The IMF Meets Commercial Banks:

Sovereign Debt Restructuring between 1970 and 1989

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Abstract

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. Examining the Fund's archives in detail provides a unique view of how this regime was gradually assembled from 1970 onward, and how it became standardized after the 1982 Mexican Crisis. Two features come out strongly. (i) Though the Fund offered neutral, third-party inputs, like a forum and information, it did not become a bankruptcy judge, or an arbiter; it also acted as a broker and entered into strategic interactions with debtors and creditors. This was ultimately reflected in a decision rule based on mutual veto power—plus strong arm politics, when needed. (ii) This regime was also marked by considerable informality: its rules were never written down officially, *and* all hard-law or contract-based regulations that could have shaped restructuring were systematically ignored or circumvented. Hence, this is not just about agency slack allowing for experimentation and innovation. It is also about principals agreeing to debase broad rules of international ordering for the sake of expediency.

1. Introduction

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. This experience of the Fund operating a debt resolution procedure is all the more remarkable given that such a role was not envisaged in its 1944 statutes: it emerged only after 1970, became standardized between 1982 and 1989, but was never restored afterwards.

At least as significant is the complex though entirely ad-hoc character of this short-lived regime. The Fund first came to offer "third-party services" to debtors and creditors: (i) it provided neutral public goods (e.g., a forum, information, expertise); (ii) as a crisis lender, it acted as a broker and so entered into strategic interactions with banks and national governments; and (iii) it offered ex post enforcement guarantees with regard to the debtor countries' economic policies (i.e., conditionality). The key problem however is that, contrary to a judge under most domestic bankruptcy laws, the IMF was not empowered to confirm and enforce a majority vote by creditors, or to impose a settlement on the parties if they failed to agree. Hence, the whole process was directly exposed to the standard problems of collective action that arise from any default with multiple creditors (Sachs 1984, Jackson 1986). Ex ante, banks might have failed to coordinate or they could have held off on making any decision in the expectation that the IMF or other official agencies would bail them out; developing countries might have also colluded at the international level so as to obtain collectively better conditions. Ex post, each of these parties could have also tried to free ride on a joint agreement.

This article asks how this debt restructuring regime was formed and how the underlying collective action problems were actually solved. Where did the innovations come from? Why did these rules remain very much ad hoc? And how were hard power relationships articulated with more neutral or equity-based features?

In practice, the core of the regime was a decision rule based on mutual veto power. Case after case, each party to a given restructuring had to endorse explicitly a "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 IMF lending. Thus, the Fund could block a debt accord that it considered to be non-viable from an economic perspective. In turn, the ad-hoc representative committee of banks could veto a loan agreement between the IMF and a member country if, for example, the country's proposed economic adjustment was seen as being insufficient to guarantee a proper level of debt service (say, because of a "preferred pupil" status or pressure from a major member state). Lastly, the country in question had to agree on both arrangements.

One key benefit of this decision rule was to build some guarantees of neutrality and equity into the process of renegotiating debt contracts. This contributed to its overall acceptability and limited the risk

that the parties would opt out of it entirely. In other words, this regime actually belonged to what Stone Sweet (1999) calls “triadic” dispute resolution mechanisms, based on some third-party mediation, hence on a notion of common good; he contrasts them with the more conflictual, un-mediated “dyadic” models, where zero-sum games tend to dominate and where the potential for institutionalization is weaker. In this case however third-party support to debt settlements was not embodied in some sort of judge, but in the decision rule per se. Hence the ambiguity of the Fund’s position: it benevolently operated and supported the procedure, but with regard to the substance of each accord, its voice was formally equal to that of the other two. Tellingly, it never tried to present itself as an arbiter or a trustee: i.e., a regulator, the legitimacy of which rests ultimately on a self-standing notion of procedural integrity and the presumption of neutrality and political independence (Alter 2008).

Still, agency had allowed for experimentation and the adoption of new, unconventional forms of interaction with banks and member states. During the prolonged trial-and-error period of the 1970s, core member states (i.e. the principals) at best tacitly tolerated experimentation and the accumulation of know-how by the IMF. After Mexico started the open debt crisis, in 1982, the Fund was able to draw from this experience and assemble a more coherent set of rules. Critically, this was also the moment when the governments of the United States and the other G7 countries (i) officially endorsed the Fund’s involvement in brokering deals; (ii) submitted their own decisions on lending upon receiving the support of private banks (i.e. the veto rule); (iii) brought their unique political leverage to bear on the negotiations, specifically on the banks, which capacity or willingness to coordinate was not warranted. Hence, the equalizing rule of mutual veto power was adopted at the same time when raw power relationships came to work in the open, typically against the risks of exit or individual opportunism. This is how the potential for gridlock which is inherent to any veto-based decision rule was controlled in the following years (Tsebelis 2002).

These rules did not have only an ad hoc, or *assemblage* character: they were *never* formalized in any international agreement, treaty, communiqué or guidelines. Furthermore, *all* alternate hard law regulations or contractual rules that could have governed or influenced debt renegotiations were systematically ignored or circumvented—a claim that holds equally for the clauses written into the initial bank loans, for national bank regulations, for rules of international public law, and for the IMF’s own Articles of Agreement. Even its internal bylaws were freely reinterpreted when convenient. This pattern extended as well to conditionality, which had been shaped since the 1950s as a high-power, bilateral arrangement with the Fund that was embedded in—and legitimized by—strong multilateral principles (Dell 1981, James 1998). From the late 1970s onward, conditionality was leveraged in favor of private banks as well.

As one might have expected, mobilizing the Fund as a de facto private debt collector proved to be no less contentious than pressuring private banks and debtor countries into collective arrangements.

Practicality and informality clearly brought with them serious problems of justification and legitimization, which the rule of mutual veto could solve only in small part.

Multilateralism and private contracts

Among the various theoretical propositions that may shed light on this experience is Randall Stone's (2008) concept of *conditional delegation*. In essence, Stone argues that there is, indeed, considerable agency slack in the Fund as well as many informal rules that preserve certain power relationships; in contrast, formal rules embody the status quo among all stakeholders. In his view, this setup allows the US government to remove itself from day-to-day monitoring while reserving the option to resume direct command when its own interests are at stake. The evidences presented here suggest that this capacity to diverge from the status quo—and hence to innovate and shape third-party rules—is shared by the Management and Staff. This is consonant with the many accounts of an organization with a large, expert staff, which often takes an active role in shaping policies and programs (Barnett and Finmore 2004, Martin 2002).

Nonetheless, the de facto suspension of all external, more formal rules that could have influenced debt renegotiations during the 1980s cannot be explained exclusively by agency slack, or by divisions between principals. The broader political and institutional environment must also be taken into account.

This pattern is in fact an example of what the legal critic and international lawyer Matti Koskenniemi calls *deformalization*: a process whereby the internal consistency of legal rules, and hence their grounding in coherent political or ethical principles, is debased by policy makers for the sake of expediency.[1] Typically, officials and principals would argue about issues by looking at the possible consequences of acting (or not) in such or such a way, rather than by asking whether the statutes, mandate or precedents allow it or not. In this way the law tends to become a mere policy instrument or coordination device, not a guardian of rights or a keeper of broad rules of international political ordering. The point therefore is that deformalization is a consequence of result-oriented policy actions that cannot be reconciliated with broader, pre-existing rules. It is different from the cases where institutional failures are first observed and then exploited by the agent (Dawkins, 2006). Neither does this experience parallels the case where a soft-law approach to a given regulatory issue is traded off against a hard-law strategy, as from some kind of *tabula rasa* (Abbott and Snidal, 2000). In other terms, deformalization is not an objective, or an opportunity that is seized upon; it is a side-cost of

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

pragmatic, short-term policy decisions, taken in an environment where the legal order is intrinsically weak.

In practice, it is argued here that, between 1970 and 1989, deformalization and the adoption of ad hoc rules responded ultimately to the difficulty of adjusting the classical, post-1945 relationship between sovereign states and the IMF to a world in which private agents were regaining independent access to the international scene. In the early 1970s, as commercial banks resumed their large-scale lending to developing countries, official agencies rapidly lost the control over international liquidity that they had maintained since the end of World War II. Soon they would be regularly confronted with the interests of private financiers, whose demands, they learned, could be quite threatening during a payment crisis. The debt cycle of the 1970s and 1980s thus became the first occasion on which the IMF and its principals had to identify effective ways of interacting directly with market agents so that large volumes of debt contracts could be restructured.

The problem is that intergovernmental organizations, such as the IMF, were never meant to interfere with private rights or to broker deals between debtors and creditors. This is a correlate of anarchy: those organizations just do not have the jurisdiction. Citizens and firms typically bring their contractual disputes to a domestic court or a private arbitration forum, while sovereign states have never delegated to a multilateral agent the authority to settle their own debt problems. Against this background, deformalization, experimentation, bargaining, and raw power politics eventually delivered a rule of renegotiation which finality was similar to that of a bankruptcy procedure: namely, sharing losses and rewriting contracts, so as to allow the resumption of market transactions. But while de facto tryadic, this regime had no judicial character and it offered only limited formal guarantees to the parties.

In order to explore how this regime emerged and evolved, this article draws primarily from the Fund's own archives. Because this organization emerged early as the single debt restructuring forum, this is actually where the rules and the "third-party services" were shaped, tested and possibly adjusted. The genealogy of those rules is nowhere else to be observed. Two types of contributions are extensively relied upon. First are the Minutes of the Executive Board meetings, which reflect how member states discussed debt issues and tried to guide the organization. Second are the various contributions of the Staff and Management, which capitalize the internal expertise and experience of the Fund and act as a constant source of proposals and appraisals.[2]

[2] Beyond the *Minutes* of the Executive Board, the Fund's archives are mostly made of : i/ *Staff Memoranda* that convey to the Board the collective experience, judgment, and proposals of the organization; ii/ the internal *Office Memoranda*, which rather reflect the internal policy debates and are typically not circulated to the Directors: iii/ the *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 five, ten, or twenty years depending on how politically sensitive the contents are.

The focus is therefore on the IMF per se, its interaction with banks and core member-states, and collective decision making. This leaves in the background the relationships between the IMF and the debtor countries or, for instance, the later' failure to coordinate and adopt a common stand on debt issues. While certainly significant and well-perceived at the time, these threats remained quite weak and they did not prove a major force in shaping this regime (O'Donnell, 1985).

The paper proceeds as follows. Section 2 describes how it fits within the academic literature on the 1980s debt crisis. Section 3 identifies the principal factors leading to the 1980s debt crisis and discusses how alternative institutional solutions were sidelined before the IMF emerged as the main forum for restructuring. Section 4 draws directly from the Fund's archives in order to identify the evolution of IMF strategy between 1970 and 1982. Section 5 describes how the 1982 Mexican crisis shaped the ulterior debt restructuring regime.[3] Section 6 discusses how this regime was then described and justified, in the shadow of deformalization. Section 7 concludes.

2. Related literature

A good entry point on the overall debt crisis is Cohen (1986), who proposes—on the basis of many interviews—an analytically informed account of the entire period extending from the 1970s oil shocks to the first post-1982 years. Kraft (1984) is also based on oral history, though his book focuses especially on the 1982 Mexican episode and is more narrative than analytical. Many macroeconomic contributions subsequently explored such issues as current account deficits, fiscal imbalances, the dynamics of debt stocks, and the so-called transfer problem. Dale and Mattione (1984), Cline (1993) or Dooley (1995) are good primers, while some texts that cover the broader financial trends of that period also allocate one or two chapters to these events (Helleiner 1996, James 1996, and Boughton 2001). Then, Reinhart and Rogoff (2009), a major contribution on sovereign defaults, does not delve much on the 1980s crisis as such.

This economic literature tends however to be rather weak on the dynamics of recontracting and the role of third-parties. For instance, the early and influential papers of Eaton and Gersowitz (1981) and Eaton et al. (1986) model a government's decision to cease debt service as a trade-off between internal political benefits and reputation costs vis-à-vis foreign creditors. In effect, this representation of the sovereign debtor closely resembles the anomic state in the standard realist literature of International Relations: it acts in an international arena where rules and institutions are not expected to have much impact.

[3] Throughout this paper, the term "regime" is used pragmatically, much as in the standard definition given by Krasner: the "principles, norms, rules, and decision-making procedures around which actors' expectations converge" (1982).

It is therefore significant that most authors ignored the parallels between sovereign debt restructuring and domestic bankruptcy laws, in spite of the fact that this later institution had already been explored by the law and economics literature.[4] A number of legal contributions could have also been mobilized to that effect[5], but this parallel was examined only after 2011, when the IMF proposed to establish a full-fledged "bankruptcy court for sovereigns": a body that would have had the same functions as the informal methods used in the 1980s but within a formal, adjudicative framework.[6]

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

In fact, state power often came with a strong flavor of hegemonic intervention. In 1982, core member states and the Fund explicitly assumed that decisive and coordinated action was needed in order to bring back under control a world financial order that debtors and creditors alike could not have stabilized if left to their own devices (Weintraub 1984, Boughton 2001, Rhodes 2011). This supposition explains the willingness of national regulators to pressure banks into participating to the Fund's strategy. This was therefore a time when the Fund acted most clearly as an agent of the core member states, which primary aim was to consolidate international capital markets (Broz and Hawes 2006, Stone 2008).

On the other hand, there is no clear evidence that these interventions reflected a situation where the IMF was captured by private banks (Gould 2003), or that three-way debt arrangements were by nature a source of moral hazard, as argued by Vaubel (1983) or Bulow et al. (1988). While these latter authors defend (theoretically) that any third-party intervention is doomed to affect market discipline in the long run, the Fund's success in imposing "burden-sharing" settlements after 1982 had a very short-term horizon: they were defended as a response to the immediate risk that banks would be able to

[4] See Jackson (1986); comparisons with domestic bankruptcies type were actually suggested by Oechsli (1981), then by Kenen (1983), Rohatyn (1983), Weinert (1983) or Cohen (1989), but there was little analytical development along these lines. See Rogoff and Zettelmeyer (2002) for a retrospective of the history of ideas on sovereign debt restructuring (rather than a history of actual rules and practices).

[5] See Wood (1982), Mudge (1984), Buchheit (1986), Buchheit and Reisner (1988); also Hagan (2002) for a more recent review.

[6] See for instance Bolton (2002) and White (2002); Imf (2002) for the so-called Sovereign Debt Resolution Mechanism.

extract a bail-out from public and multilateral agencies (Sachs 1995, Eichengreen 2003). Since then, and up to the recent restructuring of the Greek debt, international crisis managers have tried many times to design new rules to control this risk. But they never delivered a mechanism that proved as resilient and predictable as the one that was adopted during the 1980s.

3. Historical background

From recycling to debt crisis

Developing countries reentered private capital markets during the 1970s, about a decade later than developed countries (James 1996, Helleiner 1996). This trend received a strong impetus after 1973, when the current account surpluses of oil-exporting countries were largely recycled to countries like Mexico, Argentina, Brazil, Yugoslavia, etc. No less important was that private banks—and not multilateral organizations—did most of the work, typically via large syndicated loans.[7] This "recycling" set an altogether new course for the conditions under which developing countries would finance themselves, how they would address possible payment difficulties, and how the Fund might mediate on such occasions (IMF 1973, 1974).

An additional dimension is that the overall sustainability of private recycling was always a doubtful prospect. Contrary to widespread belief, the risks incurred by large accumulations of debt were well identified and did not remain unaddressed. Already by 1976–1977, US regulators were asking banks about their "country risk" procedures and about the adequacy of their equity capital to balance this new and rapidly growing class of risky assets.[8] Yet because the bank-based recycling strategy had ostensibly been supported and monitored by the leading developed countries, the expectation was widespread that, if things turned sour, their governments would step in and cover possible losses—in other words, they would bail out the banks.[9]

From the late-1970s onward, the recurrence of debt restructurings increased in response to three main factors (Cline 1984, Boughton 2001). First, after the 1979–1980 oil shock, many large developing countries began to accumulate debt at a more rapid pace. Second, the tightening of US monetary policy after 1979 led to a sharp increase in the cost of servicing debt, most of which had been contracted at flexible interest rates. Third, the world recession of 1980–1982 directly affected the capacity of these countries to generate export earnings at the very moment when their financial needs

[7] On recycling, see Cohen (1986), James (1996, Chapter 11), IMF (1973). A *loan syndication* is a collective lending operation, coordinated by a few lead banks, that raises funds from a large body of smaller financial institutions. See Clarke and Farrar (1982), Silkenat (1979), Wood (2010).

[8] Cohen (1986). The US Interagency Country Exposure Review Committee was established in 1979; Dale (1984) analyses national regulations in this matter in major OECD countries.

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

were sharply on the rise. Whereas only 10 countries had renegotiated their debt between 1975 and 1979, 20 countries concluded such arrangements between 1980 and the onset of the Mexican crisis, in August 1982. As financial tensions increased, they also spilled over from minor players (e.g., Zaire, Jamaica, communist Poland) to the major players. In the weeks after the Mexican domino fell, it was followed by many others—starting with Argentina and Brazil. The main consequence was to put direct pressure on over-extended western banks, therefore on their own governments (Mendelsohn, 1983).

Competition among forums

By the early 1970s, however, the interwar period's experience with debt restructuring had been essentially lost: there was no longer either a forum or an established set of rules to guide the negotiation and exchange of new commitments. Four options were actually tested before the Fund took over.

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

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

The third option was debt restructuring through an institutional forum designed by the United Nations Conference on Trade and Development (UNCTAD). This body, which is governed by a one-country, one-vote decision rule, was used during the 1970s by developing countries as a platform for

[10] The only well-known occurrence of litigation is the 1895 *Allied Bank* case; see Rogoff and Zettelmeyer (2002).
[11] The Peruvian experience is discussed by Stallings (1979); see also Ballivean (1976) and the panel discussion in *Syracuse Journal of International Law and Commerce* (1978).
[12] "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 1985a).

demanding better trade and financial conditions. At the 1979 Conference in Tanzania, a resolution was adopted that called for the creation of a permanent "International Debt Commission" explicitly aimed at balancing social fairness and financial commitments; the possibility of deciding across-the-board debt write-offs was also mentioned (Zivkovic 2005). However, the developed countries immediately made clear that they would not follow suit, and this proposal barely registered with the Fund.

The last alternative was bailout, an option favored by many in the banking sector in the early 1980s. As financial distress in the less-developed countries steadily increased, the banking community was awash with proposals for banks to (i) launch a mega-loan syndication on behalf of the Fund, (ii) use it to replenish the IMF's coffers, and then (iii) ask the Fund to bail them out from their excessive lending to developing countries.[13] The eventual costs would admittedly have been borne by taxpayers, but it seems that this was a price worth paying. In practice, this option was the true alternative to the Fund's negotiated approach, which, by the end of 1982, was clearly intended as a response to moral hazard. Two elements would then be brought together that had gradually emerged during the course of the 1970s: arms' length, third-party services, and a decision-making rule that addressed the underlying collective action problems.

4. How the IMF innovated

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

When the IMF discussed its first position papers on debt, in 1970–1971, the sovereign debt market bore few similarities to its subsequent incarnations.[14] In the first place, lenders were either aid agencies or export guarantee institutions; hence almost all belonged to the public sector and so, in case of trouble, they were coordinated by the Paris Club.[15] In those days, financing or arrears problems were also of a mostly short-term nature. The notion that a country might default across the board on all its debt was little more than a threat, and systemic risk was never mentioned.

[13] See, for example, Marmorstein (1978), Zolotas (1978), and Viénot (1980). Boughton (2001, pp. 291–292) suggests that, even within the Reagan administration, there was an "innate conviction" in August 1982 that a lender-of-last-resort operation was needed.

[14] On the Fund's pre-1970 experience with debt renegotiation, see de Vries (1966, pp. 593–603) and IMF (1976) as well as the 1964 and 1965 editions of the *Annual Reports*. On debt refinancing, more generally during the 1950s and 1960s, see Bitterman (1973). At that time, debtor countries could often choose between the Fund or the World Bank as a forum and a guide when restructuring.

[15] The Paris Club, created in 1956, coordinates public sector creditors (aid agencies, export guarantee institutions, etc); see Rieffel (1985). 132 restructuring agreements were signed (mostly) under its umbrella between 52 countries and their official lenders, in the 1983–1989 period.

However, the issues that emerged from early rescheduling operations bore on the Fund's jurisprudence (IMF 1970, 1971a).[16] First, debtors and creditors generally agreed that a single, multilateral arrangement was better than sequential bilateral ones, if only for reasons of transaction costs and inter-creditor equity. Then, lenders definitely wanted a neutral and credible assessment of the debtor country's economic position so that the broad parameters of the negotiation could not be contested. Lastly, it soon became clear that a multilateral agent was in the best place to give a seal of approval on an economic program. These three core points—intercreditor equity, coordination, and expertise—did not call for much guidance by the member states. The US Executive Director casually noted for instance that such assistance by the Fund "where appropriate [...] was often extremely useful" (IMF 1971b)—a statement that could still be interpreted as a green light for wading more deeply into sovereign debt matters.

In fact, the hard policy dilemmas surfaced immediately thereafter: when such disinterested, arm's-length contributions to settlements had to be integrated with IMF loans tied to tough economic programs—that is, conditionality. In retrospect, this was the conjunction that put the IMF on a trajectory that would eventually establish it as a global broker, thoroughly engaged in complex and sometimes muscular interactions with private financiers and national governments. Had the Fund provided only expertise and information, as Milton Friedman later defended, then it would have never been brought to such an exposed position.[17]

In the early 1970s, signals of this bifurcation were found in the alternative answers that could be given to an a priori simple question: Should the IMF condition its own lending decisions to the absence of arrears to other creditors, on either interest or capital payments? Or should it instead ignore such conditions? The crux of the matter is that, by deciding to "lend into arrears", the IMF would have put itself in a position quite independent of the interests and strategies of these creditors. Conversely, "not lending into arrears" implied that the Fund might be gradually drawn toward some form of coordination or negotiation with them. Said otherwise, in the former case it would act more as an independent authority, of a rather monetary character, whereas in the latter case, it might become much more easily a party in complex financial transactions.

In 1970, the Executive Board decided that any accumulated arrears should be eliminated during the period of a Stand-By Arrangement (SBA). An SBA is the standard vehicle for IMF crisis lending, and, at that time, its typical duration was 18 to 24 months (Gold, 1980). Thus, reducing arrears became part of conditionality: as long as the country remained faithful to its commitments in this respect, the Fund

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[16] Authors generally neglect the relevance of the debt restructurings during the 1970s. Kahler (1986) only mentions that there were "fragments of [a] regime", while Rogoff and Zettelmeyer (2002) briefly points at "messy experiences".

[17] "*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.*" Friedman (1983).

could indeed lend to it, even though the country was still in arrears. Yet this middle-of-the-road decision exposed the IMF to a serious threat that was actually spotted at the time: lending to a country while asking for a repayment of arrears over one or two years could lead to the Fund's resources being used to support those withdrawals, rather than economic adjustment. In other words, lending into arrears might lead to an outright bailout of other investors—with all the consequences that would come to haunt the IMF in later decades: moral hazard followed by overlending and eventually more crises. It is therefore interesting that, in the still benign environment of the early 1970s, the Fund 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" (IMF 1971a). Here, indeed, was the strategic bifurcation: most of the ulterior discussions on debt would revolve around the question of how this "balanced burden-sharing" might be indeed obtained.

1977–1981: Banks enter the scene

The next phase in the evolution of IMF strategy came with the post-oil shock "recycling" strategy, during the second half of the decade. As commercial banks came to play a greater role in financing developing countries, they brought into debt matters their own specific interests, demands, and tenacity. Moreover, as large loan syndications became the preferred lending vehicle, many banks—small and large, international and local—became no less a part of the overall scheme as of the eventual payment problems (IMF 1976).

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

A clear-cut doctrine was soon established that endures to this day: never, ever would the IMF become a rating agency (IMF 1977b, 2004). Its mandate and its own capacity to bear on real-world financial evolution require that the Fund keeps some of its own information confidential. It was thus agreed that the IMF would not publicize its judgment with respect to specific countries, though it could disseminate statistics and inform banks on whether a previously arranged IMF program was still in operation, or whether a given country still had the right to draw from the Fund. This became a

strategic issue after 1976, when a working SBA with the IMF was adopted by the banks as a de facto or de jure pre-condition to any restructuring (Gold 1988).

The point, however, is that an IMF program was not only a policy signal issued by a neutral agent, *à la Friedman*. It also transformed the Fund into a party in the bargain over burden-sharing. Rather than supporting collective action from the outside, it would have to settle with banks and debtor countries. The material constraint in this game was a Fund by-law stating that any SBA had to include assumptions on future debt service within a credible framework that described how the balance of payments would adjust over the medium term. From this emerged a classical Prisoners' Dilemma. How could such arrangements be made without some form of coordination with private financiers? And how could the IMF ever lend under this rule without conveying its own judgment on the borrowing country's overall financial needs?

By the late 1970s these questions were being solved, on a case-by-case basis, under the code name "parallel operations"—a term that wrongly suggests that the banks and the IMF never met or communicated. In fact, meetings and exchanges of information were extensive, and so allowed for de facto coordinated actions. For example, a 1977 internal memorandum mentions that, over a six-month period, the staff received nearly 400 inquiries from about 80 international banks; although a majority of these inquiries involved such routine issues as data, in other cases "the contacts were initiated by banks to help determine their immediate decision on major lending proposals" (IMF 1977e). Minutes of bilateral meetings with banks are also common in the country files retained in the archives of area departments. Finally, the personal papers of the Managing Director include many references to meetings (and dinners) with the heads of large banks, including Citibank, Warburg, Lazard, and Kuhn Loeb.[18] While the latter clearly welcomed exchanges of views and information, they were however clearly restive vis-à-vis any direct intervention by the Fund in debt relationships.[19]

The increasing difficulty of including banks in a cooperative strategy became the driving force behind the evolution in the rules of the game. The staff soon mentioned, for instance, that during crises the banks could exercise "considerable bargaining power" that may enable them to capture all the resources lent by the Fund and thus to be bailed out. Alternately, "occasions could arise in which the payments outlooks are so adverse that it will be difficult for banks whose interests may well be divergent to hold together in a common approach" (IMF 1977b). Debt restructurings therefore involved "formidable organizational problems for the banks", problems that called for "a massive effort by lead banks to ensure coordination and cooperation among all creditor banks" (IMF 1980c).

[18] See the Larosière Papers (IMF Archives, Box 19, File 3).
[19] This view is clearly reflected in the account of a series of meetings by US Treasury officials with large New York banks, in December 1977 (see US Treasury, 1997); also Gold (1988).

Hence, as the "procedures evolved and precedents were established" (IMF 1980d), the IMF gradually became a broker in debt negotiation, rather than a benevolent, though distant supporter of private dealings. Crucially, in the last few years before the 1982 Mexican crisis, the Fund began to ask for "understandings at least on the maintenance of the existing level of individual bank exposure […]; in especially difficult circumstances, [banks should] provide for new financing flows to help offset the impact of outflows of interest payment[s]" (IMF 1980c). Said differently, debt settlements would not only require parallel progress but an exchange of commitments, therefore an open bargain. The Staff then described, for instance, a difficult case in which "it had indicated to [the banks] the level of bank financing, which it considered crucial to the success of a reasonable adjustment effort. After a Fund arrangement […] had been worked out, but before it was brought to the Board, the staff participated in a meeting where the banks agreed in principle to provide a certain level of financing. After the arrangement was approved, the staff assumed an active, if informal, role in helping to ensure that the planned amount of assistance was in fact forthcoming, explaining to the banks that a shortfall would force a failure of the balance of payments test and might require explanation to the Fund Board (IMF 1980c).

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

Other indications of future trends can be found in a contemporaneous review of the Fund's policy on arrears (IMF 1980a, 1980b). Here the most interesting point lays in the staff discussion of one possible option for actually reducing arrears: that is, their inclusion in a front-loaded debt restructuring agreement, which would clear all arrears at the outset (IMF 1980a). This would not eliminate entirely the possibility that Fund loans end up financing money flows between banks and the debtor country. Money remains fungible. But the IMF's leverage would be maximized precisely because it would *not lend at all* into past, un-restructured arrears.

Here were the two main trends that eventually converged in the 1982 Mexican jurisprudence: banks would have to enter into binding, ex-ante understandings; and the silent shift to a policy of no lending into arrears would actually guarantee that banks would be indeed "bailed in".

Guidance from the principals: justification and deformalization

What positions did the principals defend during those years? How, exactly, did they contribute to the ongoing debate on debt policy? A first, significant element is that, in practice, management and staff never asked or suggested that member states formally extend the Fund's mandate to debt matter, or that they grant it new powers or new tools. Their overall attitude is rather summarized by a 1977 memo in which the staff casually mentions that it would "regard any contribution it could make to the achievement of reasonable arrangements as worthwhile in the light of the consequences, which would come from a failure to agree. The flow of bank loans is now so important to Fund members that major unresolved dispute[s] could cause a hesitation in new lending, leading to serious adjustment difficulties" (IMF 1977b). In other words, the agent justifies its right to intervene on the grounds of possible dire consequences arising from coordination failures—not because its mandate is applicable or because the member-states actually asked it to step in. This is deformalization in action.

This position stands in sharp contrast to that of the Executive Directors, who defended multilateral orthodoxy and clear-cut rules of interactions with banks. This was especially true of developing countries, who opposed a priori any interaction with private banks. The Brazilian Executive Director declared for instance in 1977 that "the staff should do nothing, either positively or negatively, to provoke or discourage such lending [by the banks] or it would […] be in the business of issuing certificates of creditworthiness or unworthiness" (IMF 1977c). The Indonesian Director then recalled that "the Fund was an organization of sovereign countries […]. It should be left to private entrepreneurs to assess the [investment] risks, receiving rewards for a correct appraisal or suffering losses for wrong judgments." Yet, the German Executive Director also declared for instance that "the Fund should avoid at all costs being drawn into debt negotiations between official lenders and debtor countries" (IMF 1977c).

That being said, the Minutes of the Board also illustrate how divorced the Directors were from the practical problems raised by the increasing number of debt restructurings and by the underlying Prisoners' Dilemma, which they raised. During the 1977 Board discussion on debt, the US representative mentioned for example that "whether the concept of parallel financing could be further developed also appeared to be worth exploring. As for the role of the Fund in the debt renegotiation and servicing, it was a sphere of activity in which the institution should be alert to doing whatever it could and properly should do to find out whether there were additional ways in which it could facilitate the smooth operation of the monetary system" (IMF 1977c). Indeed, it would be hard for even the most diligent agent to find any tangible guidance in such a statement.

Another example is provided by a 1981 Board discussion, at a time when the Fund had already asked banks to enter "understandings" as part of triangular burden-sharing agreements. On that occasion, the US Alternate Executive Director noted that "he was concerned about the recent Fund practice […] of assuming that a specific amount of debt relief [by the banks] was involved in program proposals

submitted to the Executive Board." However, it seems this representative had not thought the whole issue through: a few minutes later he argued that it "would be important to make certain that public resources were not used to finance reflows to banks".[20] Yet he did not propose an alternate option that could eliminate the bailout risk *without* entering into undue relations with the banks.

In summing up this discussion, the Fund's Managing Director, 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" (IMF 1981). What is most remarkable about this (then confidential) statement is the almost explicit 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. The 1982–1989 regime: Burden sharing and conditionality

The Mexican crisis

In August 1982, Mexico did not default on its debt, in the exact legal sense of the term. 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 months that followed has already been told in detail.[21] The first step was to negotiate a so-called bridge loan with the Bank of International Settlements and its main member states, the G10 countries; this reduced the immediate pressure on Mexico and its creditor banks. Then, over several weeks and in a context rife with confusion, an economic program was negotiated between Mexico and the IMF while exploratory meetings were being held with the banks. What was new in these circumstances was not the nature but the magnitude of the collective action problem. More than 500 banks had to be part to any agreement, and the financial stakes were huge: $8.2 billion was needed just to close the country's 1983 financing gap.

In practice, it was immediately clear to all parties that the banks would be either "bailed in" via some burden sharing agreement, or the burden would be transferred to multilaterals and to major creditor

[20] See IMF (1981, 1982a)

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

countries (i.e., to their own taxpayers). The threshold was reached on November 18, when a meeting was held at the New York Federal Reserve Bank between the commercial banks and Larosière; on the basis of financing commitments made by the Fund ($1.2 billion) and the official lenders ($2 billion), he asked the banks to commit $5 billion. He then added that the proposed Mexican Stand-By arrangement "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 (Federal Reserve Bank of New York 1982).

That same afternoon, Paul Volcker (then head of the Federal Reserve) stated that—provided American banks agreed with the Fund's demands—"new credits should not be subjected to supervisory criticism" (Kraft 1984). In other words, banks would not have to augment their loan-loss reserves or reveal their possible underlying insolvency. All other creditor countries followed this line. Beyond expediency, the main rationale for this decision was the presumption that debtor countries suffered only from a liquidity problem that would eventually solve itself by virtue of, for example, economic adjustment and international recovery.

The next challenge however was to maintain coordination *among* the banks themselves: i.e., between (i) the largest institutions, which had lent the most to developing countries, though they also maintained a major stake in the continued expansion of international capital markets; and (ii) the local 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. In the short run, it explains why, on December 23, when the Executive Directors met to discuss the Mexican SBA, the lead banks had been able to obtain commitments only for $4.32 billion (against $5 billion that had been asked). The Managing Director proposed that the whole operation proceeded, but he also carried a list that detailed how much each member country's banks still had to contribute: the Japanese were $92 million short; the Italians, $122 million; the Germans, $47 million; and so forth. He then "invited Executive Directors from countries whose commercial banks had not yet contributed their full share to consult with the authorities concerned on the best means of securing the additional funds" (IMF 1982b).

In short, if large banks were unable to coerce the smaller ones (via market power), then national domestic regulators would step in: a domestic, hierarchic relation would be mobilized in support of international coordination. Whether such actions should be viewed as "coercion" or, more charitably, as "moral suasion" is a matter of judgment.[22] Yet, the path-breaking character of this approach was beyond doubt. In the words of the Belgian Executive Director, "the generalization of the method used by the Chairman in the present instance would depend on the supervising authorities in the various

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

countries setting up appropriate arrangements" (IMF 1982b). With more 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" (IMF 1982b).

The "Four Corners" of the Stand-By Arrangements

The decision-making process that was followed in late 1982 was subsequently relied upon 109 times until 1989, sometimes with the explicit intervention of national regulators and more often under the shadow of that possibility.[23] In essence, it consisted of three steps. First, the debtor country negotiated a macroeconomic program with an IMF Mission that visited the country. This program was eventually be sanctioned by a *Letter of Intent* to the IMF Managing Director that described the economic strategy and listed the main performance targets; the Fund's acceptance of the *Letter* signaled its seal of approval. Second, the country signed a debt restructuring accord with the banks' steering committee, the so-called London Club; this typically included a rescheduling of debt service due in the coming one or two years, as well as some "new money". Third, the IMF Board would announce at last a Stand-By Arrangement and allow loan disbursements.

In other words, each of the three main parties had a right of veto over the outcome of the negotiation. The Fund thus gained considerable leverage as a gatekeeper to the financial negotiation table. But, if the banks viewed the IMF as being too lenient with a given country, then they could simply reject the whole plan. Lastly, the debtor country was a party to both bargains and so it also had to endorse the overall burden-sharing settlement. The point is that this rule did not simply structure the decision-making process so as to make sure that everybody was on board. It also provided it with some accountability and formalized a notion of equity at the core of the burden sharing deal; hence, for instance, the accord could be opposed more easily with third parties, like voters or shareholders. Of course, this hardly guaranteed that the overall process was fair from a broader social or ethical viewpoint, but it worked as an equalizing rule at the core of the regime.

Beside its third-party, triadic dimension (Stone Sweet 1999), the other main character of this rule was its utter informality. First, it was never formalized in any international agreement or guideline. Then, the veto-holding, banks' committees had no formal mandate or legal standing to enter into binding agreements. As it happened, the debtor country chose each steering committee's lead bank, which

[23] This figure excludes 18 accords signed between 1989 and 1994 under the Brady Initiative. Summary tables on restructuring operations prior to 1982 can be found in IMF (1983f); for the post-1982 era, see IMF (1991). The successive steps in the debt strategy between 1982 and 1989 are described by Cline (1993, Chapter 5), James (1996, Chapter 12), and Boughton (2001, chapters 9–11).

would then pick the five to eight other members itself. But all creditor banks never met collectively and endorsed the committee or its initiatives; instead, each individual bank would sign a separate agreement with the country and thus formalize, ex post, the terms previously arranged by the steering committee.[24]

The regular operation of this regime was also conditioned by the suspension or circumvention of all preexisting laws, regulations, and contractual clauses that could have affected debt renegotiations.

(i) First was the extraordinary willingness of Fund's Executive Board to condition its own decisions on lending on the parallel agreement of an informal committee of private banks. This self-binding commitment, however, was even not remotely founded in the IMF's Articles of Agreement or in any subsequent bylaws. In 1970 and 1980, the Board had decided that the Fund could lend into arrears, though only within the framework of an SBA. After 1982, this rule was most often interpreted as requiring that arrears be included in a front-loaded financial agreement. Thus, in effect, the original stipulation was actually reversed, whereafter the Fund would *not* lend into (non-restructured) arrears. Yet this change of doctrine was never formalized in any decision or statement by the Board.

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

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

(iv) Litigation by individual banks was largely avoided.[25] Among other factors, this successful discouragement was a result of so-called sharing clauses, written into most syndication contracts, which requested banks that obtained payments to share these proceeds with other members of the syndicate. This stipulation was therefore more of a built-in defense against disruptive strategies (Buchheit 1990).

(v) Lastly, international law had, since the early twentieth century, been developing elements of a doctrine on restructurings, e.g. on issues of sovereign immunity, hierarchy among creditors, or such principles of fairness as the *peri passu* clause. These principles were actually discussed

[24] Mudge (1984) and Clarke and Farrar (1982) underline the informal character of steering committees: they emerged over a several years from the practice of private banks. Also Lomax (1986) and Buccheit (1991).
[25] Rogoff and Zettelmeyer (2002), Hagan (2002).

> by specialist lawyers in the 1970s and early 1980s.[26] But they never surfaced in discussions at the Fund or in its written statements. To the contrary, lawyers struggled to account for the Fund's action, which, they insisted, implied no notion of legal responsibility and so "carefully avoid[ed] reliance upon traditional legal remedies" (Carreau and Shaw 1995).

That last quotation best summarizes the strategy of *deformalization* that marks this overall experience (Koskenniemi 2007). It is de facto confirmed by Joseph Gold, founder of the IMF's legal doctrine, who had once claimed that "our objective has been to set forth our understandings with members to the maximum extent within the four corners of the stand-by arrangement" (Gold 1968). When he wrote this, debt issues were not being considered, but the general strategy seems not to have changed much during the two decades that followed. In its growing involvement as an active broker in debt restructurings, the Fund discovered that protecting its resources and maximizing its leverage required inviting the banks to enter as well the "four corners of the Stand-By", which provided the institutional backbone of the three-step decision rule. In turn, this asked that all other rules and guidelines, outside the squared framework of the Stand-By, be put on hold.

6. Deformalization and its justification

How could an organization like the IMF ever act within such a weak formal framework? And how were its practices justified in ways that referred at least minimally to 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 operating principles.

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

[26] See *Syracuse Journal of International Law and Commerce* (1978), Wood (1982), *American Society of International Law Proceedings* (1983).

discussed at the same meeting, takes the same line and alludes to "possible systemic implications" (IMF 1983a); some Executive Directors also made similar arguments (IMF 1983c).[27]

This discursive strategy had a most significant corollary: in the ulterior period, the Fund would only repeat 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." Beyond that, it was up to the principals to 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" (IMF 1983b).

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

This non-commital position was consistently defended even after the three-step decision procedure had become standard practice and systemic risk had receded. The whole strategy thus remained wrapped in euphemistic language. In its own writings, the Fund was asking the banks only for "reasonable assurances" in the framework of a "concerted lending" strategy—that is, "an organized and collective effort on the part of commercial banks, official creditors, and the Fund to secure commitments to close an ex-ante financing gap for a member country" (IMF 1985b). Hence, the Fund

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

would not "condition" its own action on such commitments; it would instead "have come to expect" them or have "indicated the Fund's support" and "encouraged the banks to commit themselves" (IMF 1984); or again it would "advise banks to maintain a minimum level of new lending" (Mentré, 1983). Even a highly informative, internal report, which was prepared jointly by the different area departments, just failed to ask why on earth banks would ever commit themselves (IMF 1984b). More generally, any suggestion of a coercive relation was carefully avoided, while the hint that this regime was remotely judicial in character, or that it shadowed a bankruptcy rule, was carefully shunned.[28]

All this 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 surely considered this procedure to be the best course of action. The point is that this strategy kept causing serious problems of justification and legitimacy. Because it was even not possible to describe comprehensively the rules of the game, institutionalization was in fact impossible: those rules kept working only as long as all involved parties had no alternative, i.e. no exit option.

Here is indeed the paradox. On the one hand, the principle that adjustment costs should be shared equitably mimicked the expected outcome of a bankruptcy procedure, which, from a procedural perspective, was substituted by a rule of mutual veto and some "third-party services" (information, a forum, expertise, etc). On the other hand, the stark divergence of interests between debtors and creditors could be managed, or endogenized, only as long as the IMF and its core member states had enough leverage over them. As soon as this leverage declined, the underlying trade-offs changed and the capacity to coordinate the parties and deliver burden sharing settlements rapidly fell.

End of a regime

This shift was observed in practice after 1987. On the one hand economic adjustment in debtor countries had been fairly consistent since 1982, although the rewards in terms of growth and access to capital markets were modest (Diaz-Alejandro 1984, Sachs and Huizinga 1987). Attempts to coordinate these countries politically then started to emerge, in particular the so-called Group of Carthagena, in Latin America (Roett 1985, Kugler 1987). On the other hand, the buildup of loan-loss reserves by banks and the expansion of secondary debt markets steadily increased each bank's room to maneuver.[29] The consequence was that containing wayward strategies by individual lenders became

[28] A 1984 memo authored by the Legal Department came close to a judicial interpretation of the Fund's role as a third-party dispute resolver, but in light of the extant of actual practices it reads like an afterthought: "a more active involvement of the Fund might be envisaged, for instance, in (…) some move towards active conciliation and mediation" (IMF 1984a). See also Gold (1972) on the Fund's more general resistance to legally sanctioning member states, and Gold (1988) on the role of the Fund in debt restructurings.

[29] Although a bank was not, strictly speaking, entitled to resell its participation in a loan syndicate, secondary exchanges became possible, and prevalent, after 1985. However, transaction costs were high and the legal status

increasingly difficult. All this put direct pressure on the IMF's self-binding commitment not to lend until financial accords were reached: once it had accepted an economic program (step 1 of the decision rule), it could not wait indefinitely before actually disbursing funds (step 3).

Consequences were soon drawn. In its 1987 annual review of debt strategy, the Fund recognized for the first time that, on future occasions, "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, which would have implications for the Fund arrangement" (IMF 1987). It is remarkable that, as the Fund began indeed to dismantle the 1982 strategy, it did not follow its now usual "deformalist" line of arguments, based on expediency. Instead, the staff grandly stated that the banks' equivocations "should not appear to prejudice the autonomy of the Fund in deciding its future relations with members, nor conflict with existing Executive Board guidelines" (IMF 1987). It also noted that since 1982 it had not been "intended that the Fund would, on an on-going basis, centrally guide the allocation of a substantial part of both private and official lending to developing countries. […] There is a need to ensure that the financial system is firmly embarked upon a course that leads towards […] a restoration of direct debtor/creditor relations" (IMF 1987). In other words, the IMF was now "re-formalizing" its discourse and explicitly calling for a return to multilateral orthodoxy. Indeed, the IMF was never meant to interfere with private rights or to broker financial settlements between debtors and creditors.

One step further, in March 1989, when the principle of full-fledged debt write-offs was finally accepted (with the Brady Initiative), the "no lending into arrears" doctrine was finally shelved (IMF 1989a, 1989b). As the Managing Director then said: "It is clearly the wish of this Board that the Fund discharges in full its central responsibilities in the debt strategy, but without interference in negotiations between debtors and creditors." Thus the Fund now retained its option to "approve [an] arrangement outright", which meant that "an accumulation of arrears to banks may have to be tolerated" (IMF 1989c). A public communiqué even formalized this landmark decision and hence the ending of the rule of mutual veto (IMF 1989d).

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

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of such exchanges was never clarified; see Buchheit (1986) and Cline (1993). This trend was closely monitored by the Fund from the outset (IMF 1984, 1987).

7. Conclusion

A detailed reading of the IMF Board Minutes and the Fund's Staff Memoranda offers a unique view of how, over the course of twenty years, a rule for debt restructuring was gradually assembled, operated, and eventually abandoned. Specifically, these archives document how coordination rules, flows of information, the Fund's role as a muscular broker, or the adoption of commitment devices (like conditionality) allowed addressing the generic problems of collective action that are raised by any renegotiation with multiple creditors.

Two features came out strongly. First is informality, with its two-sided dimension: the restructuring rules per se were not institutionalized, while stronger, "hard-law" regulations were systematically ignored. This has been interpreted as the effect of a strategy of deformalization: a pragmatic, means-end rational approach to policy issues that exploit the intrinsic weakness of the rules of international political ordering when expedient. A superior example of this was the commitment of the Fund's principals not to lend to its own member states unless an informal gathering of commercial banks had agreed to follow suit. A corollary of this strategy was however a continuing problem of justification and legitimacy.

Second is the remarkable conjunction of formally neutral decision rules with the always-present option to pressure or coerce. Roughly speaking, hard power relations ensured participation and helped controlling the risk of free-riding; then, neutral, third-party elements structured the core decision rule on burden-sharing and the exchange of new contractual commitments. This allowed the regime to work as a de facto substitute for a full-fledged bankruptcy rule, even though it had no judicial character. The principle of mutual veto power was the functional, though partial substitute to a court or an arbitration board. The main limits of this approach were the always-present risk of gridlock and the limited guarantees of procedural fairness that were offered to debtors and creditors.

Still, this composite regime worked unchanged throughout the 1980s. Even its unraveling, in early 1989, did not result from the slow subversion of third-party elements by market forces or raw power politics. This was the outcome of a political decision to shelve the veto-based rule and hence to give back discretion to the IMF so as to help it address new circumstances more easily. In other words, here was clearly an equilibrium-based institution, for this sustainability over time was conditioned by the underlying power relationships between the parties, as by their respective exit options. But, at the same time, its invention, operation and abandonment resulted from a complex institutional and political process: it was very much shaped by the Fund, which brought to bear its substantial resources and capacity to innovate and experiment, even against the status-quo bias of its principals.

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