion of legal responsibility. In fact, the Fund 'carefully avoid[ed] reliance upon traditional legal remedies'.[68] MacCallum also concluded 'sovereign debt restructuring takes place in the absence of a legal framework'.[69] Norbert Horn noted that 'the service a lawyer can render in the restructuring of loans appears to be modest: he can provide the patterns and formulae for solutions dictated by economic necessities and achieved in negotiations where non-legal questions prevail'.[70] In fact, more than 'the absence of a legal framework', the procedure was marked by a strong pattern of 'deformalization', which does not imply that legal rules have been entirely voided.[71] Rather, hard law was substituted by soft, ad hoc, short-lived rules that delivered predictability and finality for a certain period before being shelved. Expediency gained precedence over legal consistency.

At least as significant is how the debt contracts that structured relationships between banks evolved over time. Each initial loan syndication listed some fiduciary responsibilities that the agent bank organizing the initial lending operation kept afterwards. Yet these responsibilities were generally loosely defined and, critically, they did not allow for a binding collective arrangement in case of a restructuring.[72] From the 1970s on and most clearly after 1982, agent banks were however substituted by ad-hoc Steering committees, which coordinated all creditor banks regardless of the syndicated loan(s) to which they had initially subscribed. These committees (often known as London Clubs) had no formal mandate or legal standing of their own. The debtor country chose a lead bank when announcing its intention to restructure; the latter would then convene a Steering committee, made up of 5–10 other banks. But all creditor banks never endorsed collectively this committee, its mandate or its initiatives; instead, each individual bank would sign a separate agreement with the country and thus formalize *ex post* the terms arranged by the Steering committee.[73] The signing of these agreements marked the moment when restructurings became legally binding and impacted the banks' balance sheets and tax liabilities. This was, most clearly, when 'moral suasion' was applied.

Mimi Panitch, 'Selected Issues in Sovereign Debt Litigation' (1991) 12(1) University of Pennsylvania Journal of International Business Law 1–49.

68 Dominique Carreau and Malcolm N Shaw, *The External Debt* (Hague Academy of International Law/Martinus Nijhoff 1995).

69 MacCallum (n 20).

70 Horn (n 18).

71 Koskenniemi calls 'deformalization' the 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. Typically, officials and principals would argue about issues by looking at the possible consequences of acting (or not) in a certain way, rather than by asking whether the statutes, mandate or precedents allow it or not. Deformalization is a consequence of result-oriented policy actions rather than the opportunistic exploitation of agency slack or other institutional failures. Deformalization is a side cost of pragmatic, short-term policy decisions, taken in an environment where the legal and regulatory order is intrinsically weak, though also ill-adapted to the policy objective that is pursued. Martti Koskenniemi, 'Constitutionalism as Mindset: Reflections on Kantian Themes About International Law and Globalization' (2007) 8(1) Theoretical Inquiry into Law 10–36.

72 Horn (n 18); Wood (n 39).

73 Clarke and Farrar (n 39) and Alfred Mudge ('Sovereign Debt Restructure: A Perspective of Counsel to Agent Banks, Bank Advisory Groups and Servicing Banks' (1984) 23 Columbia Journal of Transnational Law 59–74) describe how the London clubs emerged from several years of experimentation by private banks and always kept an informal character. See also Lee C Buccheit, 'The Sharing Clause as a Litigation Shield' (October 1990) International Financial Law Review 15–16; David F Lomax, *The Developing Countries Debt Crisis* (Palgrave 1986).

The relationships between creditor banks also changed substantially over the course of the restructuring cycle.[74] As underlined by Buchheit and Reisner,[75] these operations typically did not abolish the initial loan contracts; they changed the payment conditions and at the same time called for the forbearance of many pre-existing legal rights that stemmed from the initial contracts. But what proved most problematic was not the rescheduling of maturities on existing obligations, but the extension of 'new money' loans in which no bank was legally bound to participate. Moreover, new money loans were not formalized as an extension of the first generation of debt contracts, but as de novo contracts to which all banks involved in the negotiation adhered and which worked thereafter as a 'master syndicate'.[76] Solidarity among creditor banks was then formalized inter alia by Cross default clauses and Sharing clauses, the latter requesting that banks that obtained some side-payments share these proceeds with all others.[77] The overall effect was to make disruptive strategies by holdout investors more difficult, so that the collective of banks would act as a 'rather uneasy confederation', loosely governed by the Steering committee.[78]

Lastly, the preference for expediency over legal consistency is also observed within the Fund. The most distant origin of this pattern is in the rule, adopted at Bretton Woods, whereby the Fund is the sole interpreter of the Articles of Agreement, ie its own constitution[79]—no judicial forum or dispute resolution procedure can be called upon. Given the predominant role of the Executive Board over the Board of Governors, which meets only twice a year, the result is that the Fund is very much a self-governed organization: the Executive Board can adopt with little external constraints the rules and decisions it sees fit. Moreover, the procedure for interpreting the Articles of Agreements that was envisaged at Bretton Woods (Article XVIII) has been substituted by an even more casual practice: interpretations typically take the form of a Decision that is the least constraining form of rule that the organization can adopt.[80] The only tangible backstop to this remarkable agency structure is not legal, in fact, as it rests on the principle of a 'continuous session' of the Executive Board. Representatives of key Member States, each

74 MacCallum (n 20).

75 Buccheit and Reisner, 'The Effect of the Sovereign Debt Restructuring Process on Inter-creditor Relationships' [1988] University of Illinois Law Review 493–517.

76 ibid.

77 Note also that litigation was largely avoided with regard to the few bonds that were then in circulation. The only well-known occurrence is the long-running Allied Bank case, concerning a bond issued by Costa Rica. See Buccheit (n 73); CR Brown, 'Enforcing Sovereign Lending' (1984) 3(7) International Financial Law Review 5–8; Rogoff and Zettelmeyer (n 29).

78 Buchheit and Reisner (n 75).

79 Other financial organizations like the World Bank, or later the Inter-American Development Bank and the European Bank for Reconstruction and Development, also have this capacity. This clause remains, however, exceptional and somewhat problematic: a 'remarkable and unusual' one for Hexner ('Interpretation by the Public International Organizations of their Basic Instruments' (1959) 53(2) The American Journal of International Law 341–70) and 'a most unusual phenomenon' for Joseph Gold, 'The Interpretation by the International Monetary Fund of its Articles of Agreement' (1954) 3(4) The International and Quarterly Law Review.

80 Gold came back to this explicit preference for relatively informal decision-making on several occasions. In essence, he attributed it to practicality and the need for fast and pragmatic adjustments to changing economic circumstances. See Head (n 46), Hexner, ibid and Gold (n 34) and see Joseph Gold, *The Rule of Law in the International Monetary Fund, law and Practice, Pamphlet Series 32* (IMF 1971); Joseph Gold, 'Developments in the Law and Institutions of International Economic Relations' (1974) 68(4) AJIL 687–708.

with close links to their home governments, meet at least once a week and make or endorse the day-by-day decisions based on the quota system. Because the principal–agent relationship is very hands-on in practice, there is no need for a complex, formal legal machinery to constrain and monitor the discretion of officials.

The Fund's bias towards relative informality is indeed deeply rooted. As already said, the inventors of the SBA explicitly avoided relying on broader Fund rules, like the Articles of Agreement. Hard sanctions against non-compliance had thus been discarded early on and the first 'guidelines' on SBAs were adopted only in 1968. Similarly, the prohibition to 'lend into arrears' was adopted as only a low-key Decision in 1970, and no formal act sanctioned the later shift from the soft interpretation of this rule (interest arrears should be paid by the country during the duration of the SBA) to the hard one (they should be capitalized upfront by the banks). Last but not least, there is no mention in the Fund's paper record of its Board voluntarily conditioning its decision to lend on the acquiescence of a representative group of banks with no legal existence.

Justification

How could an organization like the IMF act within such a weak legal framework? How were its interventions justified at least minimally by its statutes? Even a summary description of its actions must have drawn from an accepted vocabulary that would signal its reliance on a given set of procedural rules. These issues were at stake in March 1983 when the Fund carried out the first review of its experience since the Mexican quasi-default, six months earlier. At this point the formal or legal conditions for routinizing the new method of negotiations should have been discussed. In four large surveys, the staff described the conditions and lessons of the recent negotiations and somewhat obliquely addressed the 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.'[81] Yet beyond this single statement there was no further presentation or analysis of these recent cases. Rather than suggesting how the Fund could find a legal basis for conditioning its own decisions to the deliberations of an informal club of bankers, the staff seized on a completely external argument: '. . . the Fund has assumed a more direct coordinating role than has normally been the case'. The reason for this new posture, it was added, was the need to preserve 'the stable functioning of the international financial system'.[82] Another paper, discussed at the same meeting, takes the same consequentialist line and alludes to 'possible systemic implications';[83] some Executive Directors also made similar

81 IMF, 'Payments Difficulties Involving Debt to Commercial Banks. Prepared by the Exchange and Trade Department' (9 March 1983) Staff Memorandum SM/83/47.

82 IMF, 'Fund Policies and External Debt Servicing Problems. Staff Memorandum to the Executive Board' (8 March 1983) Staff Memorandum SM/83/45.

83 ibid.

arguments.[84] This is a line that the Fund would use again and again in the future in order to evade or rewrite its existing rules of engagement.[85]

Yet this discursive strategy adopted in spring 1983 would never be challenged; until 1989, the Fund maintained that the Mexican experiment had just been an exceptional foray into unknown territory, it had not created any precedent. 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'.[86] Discretion and informality should thus rule, with the sole (implicit) caveat that core Member States might object at any point. Alternately, it was up to the Executive Directors to take the lead and offer guidance: '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.'[87]

Yet the Executive Board refused to be that specific. When debating the Mexican programme, first in December 1982, then during the March 1983 policy review, the Executive Board endorsed the Fund's recent action and applauded its Managing Director. The US Executive Director commended both management and staff for addressing the recent crisis 'with remarkable care and in an admirable fashion'; the UK director emphasized the 'considerable skill' exhibited during crisis management.[88] 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 were an example of delegation to a multilateral agent being affirmed *ex post*, after it had taken the organization far away from its usual practice, this was it. But the Directors refused to be more specific. The US Director simply noted that it would be important in future cases 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 it 'must always have reasonable confidence' concerning the contributions of banks.[89] 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'.[90] At the end of the day, Jacques de Larosière concluded softly, 'the relationship between Fund-supported programs and the debt relief ... should continue to be handled on a case-by-case

84 IMF (6 April 1983) Minutes of the Executive Board Meeting, EBM 83/57 and 83/58.

85 The undue identification of an 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: Robert E Weintraub, 'International Debt: Crisis and Challenges' (1983) 4(1) Cato Journal 21–61; Fred L Smith, 'The Politics of IMF Lending' (1984) 4(1) Cato Journal 211–41; Roland Vaubel, 'The Moral Hazard of IMF Lending' (1983) 6(3) The World Economy 291–305.

86 IMF (n 82).

87 ibid.

88 IMF (n 84).

89 ibid.

90 ibid.

basis'.[91] In other words, as long as the principals agreed, the Fund had a free hand: the Executive Directors trusted its competence and judgement and, of course, they relied on the 'continuous session' of the Board. Again, informality and expediency rested ultimately on the tight-leash monitoring structure that had been designed in 1944, not on legal rules.

In the following years this position was consistently defended, even after the three-step decision procedure had become standard practice and systemic risk had receded. The strategy thus remained wrapped in euphemistic language. In its own writings, the Fund asked 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'.[92] 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';[93] or again it would 'advise banks to maintain a minimum level of new lending'.[94] Even a highly informative internal report, which was prepared jointly by the different area departments in 1983–1984, failed to ask why banks would commit themselves to a burden sharing accord.[95] Any suggestion of a coercive relation was carefully avoided, while the hint that this regime was remotely judicial in character was shunned.[96]

This omission does not imply 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 considered this procedure to be the best option on the table—they even applauded it. The point is that legal uncertainty caused serious problems of justification and legitimacy. Since it was not possible to describe comprehensively the procedural rules, institutionalization remained impossible: rules first must be put into words if they are to be endowed with any legal authority. If not, as here, these rules may work only as long as all involved parties have no alternative, no exit option.

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

92 IMF, 'The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors' (23 July 1985) Executive Board Seminar EBS/85/173.

93 IMF (n 96).

94 Paul Mentré, *The Fund, Commercial Banks, and Member Countries* (IMF 1983) Report to the Managing Director.

95 IMF, Report of the Working Party on Issues Arising in Bank Debt Restructuring (27 April 1984).

96 This comparison was suggested by some Fund outsiders although these authors only use bankruptcy as an illustrative example: they do not propose an analytical account of the post-1982 regime in reference to this domestic, judicial paradigm. 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 extant practices it remained utterly plain: 'a more active involvement of the Fund might be envisaged, for instance, in . . . some move towards active conciliation and mediation'. See also Gold ('The "Sanctions" of the International Monetary Fund' (1972) 66(5) AJIL 373–762) on the role of the Fund in debt restructurings during the 1980s; and Gold on the Fund's general resistance to legally sanctioning Member States. Christopher G Oechsli, 'Procedural Guidelines for Renegotiating LDC Debt: An Analogy to Chapter 11 of the US Bankruptcy Reform Act' (1981) 21(2) Virginia Journal of International Law 305–41; Peter B Kenen, 'A Bailout Plan for the Banks' *The New York Times* (New York, 6 March 1983), s 3, 3; Felix G Rohatyn, 'A Plan for Stretching Out Global Debt' *Business Week* (28 February 1983); Richard S Weinert, 'Banks and Bankruptcy' (1983) (50) Foreign Policy; Cohen (n 39); IMF, 'The Role of the Fund in the Settlement of Disputes Between Members Relating to External Obligations' (24 April 1984) Prepared by the Legal and the Exchange and Trade Relations Departments. Staff Memorandum SM/83/47.

The decline of a regime

Here was the real fault line in this experiment. On the one hand, the principle that adjustment costs should be shared equitably before the debtor country re-enters the market mimicked the expected outcome of a bankruptcy procedure, which, in practice, was substituted by a rule of mutual veto and some 'third-party services' provided by the Fund (a single forum, information, expertise, etc). On the other hand, the stark divergence of interests between debtors and creditors could be endogenized only as long as the IMF and its core Member States had enough leverage over them—exercising raw power (or its threat) in order to corral the parties and make sure that they reached agreement.

The evolution of these power relationships that initially made collective action possible was a main cause for the demise of this regime after 1987. On the one hand, economic adjustment in debtor countries was fairly consistent after 1982, although the rewards in terms of growth and access to capital markets were modest.[97] Attempts to coordinate these countries politically then started to emerge, in particular the so-called Cartagena Group in Latin America.[98] On the other hand, the build-up of loan-loss reserves by banks and the expansion of secondary debt markets steadily increased each bank's room for manoeuvre.[99] The consequence was increasing difficulty to contain wayward strategies by individual players, small and big. Inevitably, this brought direct pressure on the Fund's self-binding commitment not to disburse loans until private financial accords were reached; once it had accepted an economic programme, the Fund could not wait indefinitely for banks to conclude their negotiation before actually lending.

In its 1987 annual review of the debt strategy, the Fund recognized for the first time that on future occasions holdout could become problematic. Hence, it suggested that 'the 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'.[100] In other words, the Fund might break with the jurisprudence it had adopted in 1970 and decide to 'lend into arrears'—that is, to ignore the travail of the private lenders. Yet as the Fund envisaged dismantling its overall strategy, it did not follow its usual line of approach based on expediency. Instead, it 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

97 Carlos F Diaz-Alejandro, 'Latin American Debt: I Don't Think We Are in Kansas Anymore' (1984) 2 Brookings Papers on Economic Activity 335–404; Jeffrey Sachs and Harry Huizinga, 'U.S. Commercial Banks and the Developing-Country Debt Crisis' (1987) 2 Brookings Papers on Economic Activity 555–606.

98 Jacek Kugler, 'The Politics of Foreign Debt in Latin America, a Study of the Debtors' Cartel' (1987) 13(2) International Interactions 115–44; Guillermo O'Donnell, 'External Debt: Why Don't Our Governments do the Obvious' (1985) 27 CEPAL Review 27–33; Riordan Roett, 'Latin America's Response to the Debt Crisis' (1985) 7(2) Third World Quarterly 227–41.

99 Although a bank was not, strictly speaking, entitled to resell its participation in a loan syndicate, secondary exchanges became widespread after 1985. However, transaction costs were high and the legal status of such exchanges was never fully clarified; see Buchheit (n 19) and Cline (n 12). This trend was of course closely monitored by the Fund see IMF. 1986. The Debt Situation – Prospects and Policy Issues. Executive Board Seminar EBS/86/43.February 28, 39 p. And: IMF. 1987. Implementation of the Debt Strategy – Current Issues. Executive Board Seminar. EBS/87/38. 20 February, 54 p.

100 IMF, 'Implementation of the Debt Strategy – Current Issues' (27 February 1987) Executive Board Seminar EBS/87/38.

guidelines'.[101] However, it did not admit that for five years it had done just the contrary. Finally, the decision in March 1989 to accept fully-fledged debt write-offs under the umbrella of the Brady Initiative came together with the (formal) announcement that the (informal) 1982 regime would be shelved.[102] 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.'[103] A public news release even formalized the ending of the 'no lending into arrears' doctrine, hence that of the rule of mutual veto.[104]

7. Conclusion

A detailed reading of the IMF Board Minutes and the Fund's Staff Memoranda offers a unique view of how between 1971 and 1989 this multilateral organization first assembled and then operated a stable and predictable procedure for restructuring sovereign debts. Specifically, these archives document how coordination rules, flows of information, the Fund's role as a muscular broker or the reliance upon the old practice of conditionality enforcement, allowed the Fund to address the generic problems that arose from the absence of an authority with a fully-fledged jurisdiction over sovereign debt restructurings. A further feature of this procedure is its remarkable informality, from two-sides: the restructuring rules were not themselves institutionalized, while alternate, stronger 'hard-law' regulations were systematically ignored. This double informality exposed the strategy to continuing problems of justification and legitimacy.

At the core of this multilateral procedure lay the old structure of the SBA that the Fund had gradually developed since the early 1950s as its standard instrument for lending under macroeconomic conditions to member-countries. This original two-track 'exchange transaction', which had been conceived as neither a contract nor a treaty, proved remarkably adaptable as it was gradually opened to commercial banks: between 1982 and 1989 private creditors, debtor countries and the IMF coordinated within this 'transactional vehicle' whose governance was structured by the rule of mutual veto though, as seen power relationships were not absent. Once adhesion had been obtained, however, the Fund could mobilize its many policy tools and give credence to the commitments made by the parties, especially regarding the economic policies of the debtor country.

This analysis of the procedure that governed debt restructuring during the 1980s underlines further the magnitude of the structural changes observed since then. Usually, analysts first point to how renegotiations were made easier by the relatively stable relationship between a group of dominant international banks and sovereign states. It

101 ibid.

102 IMF, 'Fund Involvement in the Debt Strategy – Further Considerations' (12 May 1989) Executive Board Seminar EBS/89/96; IMF (23 May 1989) Minutes of the Executive Board Meeting 89/61.

103 IMF, 'Summing Up by the Chairman – Fund Involvement in the Debt Strategy' (24 May 1989) Executive Board Meeting 89/61.

104 IMF (24 May 1989) Press Release no 89/117.

appears, however, that the success of the regime of the 1980s hinged also on the capacity of national authorities to arm-twist local banks and to adjust their own domestic regulations when expedient. Successful pragmatism at the multilateral level thus rested indirectly on national regimes of regulated finance typical of the post-World War II Keynesian settlements.

By comparison, the present, twenty-first-century non-regime reflects two movements away from this past institutional context. On the one hand, financial deregulation at the domestic level has considerably reinforced private contractual rights, a trend that is associated with the emergence of the national courts of issuing countries as the key regulatory forum in debt matters. During the 1980s courts had no role in the debt game, while today their (domestic) constitutional mandate to interpret and enforce contractual rights has de facto displaced the Fund's mandate. The latter's parallel weakening is therefore the other striking feature of the present situation. Not only are its meeting rooms in Washington no longer where the action takes place. Today, the Fund is fighting for a place at the table. Not surprisingly, the link between economic adjustment and debt settlement that was at the core of the bargain over burden sharing has now become ad hoc, and any notion of comparability of treatment across countries has been essentially lost.