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Governing Financial Distress

The Making of Global Debt Management in the 1980s

Abstract

This paper revisits the political economy origins of the debt management strategy set up to deal with the international debt crisis of the 1980s. It explores the coordination strategies undertaken by the group of creditors, such as commercial banks, developed countries' governments and multilateral organizations, to face the Mexican crisis of 1982 as well as the institutional arrangements leading to the establishment of the debt policy regime that would govern external debt rescheduling during the rest of the decade. Based on historical documentation from the Federal Reserve Bank of New York, the paper provides new archival evidence on the leading role played by U. S. political and financial authorities in the formation and enforcement of the global debt strategy in the 1980s.

Introduction

On the morning of January 10, 1984, a meeting of the Philippine Advisory Committee was held at Manufacturers Hanover Trust Company in New York. Attended by representatives from each of the 12 commercial banks involved in this committee, and also by officers of the International Monetary Fund (IMF), the World Bank (WB) and the Federal Reserve Bank of New York (FRBNY), the committee reviewed the financial situation of the Philippines and the evolution of its external debt negotiations.

Led by the IMF representative, the members discussed the development of conversations between the Fund and Filipino authorities about the Philippines' macroeconomic adjustment program. One issue raised was banks "apparently taking the position with the Filipinos that they [were] not a party to the IMF pro-

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gram with regard to macroeconomic policy but [could not] act themselves unless a programme [was] in place".[1] Banks' financial cooperation was an element of major concern in dealing with the Philippines' debt payment problem and with averting its further deterioration. In this respect, David L. Pflug Jr., chairman of the Philippine Advisory Committee, reported that "the State Department had been briefed on the situation and undertook to assure that the highest levels of U. S. Government were alerted".[2]

It was the time of the Third World international debt crisis, and these kinds of gatherings were frequent events in New York. Bank Advisory Groups (BAG) was the institutional arrangement created by commercial banks for handling developing countries' debt problems.[3] They met regularly to discuss debt policy issues that arose in negotiation with other banks and with debtor countries. Even though they were bankers' forums, official guests of creditor governments and multilateral institutions also participated actively. By that time, commercial banks' debt problems had traversed the boundaries of the private sector, becoming a matter of public concern. With banks' loans to defaulting countries representing several times their capital, the whole international banking and financial system was threatened with collapse. From the time of Mexico's moratorium announcement in August 1982, creditor institutions in developed countries engaged in cooperative efforts to handle the emerging debt crisis. On the basis of individual renegotiating experiences, an *ad hoc* multilateral routine for dealing with sovereign debt servicing difficulties was progressively adopted. An IMF adjustment program and commercial banks' conditional new lending came to be essential elements of almost every rescheduling agreement. The IMF would become the manager of the crisis and commercial banks' financial contribution was a main feature of this concerted approach.

In this regard, there is an extensive literature, with most of it dating back to the time of the crisis or immediately after. The crisis and the way it was managed has interested a great number of researchers in the social sciences, especially economists and political scientists. The debate on the political economy of debt renegotiation has been largely defined by the books of William R. Cline – *International Debt Reexamined,* Washington, D. C., 1995 – and Robert Devlin's *Debt and Crisis in Latin America: The Supply Side of the Story,* Princeton, 1989. Although they offered competing hypotheses on the making and the managing of the crisis, they both stress creditors' coordination as the key element in the debt management strategy, and its success in keeping the international financial system afloat.[4]

1 Federal Reserve Bank of New York (FRBNY) archives, Box N° 0050853, Folder 740f (L).
2 Ibid.
3 They were also referred to as The London Club.
4 The main references on this subject among economists or economic historians: Vinod K. Aggarwal,

On the basis of new archival evidence, this paper explores the political economy of the international debt management regime of 1982–1989. With special focus on the role played by the U. S. Government, it attempts to shed new light on the conditions leading to the establishment of this complex renegotiating procedure by the time the Mexican crisis erupted. I argue that the U. S. Government was the leading actor in the definition and implementation of this financial stabilization strategy. It found in the IMF an institution with both the capacity and the need to organize and execute an international interventionist effort to deal with debtor countries' external difficulties. Both the U. S. government and the IMF worked hard to encourage commercial banks to avoid disruptive behavior, and enforced the working of this collective strategy.

The United States Government: Tackling the Crisis

On January 24, 1983, U. S. Secretary of the Treasury Donald Regan wrote a letter concerning Argentina's debt situation to Paul Volcker, Chairman of the U. S. Federal Reserve Board (Fed). In discussing a solution for Argentina, Regan held that with the IMF's agreement being reached, the first step had already been taken. It was now time to guarantee the financing, the country would need to implement its adjustment program, and the IMF and the international banking community were expected to fill the need. The Bank of International Settlements (BIS) would also participate, providing temporary bridge financing. Since the onset of the crisis, the U.S Treasury and the Federal Reserve had been working together to develop programs, enabling orderly solutions for developing countries' financial problems.
In the letter, Regan stressed the importance of an agreement between the Fed and the participating member central banks, based on a financial facility "arrangement with the BIS to provide liquidity support to the BIS in the unlikely event that Argentina does not repay the facility at maturity".[5] U. S. financial and political authorities were actually a leading influential part of a broader international coordinating effort for managing the crisis and guaranteeing international stability. In that spirit, Regan concluded his letter by stating that "the Treasury Department view[ed] the proposed

Debt Games. Strategic Interaction in International Debt Rescheduling, Cambridge 1996; James Boughton, Silent Revolution. The International Monetary Fund, 1979–1989, Washington, D.C. 2001; Harold James, International Monetary Cooperation since Bretton Woods, Washington, D.C. 1996. The main references in the field of political science; Benjamin Cohen, In Whose Interest? International Banking and American Foreign Policy, New Haven 1986; Philip A. Wellons, Passing the Buck. Banks, Governments, and Third World Debt, Boston 1987; Charles Lipson, Bankers' Dilemmas. Private Cooperation in Rescheduling Sovereign Debts, in: World Politics 38 (1985), p. 200–225.

5 FRBNY archives, Central Records, File N° 260.44f.

credit facility as serving the interest of the United States with respect to Argentina and our broader efforts to assure a stable and smoothly functioning international monetary system".[6] By that time it had been five months since the international debt crisis had begun in the fall of 1982, and several developing countries were renegotiating their external debts.

When Mexico announced a moratorium on its external debt, on Thursday August 12, 1982, the U. S. Federal Reserve and the Treasury Department promptly developed a coordinated rescue strategy. Faced with Mexico's insufficient reserves to meet the country's debt obligations to U. S. and foreign banks, U. S. Treasury officials scrambled during the "Washington week-end" to find emergency funding, in order to provide Mexico with enough liquidity to service debt obligations falling due the following Monday. In addition, the Fed immediately took the lead in organizing international cooperation and promoting medium-term financial assistance from the BIS and commercial banks.[7]

The approach and arrangements developed by the U. S. authorities to deal with the Mexican situation would be eventually extended and applied to other developing countries going through a debt crisis. As stated by Paul Krugman, this emergency financing played the role of a bridge to the more organized process of conditional rescheduling plus concerted lending that would dominate debt restructuring practices thereafter.[8] In hindsight, the Mexican moratorium announcement launched not only the international debt crisis but also a financial assistance program that would prove to be a watershed in sovereign debt management.[9]

According to a study of the United States General Accounting Office, U. S. preparedness planning had taken place before the crisis began.[10] As a matter of fact, the Fed and the Treasury had been already in contact about the Mexican situation for some time. The report states that by the moment the crises emerged, U. S. officials were already coordinating on a financing strategy, and leadership issues had been resolved among them. State Department officials had asked the Federal Reserve and the Treasury for an inter-agency meeting concerning the Mexican

6 Ibid.

7 See Joseph Kraft, The Mexican Rescue, New York 1984, for a description of the frenzy of negotiations developed during the weekend of August 13–15, 1982, and the Fed efforts in coordinating international financial assistance for Mexico.

8 Paul Krugman, LDC Debt Policy, in: Martin Feldstein (ed.), America Economic Policy in the 1980s, Chicago 1994, p. 691–772, here p. 694.

9 William Rhodes stresses that "many of the modern debt management techniques and financial instruments that we now take for granted began during those stormy days". See William Rhodes, Banker to the World. Leadership Lessons from the Front Lines of Global Finance, New York 2011, p. 65.

10 United States General Accounting Office, Financial Crisis Management. Four Financial Crises in the 1980s, Washington, D. C. 1997.

debt situation as early as January 7, 1982.[11] The meeting took place a few weeks later, and over several succeeding months Mexican and U. S. authorities met regularly on this matter.

The first steps in coordinating debt policy responses of and emergency assistance from U. S. authorities were developed during this period. As of the end of April 1982, the Treasury began to guarantee Federal Reserve currency swaps granted to the Bank of Mexico. As the Fed could not approve an extended swap without assured means of repayment, the "Federal Reserve staff drafted a letter from the Secretary of the Treasury to the Chairman of the Federal Reserve in which the Treasury agreed to provide backing for the swaps".[12] The Treasury therefore stepped in to satisfy this requirement, thus assuring the repayment of any drawings by Mexico, in turn allowing it to meet its month-end liquidity needs.

Thus, at the onset of the debt crisis, the Fed and the Treasury were already actively involved in the Mexican situation and they were working on emergency solutions to keep the country afloat. The large exposure of U. S. money-center banks to Mexican debt was a crucial factor in this regard, since a default might have jeopardized the stability of the U. S. banking and financial system. The strategy for dealing with Mexican economic and financial problems was aimed at ensuring that the country could continue to service its international debt and especially not interrupt repayments to commercial banks.

However, the extent of Mexico's repayment obligations relative to creditors' individual resources would eventually demand a cooperative effort of all creditors. Until August 12, 1982, U. S. efforts for dealing with the Mexican debt problems had been kept inside national boundaries, and corresponded essentially to unilateral official initiatives to assist the country. But, with the crisis growing beyond its own financial capacities and managing control, U. S. authorities sought international political and economic aid to prevent Mexico's default. Debtor governments, European and Japanese central bankers and finance ministries, the IMF, and commercial banks in the U. S. and abroad were mobilized in this regard. An international policy response to confront the Mexican crisis was developed among all these actors, and the United States took the lead in coordinating it.

The collective strategy would broadly conform to the function of a lender of last resort for the national and international banking system. For Philip Wellons, the debt management strategy was actually a complex device developed to enable participation of a multiplicity of actors in providing international lender of last resort assistance, though in diffuse and indirect ways.[13] According to him, the central banks of the G5

11 Ibid., p. 21.
12 Ibid., p. 24.
13 Wellons (see note 4).

were the leaders of this interventionist effort, envisaging keeping all the players in the game and providing enough liquidity. In fact, Volcker himself explicitly defined the strategy in these terms. In discussing the principal role of a central bank as a lender of last resort, he stated that "in effect, that is what we collectively were doing on an international scale, which complicates things a lot".[14]

This vision dominated debt policy-making among U. S. authorities, as clearly stated by Volcker in a letter of December, 1982, to Fernand St Germain, Chairman of the Committee on Banking, Finance and Urban Affairs of the House of the Representatives: "My concerns in this situation are not limited to the direct effects on the major borrowers and to the international banks that have lent to them. The uncertainty and strains generated for the financial system more generally have direct implications for the economy of the United States and other developed countries. Specifically, failure to deal with the emerging strains effectively, because of the actual and potential effect on key interest rates and lending policies, could have strong implications on domestic markets and prospects for non-inflationary recovery in the United States and elsewhere inasmuch as we are dealing with the stability of a financial system upon which we are all dependent [...]. I feel confident that problems are manageable, but such management implies a willingness by the United States to act."[15]

The International Monetary Fund: Finding the Way Out

The Mexican crisis would be a major event in the life of the Fund. In IMF historian James Boughton's words, it would make its daily existence "more frenzied and intense than at any time since U. S. President Richard Nixon had suspended convertibility of the dollar on another August evening eleven years before".[16] The crisis would actually create a new role for the IMF in the international financial system, since it would become a central actor in the handling of Third World sovereign debt problems thereafter. Its renewed position on the international scene would enable it to regain a legitimacy it had lost after the end of Bretton Woods.

The IMF would emerge as the institution responsible for the management and the execution of the creditor's collective strategy. On the one hand, the Fund's long experience in dealing with developing countries' external liquidity problems gave

14 Paul Volcker, Toyoo Gyohten, Changing Fortunes. The World's Money and the Threat to American Leadership, New York 1992, p. 203.

15 FRBNY archives, Central Records, File N° 260.44f. For a historical analysis of the role of the U. S. Government in debt renegotiations, see Carlos Marichal, The Finances of Hegemony in Latin America; Debt Negotiations and the Role of the U. S. Government, 1945–2005, in: Fred Rosen (ed.), Empire and Dissent; The United States and Latin America, Durham 2008, p. 90–116.

16 Boughton (see note 4), p. 281.

it an advantage and *know-how* in treating the Third World debt troubles, compared to the rest of the creditors. On the other hand, the IMF's need for legitimacy made it willing to assume new functions in the international financial system. As Michael Bordo and Harold James observe: "There was some institutional momentum: the IMF was looking for a role that it might play in a world in which rules (the par value rule) had become less important and in which more room for maneuver and more policy choices seemed to be open to national governments."[17] In Boughton's opinion, the international debt crisis of 1982 was a defining moment in the evolution of the IMF in its role as crisis manager as we know it today.[18]

The Fund's actions in response to the international debt crisis would be strongly leveraged and supported by governments of industrial countries, and especially by the United States. Once they realized the need for keeping key debtors afloat with enough liquidity, the Fed and the Treasury would turn to the institution with most experience in assisting developing countries' external problems. The IMF's adjustment programs would be a central feature of the creditors' debt policy and an unavoidable condition for borrower countries wanting to access the Fund's resources and those of private sector banks. The whole approach used to face debt problems would be based on the Fund's policy and methodology of dealing with more general external liquidity difficulties.

Until the eve of the crisis, the IMF had been criticized in the financial press and by the U. S. executive branch and the Congress. During the first years of the Reagan Presidency, the U. S. administration had maintained strained relations with multilateral lending institutions, especially with the IMF. The Reagan administration had actively opposed an enlargement of the IMF resources, due to its critical view of the generous low-conditionality loans granted by the Fund to developing countries during previous years. Faced with the opposition of its major member countries, the Fund had actually started looking for new sources of funds, and accessing international private capital markets (bond markets) was one of the options under discussion.[19]

However, the U. S. position would soon be reconsidered in light of the Mexican crisis. As a matter of fact, the Treasury promptly sent a proposal to the U. S. Congress for an increase in IMF's resources, noting the importance in the new renegotiating strategy. On the occasion of U. S. Congress debates about increasing IMF quotas,

17 Michael Bordo, Harold James, The International Monetary Fund. Its Present Role in Historical Perspective, Cambridge 2000.

18 James Boughton, From Suez to Tequila. The IMF as Crisis Manager, in: The Economic Journal 110 (2000), p. 273–291.

19 For a review of the situation from the standpoint of the U. S. Executive Director in the IMF see Richard Erb, The IMF and World Economic Stability, in: Challenge, September–October 1981, p. 22–27.

Volcker stressed the important role of the IMF for the U. S. interests: "strengthening the IMF's resources is directly supportive of [U. S.] domestic economic objectives and is essentially an investment in our future economic well-being [...] the realization of these benefits rest on intelligent, disciplined use of the resources available to the IMF [...] the essential criteria [...] and the past record of the Fund proves a strong base of confidence in the prudent use of its resources. [Besides], the United States and other potential creditor countries are, of course, strongly represented in IMF deliberations"[20]

In a broader perspective, creditor governments and the IMF had been in discussions about sovereign debt issues in the context of the Paris Club since its creation in 1956.[21] From the beginning, IMF officials had attended the Paris Club's meeting with the status of observers, and, reciprocally, the members of the Paris Club sat on the Board of the IMF.[22] For the Paris Club, the IMF played a key instrumental role in its conditionality policy: the IMF's adjustment arrangement was a precondition for a debtor country to meet the Paris Club and reschedule its debt.[23] But it was only when the number of countries facing debt problems increased at the end of 1970s and the beginning of the 1980s that these institutions started to meet more frequently and to collaborate on debt matters in a regular way.[24]

From the standpoint of creditor governments, the IMF served two appropriate functions. On the one hand, the Paris Club's rescheduling experiences highlighted the importance of IMF's adjustment programs as instruments to condition developing countries' policies and supervise them.[25] On the other hand, as a financial institution, the IMF disposed of funds to help meet developing countries' external deficits. In this regard, as the Mexican crisis required the coordination of a large amount of funds, the IMF was a natural candidate to cover the liquidity needs of the country. With Third World external debt growing throughout the 1970s, and the emergence of balance of payment difficulties, internal deliberations in the IMF on developing

20 FRBNY archives, Central Records, File N° 260.44f.

21 For a brief review on the history of the Paris Club see Alexis Rieffel, Restructuring Sovereign Debt. The Case for Ad Hoc Machinery, Washington, D. C. 2003.

22 For a closer examination of the relationship between the Paris Club and the IMF see Christian Noyer, Le Club de Paris et le Fonds Monétaire International, in: Thierry Walrafen (ed.), Bretton Woods. Mélanges pour un cinquantenaire, Paris 1994, p. 389–395.

23 See Alexis Rieffel, The Role of the Paris Club in Managing Debt Problems, Princeton (NJ) 1985.

24 Up to 1988 the Paris Club had rescheduled a total of approximately 100 bn $, of which 82.4 bn $, had been rescheduled during the years 1983–1988. Although they previously met only sporadically, since 1983 IMF and Paris Club's officials had been meeting one week every month in Paris. See Jean-Claude Trichet, Official Debt Rescheduling. The Paris Club, in: Christine Bogdanowicz-Bindert (ed.), Solving the Global Debt Crisis. Strategies and Controversies by key Stakeholders, New York 1989, p. 109–122, here p. 110.

25 See Louis W. Pauly, The Institutional Legacy of Bretton Woods. IMF Surveillance, 1973–2007, in: David M. Andrews, Orderly Change: International Monetary Relations Since Bretton Woods, New York 2008, p. 189–210.

countries' external financing issues and debt restructuring practices became frequent.[26] Given the increasing role of the banking sector in financing developing countries, the IMF and commercial banks would meet sporadically to exchange information on developing countries' lending and debt issues.[27] William Rhodes says that, given the similarities in credit criteria, commercial banks had looked for the IMF's evaluations of borrower countries as early as the 1960s, sometimes informally linking their own loans to IMF disbursements.[28] However, as regards debt restructuring practices, banks operated in separate parallel negotiations with the Paris Club, and it was only during the first stages of the international debt crisis of the 1980s that the IMF's and commercial banks' debt policies became mutually contingent for the first time.[29]

The Commercial Banks: Engaging the Loose Element

Commercial banks were officially told of Mexico's external debt payment difficulties on August 20, 1982, in a meeting at the FRBNY. The meeting was between Mexican authorities and worldwide commercial bankers holding Mexican debt, but it was also attended by U. S. officials of the Treasury and the Fed, as well as representatives of the IMF. During the conference, Mexico's Finance Minister Silva Herzog announced that discussions for the IMF adjustment program had already been initiated and that a postponement of 90 days on principal payment obligations would be needed on the part of the banks. He also announced that a BAG had been formed for this purpose.[30]

At the meeting, the international banking community was not consulted by Mexican authorities in an isolated bilateral way, but as part of a common approach with official creditors who were already working out a solution to Mexico's problems. In that sense, banks were not so much consulted about the way they would deal with the crisis as asked to participate with a precise task, which was part of a broader collective effort to keep Mexico afloat. Far from elaborating their own individual policy responses, banks were to be integrated into a multilateral rescue effort with given roles.

Securing the participation of commercial banks in this complex collective approach to handle the crisis was one of the major challenges of the creditor's debt strategy.

26 For a review of the history of the Fund's debt policy during this period see Jérôme Sgard, The IMF Meets Commercial Banks. Sovereign Debt Restructuring between 1970 and 1989, Paris 2012.
27 See Charles Lipson, The IMF, Commercial Banks, and Third World Debts, in: Jonathan D. Aronson, Debt and Less Developed Countries, Boulder (CO) 1979, p. 317–333.
28 William Rhodes, Le FMI et le Club de Londres, in: Walrafen (see note 22), p. 397–401.
29 IMF archives, IMF SM/80/275, Debt Restructuring by Commercial Banks: Experience of Some Member Countries, December 31, 1980.
30 Kraft (see note 7), p. 19–25.

Banking was a large international sector, with heterogeneous institutions facing different interests and stakes regarding Third World debt problems. However, the evolution of the structure of international banking into a complex interconnected network rendered cooperation an essential requirement of dealing with the threatened stability of a system on which they were all dependent.

BAG would become a crucial institutional arrangement in facilitating creditor coordination with and within the banking sector. Based on previous syndicated groups, these committees "assembled representatives of 12 to 15 major banks, which, in turn, acted on behalf of 500 to 1000 other banks [...] with membership based on the size of [the banks'] exposure and geographic representation".[31] There was one committee for each debtor country, with the bank that was the most exposed to that country usually heading the group. Its chairman was the banks' direct communication line with officials of the multilateral agencies and treasurers and central bankers of all countries involved.

By that time, though banks had developed a systematic procedure for approaching developing countries for joint lending purposes, no regular mechanism existed to deal with debtors' eventual repayment difficulties. In the 1970s, debt re-schedulings were unlikely events, and it was not until the end of the decade that banks started to enter and later conclude multilateral debt renegotiation agreements with indebted countries.[32] Banks' own experiences and capacity to handle sovereign debt problems were inadequate for dealing with a major case such as the Mexican crisis. In this respect, William Rhodes declared that "those of us [the bankers] who were approached by Mexico to work on the problem in August 1982 had no road map to deal with anything of this size".[33]

The relative lack of standardized procedures for bank debt restructuring, or any other program to confront the crisis, created a space for governments and the IMF to propose a solution to banking difficulties. Official creditors' more long-standing experience (compared to banks) in rescheduling developing countries' debt gave them a competitive advantage in dealing with sovereign debt troubles.[34] After 1982, rescheduling of outstanding debt (with stretching out of principal payments) and extending new money facilities conditioned on IMF agreements with debtor countries became the role that banks were assigned to play in the broader debt management strategy.

31 Rhodes (see note 9), p. 208.

32 See Chandra Hardy, Rescheduling Developing-Country Debts, 1956–1981. Lessons and recommendations, Washington, D.C. 1982, and Irving Friedman, The World Debt Dilemma: Managing Country Risk, Washington, D.C. 1983, p. 127–171.

33 Rhodes (see note 28).

34 Chandra Hardy holds that "in the 25 years through 1982, a total of 80 debt relief agreements were signed [with the Paris Club], but only 13 with commercial banks". Cf. Hardy (see note 32), p. 3.

As Lipson (1987) observes, one of the most salient aspects of the new debt policy regime was the level to which IMF agreements conditioned and determined banks' private lending and rescheduling activities. On the one hand, the IMF's adjustment programs became a standard and unavoidable condition for developing countries to have their debts restructured by commercial banks and to receive new loans. A second novel element also reinforced the linkage between commercial banks and the IMF, making commercial banks' financing a condition for IMF approval of stand-by or extended agreements with developing countries.[35] The Fed and the Treasury, but also central banks of developed countries, were strong supporters of the Fund managing intervention, and they reinforced the IMF's role by making their assistance conditional on IMF programs. As Volcker stated: "Fundamental to all else is action by major borrowing countries [...] to change economic policies [...] typically, that process will be assisted by reaching agreement with the IMF on stabilization programs that justify the IMF in providing temporary financial support."[36] As a matter of fact, when the BIS and U. S. bridge financing for Mexico was concluded by the end of August 1982, it was made contingent on progress toward IMF agreement.

However, during the following months, as the bridge financing proved insufficient, a new step was taken to raise enough funding to cover Mexico's external financial needs. On November 16, 1982, with a Letter of Intent for a three-year IMF adjustment program being recently signed by the Mexicans, de Larosière met representatives of the 13-bank Mexican BAG at the FRBNY. Among other measures, the Fund's Managing Director asked the banks to commit the "critical mass" of 5 m $ in new lending to complement IMF assistance to Mexico. Otherwise, he said, he could not recommend to the Board of the IMF the acceptance of the Mexican program. The Fund's Board of Directors would treat the Mexicans' extended exchange program on December 23, 1982, and the banks were given the deadline of December 15 to subscribe to a written commitment on the requested points.[37] This would be the first (but not the last) time that the IMF sought complementary financing from the banking system as an essential part of an agreement with a member country.

Asking commercial banks to extend new loans as a complement to IMF assistance programs was also supported by U. S. financial and political authorities. As Volcker put it, "linked with such a [IMF] program in some cases would be a commitment or understanding by the bank creditors of the need to avoid actions that would

35 Lipson argues that until then, neither the Fund nor major central banks had intervened to establish rescheduling terms or to ensure their ratification by private creditors. See Charles Lipson, International Debt and International Institutions, in: Miles Kahler (ed.), The Politics of International Debt, London 1987, p. 219–243.

36 FRBNY archives, Central Records, File N° 260.44f.

37 Ibid.

threaten the success of the IMF-approved stabilization program. In many cases, that may well involve an undertaking to provide additional credits, though on a reduced scale and subject to the condition that the country is indeed carrying out the needed adjustment measures."[38] Thus, by the end of 1982 the role of banks in the debt policy strategy was already defined, thereby rescheduling short and medium-term debt and providing new "forced" loans, all conditioned on the signature of IMF adjustment agreements.

However, the willingness of commercial banks to assume and carry on this function is far from evident. The literature often refers to arm-twisting as a crucial factor in making banks cooperate in the debt management strategy. For instance, Harold James remarks upon the importance of the coercive feature of the renegotiation process after 1982 and states that "coordination of additional lending [by commercial banks] required the most extreme pressure applied on banks in the story of the international debt crisis".[39] In this regard, Barry Eichengreen mentions that during the 1980s the U. S. government used "regulatory incentives and moral suasion to pressure banks to reach agreement on negotiating sovereign loans".[40]

Sachs and Huizinga explore the relationship between U. S. regulators and commercial banks from 1982 on, and underline the high level of discretion with which U. S. regulators applied legislation regarding commercial banks' activities during this period.[41] Exploratory archival evidence suggests that the Federal Reserve might have been an important actor in influencing banking decisions through regulation in order to press them to act according to the IMF concerted strategy. Regarding the U. S. position with respect to regulatory aspects concerned by Mexican interest arrearages, in a telex to all Federal Reserve Banks' Presidents on December 13, 1982, Paul Volcker communicated that: "assuming a satisfactory overall structure resulting from the responses to the Mexican request for the new money facility by the international banking community, the Advisory Group has been advised by the Federal Reserve Board, the Comptroller of the Currency and the SEC staff that they would be prepared to confirm before the end of this year their preliminary view that the loans on which interest payments have been made to Banco de Mexico would be considered to be current, that such interest payments may be reflected in current income, and that appropriate disclosure of these arrangements should be made where material for the institution involved [...] Let me emphasize that Secretary Regan and I strongly support the proposed IMF programs for Mexico

38 Ibid.

39 James (see note 4), p. 382.

40 Barry Eichengreen, Restructuring Sovereign Debt, in: The Journal of Economic Perspectives 17 (2003), p. 75–98, here p. 81.

41 Jeffrey Sachs, Harry Huizinga, U. S. Commercial Banks and the Developing Country Debt Crisis, in: Brookings Papers on Economic Activity 2 (1987), p. 555–606.

and Argentina, and recognize the role of further private credit in the success of these two programs"[42]
Bank linkages and cooperation with the IMF was crucially promoted by U. S. regulators. As stressed by James "the IMF had become for practical purposes a part of the domestic regulatory mechanism of U. S. banking [...] [since] the definitions of what constituted sound banking were being written in accordance with the requirements of the world financial system as a whole".[43] There were actually two ways by which regulators enforced the IMF demands on commercial banks: on one hand, discretionary legal treatment and easy line application of financial regulation to commercial banks' sovereign debt restructuring activities (regulatory laxness); on the other, regulators would formally incorporate IMF programs as part of the legal corpus regulating banking activities. As for the first mechanism, Sachs and Huizinga underline the fact that banks were allowed to carry almost all of their LDC exposure on their books at face rather than market value, and that they were able to count as current income all the interest payments they received on their loans, even when the interest payments were made possible only by new "involuntary" loans to the debtor country.[44] With regard to the second point, the 1983 International Lending Supervision Act authorized regulators to declare a loan to a country to be value-impaired, and compelled banks to write down the assets of that country if it had no IMF program and no prospect of negotiating one.

Conclusions

The brief period between August 12, 1982, when Mexico's debt moratorium was announced, and December 23, 1982, when the IMF approved Mexico's Extended Arrangement, was decisive for the making of the global strategy that would govern sovereign debt problems from then on. During these months, developing countries' creditors coordinated their actions to agree on a collective approach for managing the international debt crisis. The first response to the crisis was developed on a case-by-case basis, in which borrower countries would reschedule their debt and receive new loans from the IMF and commercial banks in return for submitting to IMF adjustment programs. Each creditor was assigned a specific role in this complex renegotiating game.
By the time the Mexican crisis began, the U. S. Treasury and the Federal Reserve were already working together to help Mexico manage its growing financial problems.

42 FRBNY archives, Central Records, File N° 260.44f.
43 James (see note 4), p. 370.
44 Sachs/Huizinga (see note 41).

Once the crisis outran its management and financial capacities, the U. S. reached out to the international community, looking for funding to help keep Mexico afloat. They turned to the IMF as an institution with both the resources and the expertise to deal with developing countries' external liquidity problems. Its role had always been to deal with external financial difficulties and it had developed adjustment programs as a conditional instrument to redress these problems. Strongly supported by the U. S. government, the IMF emerged from the Mexican crisis as the manager and executor of the debt management strategy in dealing with the international debt crisis.

Commercial banks were the most exposed sector to Third World debt. During the 1970s, they had organized among themselves to approach borrower countries to offer funding, but no regular mechanism existed to deal with defaults. Cooperation with, and inside, the banking sector was a major challenge in organizing a common response to the crisis. Banks' participation in the collective strategy was made possible thanks to the role of the BAG and the U. S. regulators. By discretionary application of U. S. financial regulation and the inclusion of the IMF's adjustment programs in banking legislation, the U. S. cajoled the banks to play their assigned role in debt policy strategy.

In retrospect, the debt management strategy was developed based on the idea that major debtor countries must continue to service their debt without major interruptions. The debt management strategy was built on the IMF's methodology of dealing with external liquidity problems. This complex multilateral mechanism filled the function of an international lender of last resort and finally succeeded in averting a collapse of the banking system.