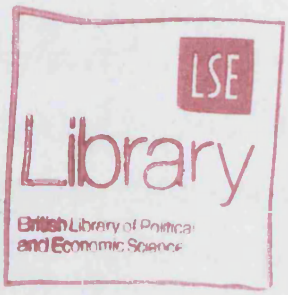
THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

The Four Faces of Power in Sovereign Debt Restructuring:
Explaining Bargaining Outcomes Between Debtor States and Private Creditors Since 1870

Deirdre Shay Kamlani

A thesis submitted to the Department of International Relations of The London School of Economics and Political Science for the degree of Doctor of Philosophy, London
February, 2008

ProQuest LLC
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106-1346



DECLARATION

I certify that the thesis I have presented for examination for the MPhil/PhD degree of the London School of Economics and Political Science is solely my own work other than where I have clearly indicated that it is the work of others (in which case the extent of any work carried out jointly by me and any other person is clearly identified in it).

I warrant that this authorization does not, to the best of my belief, infringe the rights of any third party.

ABSTRACT

This thesis examines four discrete periods of sovereign default and restructuring over the past 135 years and seeks to explain the observed variation in aggregated bargaining outcomes between debtor states and private creditors. Utilizing a power-based analytical framework borrowed from Barnett and Duvall (2005), the study assesses the relative impact of four principal regime components on distributional results: the private creditor representative body (*institutional power*); the degree and orientation of creditor country government/IFI intervention (*compulsory power*); the structure and condition of the capital markets (*structural power*); and, the discursive practices surrounding sovereign default (*productive power*). The analysis suggests that the key private creditor institutions – the British Corporation of Foreign Bondholders, the American Foreign Bondholders Protective Council, and The London Club - have only marginally influenced results, and that outcomes were instead driven by the action (or inaction) of creditor governments, the structure of capital access (centralized or decentralized), and the relative condition of the private capital markets (robust or collapsed). The paper concludes that compulsory and structural regime elements are therefore more salient than institutional ones in the sovereign debt bargaining exercise. From a public policy perspective, this study cautions those who seek a newly-constituted, 21st-century bondholder council, since such an institution – like its historical predecessors – would find its impact on the sovereign debt management process highly circumscribed. The thesis also challenges economic theory on the matter of sovereign repayment incentives, arguing that the "either-or" nature of the reputation-sanctions debate (Eaton-Gersovitz (1981) vs. Bulow-Rogoff (1989)) distracts from the fact that these incentives have operated simultaneously over the past 135 years. More specifically, the evidence suggests that structural and compulsory regime elements – the equivalent of reputation and sanctions in the formal models – have largely reinforced one another in the sovereign debt restructuring process, thereby amplifying their impact on negotiating outcomes in each historical period.

ACKNOWLEDGEMENTS

While this thesis examines sovereign debt restructuring over the past one hundred and thirty-five years, it is important that I first acknowledge some important debts of my own.

I wish to thank my supervisor, Dr. Daphne Josselin, who has guided this project since its inception as a master's thesis at the London School of Economics. I can only hope that every PhD student has a supervisory experience like mine. It has been both a privilege and a pleasure to work with Dr. Josselin, whose dedication to my progress, intellectual rigour and unerring judgment have all contributed much to the pages which follow.

I would also like to acknowledge the advice and counsel I received from other members of LSE's International Relations Department: Drs. Andrew Walter, Mark Duckenfield, Razeen Sally, and Jeffrey Chwieroth, in addition to Professors Michael Cox and Margot Light. It is most fortunate that LSE is a place where the walls between departments are permeable. This afforded me the opportunity to engage with scholars in other disciplines and seek their counsel, like Dr. Ken Shadlen of the Development Institute and Dr. Cheryl Schonhardt-Bailey of the Government Department. I especially appreciated the many cups of coffee that Dr. Gus Van Harten of the Law Department agreed to have with me. During our meetings, he would inevitably (and patiently) explain some of the more esoteric legal concepts that I confronted in my research. Also, Robert Kissack (now Dr. Kissack) deserves special recognition for helping me put my analytical framework to much better use.

Moving outside the confines of LSE, there are an equal number of people to mention. In what may have been a case of e-mail serendipity, Dr. Eric Helleiner connected me with Matthew Tubin, a PhD student at the University of Pennsylvania. Matthew is one of the few people who share my keen interest in bondholder councils, and his encyclopaedic knowledge of matters relating to sovereign debt allowed him to give me much in the way of specific feedback on my case study chapters. I am not only grateful for his critical input, but also for his continued friendship. Through Matt, I had the great pleasure of meeting Tom Callaghy, his faculty advisor and someone whose prolific scholarship in the field of sovereign debt management has enlightened all of us.

I owe a rather large debt to Dr. Christian Suter for sharing his historical data sets on settlement periods and bargaining outcomes. Without Dr. Suter's early, painstaking work, my research would not have been possible. I am especially thankful for the time he spent locating his original spreadsheets and for his willingness to review them with me in Switzerland. His kindness even extended to translating some of the key text for a non-German speaker.

The important groundwork laid by the historian, Dr. Michael Adamson, on the Foreign Bondholders Protective Council ("FBPC") was something I hoped to build upon in this dissertation. Michael generously took the time to meet me when I was in Stanford, and he then agreed to read and comment upon my draft chapters. With his work as inspiration

and his helpful suggestions, my next academic endeavour might be a more complete study of the FBPC.

During the time I spent at the Centre for Global Economic Governance at University College, Oxford, I had the good fortune to meet Dr. Louis Pauly. I wanted to thank him for his time, his words of encouragement, and his advice regarding potential avenues for publication.

This dissertation also required me to impose on the good offices of two research libraries – the Guildhall Library in the City of London and the Green Library at Stanford University. I cannot thank the curators of those institutions enough for their patience as they arranged for hundreds of dusty (and heavy) boxes to be pulled from storage. Special thanks go to Stephen Freeth at the Guildhall Library, and Tony Angiletta, Robert Trujillo, and Bill O'Hanlon at Stanford. While at Stanford, I also had the pleasure of meeting Professor Michael Tomz, who took the time to discuss my research project and offered me some valuable suggestions regarding methodology.

The many market practitioners who agreed to interviews have added both colour and depth to my analysis. While most of them preferred to keep their participation anonymous, I am able to publicly thank Mr. John Petty, President of the FBPC. It should become evident to any reader that, absent the cooperation and candour of all the interviewees, I would only have been able to tell part of the story.

In closing, I want to thank those who have been closest to me for the longest. I was blessed with parents who taught me that anything was possible, and I was blessed again with a husband who seems to make everything possible. His understanding, support and enthusiasm for this endeavour never waned, and his sacrifices over the past several years will never be forgotten. It is therefore to him that I dedicate this dissertation.

TABLE OF CONTENTS

LIST OF TABLES AND APPENDICES

TABLES

APPENDICES

LIST OF ABBREVIATIONS

ABRA	Argentine Bond Restructuring Agency
BAC	Bank Advisory Committee
BIS	Bank for International Settlements
CACs	Collective Action Clauses
CEO	Chief Executive Officer
CFBH	Corporation of Foreign Bondholders
EMBI	Emerging Markets Bond Index
EXIM	Export-Import
FBPC	Foreign Bondholders Protective Council
FSIA	Foreign Sovereign Immunities Act
G-5	Group of Five (US, Germany, France, UK, Japan)
G-7	Group of Seven (Group of Five + Canada, Italy)
G-10	Group of Ten (Group of Seven + Belgium, Netherlands, Sweden, Switzerland)
GCAB	Global Committee of Argentina Bondholders
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Countries
HM	His/Her Majesty
IBA	International Bankruptcy Agency
IBRD	International Bank for Reconstruction and Development
ICSID	International Centre for the Settlement of Investment Disputes
IFI	International Financial Institution
IIF	Institute of International Finance
IMF	International Monetary Fund
IPE	International Political Economy
IR	International Relations
LDC	Less Developed Country
LIBOR	London Inter-bank Offer Rate
LOLR	Lender of Last Resort
MP	Member of Parliament
NGO	Non-Governmental Organization
PSI	Private Sector Involvement
ROSC	Reports on Observance of Standards and Codes
SDDS	Special Data Dissemination Standards
SDRM	Sovereign Debt Restructuring Mechanism
SEC	Securities and Exchange Commission
SIA	State Immunities Act
US	United States
UK	United Kingdom
WWI	World War I
WWII	World War II

Chapter 1

Sovereign Default Through the Ages

We stop this recital with misgiving, for our prophetic soul tells us what will happen in the future. Adjustments will be made. Debts will be scaled down and nations will start anew...And the process known for more than two thousand years will be continued. Defaults will not be eliminated. Investors will once again be found gazing sadly and drearily upon foreign promises to pay.[1]

Max Winkler

1.1 The Cycles of Sovereign Default

In the fourth century B.C., ten Greek city-states walked away from their debt obligations to the Delos Temple.[2] A little over two millennia later, Argentina ceased payment on 178 foreign bonds with a face value totalling $81.8 billion dollars.[3] While ancient Greece may have brought us the first recorded act of sovereign default, and Argentina, the largest, the intervening years have witnessed consistent and disruptive episodes of sovereign bankruptcy.

At the centre of international bond finance in the 19th century, London witnessed two periods of large-scale sovereign lending and default. The first began in 1822, when Latin American states borrowed heavily to finance their wars of liberation. In most cases, default followed shortly on the heels of initial bond floatations, with some rescheduling negotiations lasting sixty years.[4] But troubled Latin American debtors were hardly alone in their predicament. Beginning in the late 1830s, nine U.S. states, including Maryland, Pennsylvania, Mississippi and Louisiana, all suspended debt service. Investor outcry in London and Paris was so loud that London-based Barings took it upon itself to finance the political campaigns of state candidates who would prioritize raising new taxes in order to settle the defaulted obligations. This strategy was largely successful with one

[1] Winkler (1933), p. 179.
[2] Dammers (1984).
[3] Republic of Argentina (2005).
[4] Aggarwal (1996), p. 19.

notable exception: the state of Mississippi refused to negotiate with British representatives and remains in default to European bondholders to this day.[5]

The second lending boom of the 19th century began in 1860, with capital flowing back into Latin America, Egypt and Turkey. Euphoria swept the London bond market from 1870 to 1873 during which time it seemed that "any government which claimed sovereignty over a bit of the earth's surface and a fraction of its inhabitants could find a financial agent in London and purchasers for her bonds."[6] Unscrupulous underwriters even managed to sell bonds to an eager but unsuspecting public on behalf of fictitious countries.[7] The first Great Depression of 1873 brought this cycle of lending to an abrupt halt, and defaults ensued once again. Although the Bank of England was successful in its efforts to save Barings, one of Britain's leading merchant banks, from its near fatal exposure to Argentina in 1890, investor enthusiasm for sovereign bonds predictably waned.

The end of World War I marked the ascendance of American power and the rise of New York as the world's financial centre. Despite this shift, boom and bust lending cycles continued just as they had in 19th century London. By 1933, in the depths of the Great Depression, twelve Latin American and nine European countries, including Germany, curtailed at least part of their debt servicing. Some defaults remained uncured into the 1950s.[8]

The post-World War II era seemed to usher in a new, and seemingly more stable, era of sovereign financing. While defaults had historically been followed by renewed bond market access in the 19th century, the experience of the Great Depression had the effect of closing the bond market to sovereigns. And, with capital controls enshrined in the Bretton Woods regime, the early post-war period saw bi-lateral and multilateral official lending replace private bonds as the primary source of financing.

---

[5] McGrane (1935); Dammers (1984), p. 78; The Corporation of Foreign Bondholders (1873-1987), Report of 1987. Note that Florida, although counted as one of the nine states, was technically a territory at the time of default.

[6] Aggarwal (1996), p. 27.

[7] Tomz (2001) identifies the fictitious state as Poyais, a country invented by a Scottish adventurer named Gregor MacGregor who devised the fraud on a trip to the Mosquito Coast, off modern day Nicaragua. See also Lipson (1985b), p. 44.

[8] Winkler (1933); McGrane (1935); Borchard and Wynne (1951b); Kindelberger (1978 [2002]); Dammers (1984); Eichengreen and Lindert (1989); Aggarwal (1996); Eichengreen and Fishlow (1996).

This era of official lending reigned until the 1970s, when the growth of the offshore Eurodollar market enticed commercial banks to recycle large surplus deposits from oil-exporting Middle Eastern countries as loans to developing countries. Such direct financing by financial institutions had last been attempted by the Bardi, Peruzzi, and Medici banks of medieval and Renaissance Italy. However, the lessons of history were lost on the commercial bankers of the 1980s. Just as the Bardi and Peruzzi banks failed in 1327, when Edward III of England repudiated his debts, major money centre banks in the 1980s stood on the precipice of insolvency when the Latin American debt crisis began.[9] The decade-long restructuring process that followed Mexico's default in 1982 was ultimately resolved with the adoption of the Brady Plan, in which banks offered partial debt forgiveness and exchanged their bank loans for collateralized bonds. The Brady Plan had the effect of returning defaulted sovereign debtors to the bond markets for the first time since the 1920s, ironically sowing the seeds for the next round of sovereign debt troubles. Beginning in 1994 with Mexico, contemporary sovereign financial crises once again circled the globe, extending to Asia, Russia, Brazil, Turkey and Argentina.[10]

1.2 Private Creditors vs. Sovereign States – The Ad Hoc Machinery

Despite this long history of sovereign default, no formal sovereign bankruptcy framework has ever evolved at the international level. So, how have private creditors and sovereign states negotiated mutually acceptable settlements following a default? Most would say that it was through a series of ad hoc representative bodies that emerged in different historical periods with two principal purposes: to consolidate the interests of a disparate group of private creditors and act as a focal point for negotiation with sovereign states.[11] Since the 19th century, we have seen the emergence of three such bodies in major centres of capital export: The British Corporation of Foreign Bondholders ("CFBH"), The American Foreign Bondholders Protective Council ("FBPC"), and the "G5-centric"

---

[9]Dammers (1984), p. 77; Cline (1995).

[10] "Default" shall be taken to mean the cessation of principal and/or interest payments as required under the debt contract. "Restructuring" will refer to any instance in which debtors and creditors come together to renegotiate the terms of a debt contract, either pre- or post-default. "Sovereign debt management" will have a meaning that is equivalent to "restructuring". Debt held by official creditors is excluded from this analysis.

[11]The Market-Based Debt Exchange is not a creditor representative body but a process in which investors are canvassed by a sovereign's bank and legal advisors for comment on proposed exchange offers.

London Club. The table below provides a brief overview of each entity along with the market-based debt exchange, a practice which has emerged since 1998 to partially compensate for the lack of a bondholder representative:[12]

Table 1A: Private Creditor Representative Bodies

Name	*Date of Origin*	*Type of Organization*
The Corporation of Foreign Bondholders ("CFBH")	1868 (ceased operations in 1988)	Legal entity. Formed in 1868 but granted a license under the 23rd Section of the Companies Act in August, 1873. In 1898, the CFBH was reconstituted under a special Act of Parliament.
The Foreign Bondholders Protective Council ("FBPC")	1933 (still operative, although largely dormant)	Legal entity. Founded by the U.S. State Department in December 1933 as a non-stock, non-profit organization under the laws of the State of Maryland.
The London Club (the only body to represent commercial bank, as opposed to bondholder, interests)	1976 (still operative, although with a lower profile since 1980s Latin American debt crisis)	Informal organization. Developed during debt negotiations with Zaire, Peru, Turkey, Sudan and Poland from 1976 – 1981, but emerged as a distinct negotiating body during the 1980s Latin American debt crisis.
Market-Based Debt Exchange	1998	Informal but increasingly patterned process by which sovereign debtors, represented by investment bank and legal advisors, approach investors with exchange offers, either pre- or post-default.

Sources: The Corporation of Foreign Bondholders Annual Report (1873); Foreign Bondholders Protective Council Annual Report (1936); Rieffel (2003).

The fact that today's markets lack a bondholder representative remains the subject of intense debate, and there has been no shortage of recommendations to revive one. For instance, after the International Monetary Fund failed in its bid to create the functional equivalent of a supra-national bankruptcy court, the Institute of International Finance ("IIF"), a group acting on behalf of large financial services firms, redoubled its efforts to mandate bondholder representative committees, albeit on a voluntary, case-by-case basis. In so doing, the IIF built on recommendations made by other market practitioners and academics since the mid-1990s.[13]

[12] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, pp. 6-7; Foreign Bondholders Protective Council (1941-1944), Report of 1941-1944, p. xiv; Rieffel (2003), p. 97; Foreign Bondholders Protective Council (1936-1977).

[13] Krueger (2002); Institute of International Finance, International Primary Markets Association et al. (2003); Institute of International Finance (2006); Institute of International Finance (2007). The IIF strongly encourages sovereign debtors to fund bondholder committees at the time of a default as part of its Voluntary Code of Conduct. See also MacMillan (1995a), Eichengreen and Portes (1995), and Portes (2004), all of whom discuss the efficacy of resurrecting bondholder councils.

Why should we attempt to reconstitute a bondholder council in the 21st century? The IIF argues that such a body would markedly improve the fairness of the sovereign debt management process.[14] Without them, bondholders since 1998 have been subjected to an increasingly patterned process called the Market-Based Debt Exchange.[15] This practice offers debtors and creditors limited scope for communication through investment bank and legal advisors, and it falls far short of the negotiating model of previous eras. Since its goal is simply to determine the lowest market-clearing price at which a successful exchange will take place, investors have described it as "aggressive" and "non-consensual."[16] This is largely because, absent negotiation, sovereign debtors make unilateral, one-time, "take-it-or-leave-it" offers to bondholders.[17] Creditors - and those who represent their interests - see the bondholder council as a way to counteract the perceived one-sidedness of the current exchange process.

It is important to point out that bondholder councils are not only being recommended as an antidote to unfairness; they are also seen as a way to improve efficiency. At the moment, when a sovereign defaults, there is a great deal of uncertainty as to how the process will unfold. How will debtor states communicate with creditors? How can information be shared between debtors and creditors and among creditors themselves? In previous eras, bondholder councils were the focal point for bargaining and information dissemination. For these reasons, MacMillan (1995a, 1995b) and Portes (2004) highlight the efficiency gains that could be reaped from the creation of a more formal bondholder representative today: enhanced information flows, reduced uncertainty, and more coordinated decision-making across different bond issues and different classes of debt.[18] While the goals of sovereign debt reformers to improve the fairness and efficiency of the process are worthy, the question remains: how much have private creditor representative bodies actually contributed to the sovereign debt management process in the past? What can an investigation into their historical operation tell us about their impact on negotiations between debtor states and private creditors? Did

[14] Author Interview O.
[15] The Market-Based Debt Exchange has taken shape since 1998, after the Russian debt crisis.
[16] Author Interview D.
[17] Bulow and Klemperer (1996). The authors argue that auctions are more favorable than negotiations; the debt-exchange process is more closely aligned to an auction process than a negotiation.
[18] MacMillan (1995a); MacMillan (1995b); Portes (2004).

these entities make such important contributions – either by improving the speed of the negotiations or the fairness of distributional results - to warrant their resurrection today?

In seeking answers to these questions, this thesis has endeavoured to make both empirical and theoretical contributions to the existing sovereign debt literature. From an empirical perspective, fresh insights are offered into the operation, staffing, and funding of the CFBH, FBPC and London Club, and the role these institutions played in sovereign debt management. In the case of the American FBPC, we have been able to draw upon newly available archival sources to supplement the limited secondary literature. Theoretically, the analytical framework that will be developed in this study attempts to bridge two sides of the debate in economic theory regarding sovereign repayment incentives.[19] In so doing, the thesis makes the following key arguments: i) that private creditor representatives were not as critical in the production of bargaining outcomes as previously thought; and, ii) that the two sovereign repayment incentives that have been characterized in economic theory as competing – sanctions and reputation – instead operate concurrently and have reinforced one another in debt restructurings since 1870. The relevance of the research project and its contributions will be discussed in more detail in Section 1.5.4. In the next section, the focus returns to the sovereign debt restructuring regime and the development of our analytical framework.

1.3 Private Creditor Representative Bodies as a Regime Component

While we are interested in assessing the independent effects of private creditor bodies on sovereign debt restructurings, we maintain that the focus of the current policy debate on these entities has construed the process of sovereign debt management much too narrowly. Drawing from economic theory as well as primary and secondary empirical sources, we would argue that it is more accurate to portray the private creditor representative body as simply one element in a much larger **regime** for sovereign debt restructuring.[20] This gives us the scope to examine not only the more institutionalized aspects of the process – like the CFBH, FBPC and London Club - but also the variables

[19] Eaton and Gersovitz (1981); Bulow and Rogoff (1989a); Bulow and Rogoff (1989c).

[20] Krasner (1983). Also, see Haggard and Simmons (1987), p. 493. In this study, we will use the term regime in accordance with the widely accepted formulation by Krasner (1983): "implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge" in the issue area of sovereign debt management.

outside the creditor representative body which have impacted the efficiency and fairness of sovereign debt management. Therefore, for the purposes of this analysis, we will define a **sovereign debt restructuring regime** to include the following four elements:[21]

- **Creditor Representative Body:** Depending upon the historical period, the dominant organization would be the CFBH, the FBPC or the London Club. We intend to give the Market-Based Debt Exchange the same analytical standing as its more formal counterparts, remaining mindful of the fact that it is a patterned process, not a legal entity or recognized organization.
- **Degree and Orientation of Creditor Country Government Intervention:** We are interested in examining the willingness of creditor country governments to intervene directly in the negotiation process between defaulting states and private creditors. This intervention has taken many forms throughout history, from military campaigns to subtler forms of moral suasion. And, the orientation of this intervention is also important. During certain periods it has worked to benefit private creditors while at other times it has worked to their detriment.
- **Structure and Condition of the Global Capital Markets:** The structure and condition of the capital markets has historically exerted an influence on sovereign debt negotiations. For example, centralized control of the markets provides creditors with greater leverage, while market collapse or a high degree of market liquidity tends to work in favour of debtors.
- **Characterization of the Act of Default**: It is important to consider that all episodes of sovereign default take place in distinct historical eras, each of which ascribes a unique meaning to the act of default. These meanings, in turn, help define the permissible array of remedies available to creditors, many of which are enshrined in an evolving framework of international law.

1.4 Bargaining Outcomes in Sovereign Debt Restructuring Since 1870

Now that we have more accurately identified the components of sovereign debt restructuring regimes, we can look at the outcomes produced by those regimes across

[21] These four variables have been distilled from economic theory as well as a detailed review of the empirical record.

time. In our study, we intend to use two key variables to measure outcomes: the average length of time from default to settlement (an efficiency measurement) and the amount of debt forgiven (a distributional/fairness measurement). Time measurement is important because it has customarily been the case that the longer the negotiation process, the more punitive it is to the debtor. This is because defaulting countries are generally unable to access the capital markets until they have reached an acceptable settlement with their creditors.[22] The level of debt forgiveness is important since it represents the result of the redistributive bargaining process. If private creditors forgive thirty percent of the contractual debt, this thirty percent becomes a gain which accrues to the benefit of the sovereign debtor. However, if the thirty percent level is agreed after two years, it is much more valuable to the debtor state than if it is agreed after twelve years. For this reason, the two variables must always be examined in tandem. The table below helps to illustrate this point.

Table 1B: Debt Forgiveness and Settlement Times

Settlement Period (Years)	*Debt Forgiven (%)*	*Outcome*
Long	Low	Punishes Debtors
Long	High	Balanced
Short	Low	Balanced
Short	High	Favours Debtors

We have aggregated a number of separate econometric studies over these four historical periods to provide a starting point for assessing the variance in outcomes across eras. The data show that both settlement periods and levels of debt forgiveness were dramatically different under the auspices of each regime:[23]

[22] Tomz (2001). The only exception in Tomz' model was Greece, which secured a loan in 1833 while in default. He attributes this to the loan guarantee offered by England, France and Russia.

[23] Suter (1992), pp. 91-95; Cline (1995); Bowe and Dean (1997), p. 12; Singh (2003), p. 12; Sturzenegger and Zettelmeyer (2005a); Roubini and Setser (2004a), Table A3; Dhillon, Garcia-Fronti et al. (2006); Miller and Thomas (2006b); Rieffel (2003). Quantifying the period from default to settlement was a device borrowed from Suter (1992). Measuring debt forgiveness is more universally recognized in the literature as a way to quantify the outcome of a negotiation. These figures are discussed in more detail in the case study chapters.

Table 1C: Negotiating Outcomes Between States and Private Creditors

Time Period	*Dominant Creditor Representative Body*	*Number of Cases*	*Average Time from Default to Settlement*	*Debt Forgiveness*
1871-1925	Corporation of Foreign Bondholders	52	6.3 years	12% (15.9%)*
1926-1975	Foreign Bondholders Protective Council	37	10.1 years	23.2% (55.9%)*
1980 - 1997	The London Club	21	8.5 years	35%
1998-2005	Market-Based Debt Exchange	6	1.19 years	48.67%

Sources: Suter (1992); Cline (1995); Bowe and Dean (1997); Singh (2003); Sturzenegger and Zettelmeyer (2005a); Roubini and Setser (2004a); Dhillon, Garcia-Fronti et al. (2006); Miller and Thomas (2006b); Rieffel (2003).

*Bracketed results for the periods beginning in 1871 and 1926 also take into account the forgiveness of accrued interest and reductions in contractual interest rates. They were calculated using data sets provided by Christian Suter which are also available in Suter's *Schuldenzyklen in der Dritten Welt* (1990). These recalculations help to put the earlier debt forgiveness figures on a more comparable basis with those beginning in 1980. Also, the average time from default to settlement in the period 1980-1997 does not account for interim accords under the multi-year rescheduling agreements; in this era, settlement dates are taken to mean the dates on which debt forgiveness was finally agreed under the Brady Plan.

The data account for all cases of sovereign debt restructuring in each period, and suggest that the relative capabilities of states and private creditors in the negotiation process were different depending on the operative regime.[24] Sovereigns clearly paid more to investors in some periods than in others. For instance, British bondholders in the last quarter of the 19th century and commercial banks in the 1980s fared better than their Depression era and 1990s counterparts. Also, it is important to reiterate that that we are not ascribing these results solely to the workings of the creditor representative body. As we stated earlier, these organizations are part of the larger regime of debt restructuring, and their impact needs to be evaluated in context.

[24] In the period 1871-1975, default and restructuring cases are confined to bond debt. In the period 1980-1997, these cases are confined to commercial bank debt because bond debt was viewed as too difficult to restructure. Bondholders therefore enjoyed *de facto* seniority in this era, despite the fact that their claims were *pari passu* with the banks. In the period 1998-2005, both bank and bond debt are restructured. However, our study focuses on bond debt since it was the most significant component of sovereign borrowing in this period; additionally, data for commercial bank debt forgiveness is not available. However, it should be noted that in the 1998-2005 period, both the London Club and the Market-Based Debt Exchange operated simultaneously.

1.5 The Research Agenda

The history of sovereign debt restructuring therefore presents us with an important puzzle. **How do we explain the historical variation in bargaining outcomes between debtor states and private creditors?** For instance, is there a single aspect of the regime that is critical in producing the outcome? Or, do the various regime components work together such that they offset or reinforce one another to produce the observed results? How much independent impact does the private creditor representative body have? The research agenda of this thesis has been to devise an analytical framework that will help answer these questions.

Bargaining outcomes will not be measured by looking at individual cases of negotiation, but rather at aggregated outcomes in each of the four historical periods that correspond to the principal operation of the private creditor representative bodies cited above. While we acknowledge that variation can occur in individual instances of negotiation, we maintain that the regime's performance can best be judged by measuring outcomes for the largest number of cases in each historical period. Additionally, we have excluded debt held by the official sector - governments and multilateral financial institutions - from this study. However, we remain keenly interested in how the actions of the official sector influence outcomes for private creditors. As a result, the undertakings of bi-lateral and multi-lateral players in sovereign debt restructurings will be a key focus of this study. Although we will not be examining bi-lateral, Paris Club bargaining results, we will seek to isolate the ways in which official actors either promote or hinder the bargaining prospects of private creditors.

1.5.1 A Power-Based Analytical Framework

We intend to employ a power-based framework to analyze the outcomes produced by sovereign debt restructuring regimes over four historical periods. As we will explain more fully in Chapter 3, this is in part because we consider sovereign debt management to more closely approximate a zero-sum - as opposed to a joint-gains – issue-area. The characterization seems appropriate since the act of negotiation seeks to redress distributional conflicts. In game theoretical terms, the process is not characterized by Nash equilibria that are Pareto suboptimal, but rather by disagreements about which point

along the Pareto frontier should be chosen.[25] In other words, it is not generally the case that two parties to a debt negotiation can jointly improve their outcomes through cooperation. In fact, any improvement to the outcome of one party will most likely result in an injury to the second. That is because once the decision is taken to negotiate, each party knows that any concession on his part translates into a gain for the opposing side. Also, sovereign debt management is always and everywhere a *political* phenomenon.[26] This is not only because one party to the negotiation is by definition a state; it is also because creditor country governments have often inserted themselves into the process. These considerations lead us to conclude that power and bargaining leverage are more salient when trying to explain regime design and outcomes across time.

1.5.2 The Four Faces of Power

We have chosen to use the particular power-based framework developed by Barnett and Duvall (2005b) since it is well-suited to an analysis of a process as multi-faceted as sovereign debt restructuring. Barnett and Duvall generate a taxonomy of four types of power which captures the different aspects of the sovereign debt management regime discussed earlier: i) the private creditor representative body; ii) the degree and orientation of creditor country government intervention; iii) the structure and condition of the capital markets; and, iv) the evolution of the meaning of default. They define power more generally as "the production of effects...that shape the capacities of actors to determine their circumstances and fate."[27] Within this context, they consider power to have a polymorphous character, identifying the distinct types as **institutional, compulsory, structural, and productive.**

[25] Krasner (1992), p. 336. A Nash equilibrium is said to exist whenever two or more players in a game are unable to gain by a change in their strategies given the strategies being pursued by others. Such a non-cooperative equilibrium is not Pareto-optimal and could therefore be improved upon by some form of cooperation. Pareto-optimality is said to exist when there is no feasible way for one party to improve his/her welfare without lowering the welfare of someone else.

[26] We have borrowed the famous phrasing from Milton Friedman, who said that inflation was "always and everywhere a monetary phenomenon."

[27] Barnett and Duvall (2005), p. 42. The definition has been adapted for our purposes by eliminating the phrase "in and through social relations." This is because we need to accommodate the concept of impersonal market forces in our analytical framework.

Institutional power is taken to mean "the control that actors exercise indirectly over others through diffuse relations of interaction."[28] For our purposes, institutional power will correspond to the bargaining process mediated by the private creditor representative body. In other words, it is the power that unified creditors can exercise through the CFBH, the FBPC and the London Club, permitting us to offer some assessment of the independent effect of these bodies on negotiated outcomes.

Compulsory power refers to "relations of interaction of direct control by one actor over another actor."[29] In a sovereign debt restructuring context, this type of power would normally be exercised by creditor country governments or other official sector actors. It can either help or frustrate the interests of private creditors, depending upon its orientation. In the 19th century, we saw Britain intervene on behalf of private creditors in a number of sovereign default cases, thereby strengthening the position of bondholders and improving their bargaining outcomes.[30] In the interwar period, by contrast, the U.S. government tended to undermine private creditor interests by inserting itself into the negotiation process and routinely pressing bondholders to accept sub-standard settlements.[31]

Structural power is defined as "the production and reproduction of positions of domination and subordination that actors occupy."[32] Barnett and Duvall used the examples of capital-labour and master-slave as structural positions. In our analysis, we will be interested in the structural positions of capital exporters and capital importers (which are roughly similar to core and peripheral countries) and how those roles generate unequal capacities and privileges in a debt restructuring exercise. More specifically, we will want to examine the benefits that credit exporters have traditionally enjoyed in designing the rules of debt management regimes and controlling the supply of credit to developing countries. We will also consider that structural power accrues in certain periods to impersonal market forces, making the market another distinct "actor" in the

---

[28] Barnett and Duvall (2005), p. 43.
[29] Barnett and Duvall (2005), p. 43. Private creditors have not generally been able to exercise compulsory power in the sense their remedies tended to be limited to those that could be exercised through joint action. Even today, when private creditors are able to bring a suit directly against a sovereign state, this type of remedy has proved to have limited value in practice.
[30] Suter (1992), p. 93.
[31] Adamson (2002).
[32] Barnett and Duvall (2005), p. 43.

sovereign debt restructuring process. We therefore need to inquire about the condition of the markets in each historical period. Are they highly liquid and permissive, highly controlled, or have they collapsed? During the Great Depression of the 1930s, the condition of the capital markets provided defaulted sovereigns with little incentive to repay, since regaining market access was seen as largely impossible, even if debt obligations were fully honoured. And, when markets were highly centralized, as they were in the 19th century and the 1980s, creditors had much greater bargaining leverage, since they effectively controlled the supply of new credit to sovereign borrowers.

Finally, **productive power** is taken to mean "the socially diffuse production of subjectivity in systems of meaning and signification."[33] In other words, it is the power to create and fix meanings. Barnett and Duvall point out how basic categories of classification, including "civilized," "rogue," or "democratic" state, are all examples of productive power since they create meanings that are taken for granted in the world of politics. Such processes can be readily observed in the issue-area of sovereign debt management. Policymakers before the Great Depression routinely referred to sovereign default as an "uncivilized" act or a breach of international and moral law.[34] In the 1930s, we see a shift in perception as both Britain and Germany found themselves facing serious debt problems. The old stigma placed on developing countries did not suit western industrialized countries very well, and soon default was seen more as a calculated policy response to external economic and political shocks, including war. By the 1980s, sovereign default became a technocratic problem, one that was best managed by macroeconomists and "remedied" through a debtor's enactment of Washington Consensus directives.[35] While historical changes in the meaning of default did coincide with adjustments in regime design, we have also been attentive to their source. For example, where these pronouncements and prescriptions came largely from capital exporting countries, their basis was identified as material and not the manifestation of some universal normative code.

This framework has helped us to better analyze the outcomes in complex negotiations between private creditors and sovereign debtors across time, by highlighting

[33] Barnett and Duvall (2005), p. 43.
[34] Winkler (1933), p. 9; Mitchener and Weidenmier (2004).
[35] Williamson and Kuczynski (2003).

how power capabilities are accorded to different aspects of process. The schematic below illustrates this approach:

Table 1D: The Four Faces of Power in Sovereign Debt Restructuring

Regime Element		*Aspect of Power*
Creditor Representative Body	→	Institutional Power (Organization- Mediated)
Degree and Orientation of Creditor Country Government Intervention	→	Compulsory Power (Direct)
Condition of Capital Markets and Structure of Sovereign Lending	→	Structural Power (Market-Determined)
Default characterization and generally accepted standards of creditor behaviour towards defaulting sovereigns	→	Productive Power (Meaning- Determined)

1.5.3 Methodology

Our research has included an examination of archival material for both the Corporation of Foreign Bondholders and the Foreign Bondholders Protective Council. The CFBH produced detailed annual reports for each year of its operation, as well as over five hundred volumes of clippings and three hundred volumes of original correspondence, all of which are housed at the Guildhall Library in the City of London.[36] A similar record of close to one hundred boxes of original, unprocessed material has been preserved in the annual reports of the FBPC and the Council's archives which are held at Stanford University.[37] These archives had not yet been researched since they were only recently moved by the FBPC to Stanford. We were fortunate to have been the first researcher granted permission to examine the original source material for the FBPC.

More relevant to an analysis of the post-1982 period will be nearly twenty interviews with a wide range of market practitioners, including sovereign debt advisors, capital markets professionals, bank creditor officers, central bankers, IMF staff, bank lobbying organizations, lawyers, rating agency professionals, and finance and treasury

[36] The Corporation of Foreign Bondholders (1873-1987).
[37] Foreign Bondholders Protective Council (1941-1944); Foreign Bondholders Protective Council (1936-1977).

ministers from emerging markets countries. A list of completed interviews appears in Appendix 7B.

1.5.4 The Relevance of the Research Project and Proposed Original Contributions

Sovereign debt restructuring is an issue-area that exhibits some of the main tensions that are of interest to political economists: those between developed and developing countries, state and non-state actors, and states and markets.

In the case study chapters which follow, we have used the "four faces of power" model to isolate those elements of debt restructuring regimes that are most responsible for producing bargaining outcomes. Our findings have both theoretical and practical significance, and also refute some of the longstanding conventional wisdom held about the CFBH, FBPC and London Club.

In Chapter 2, we assess the shortcomings of economic theories that seek to identify sovereign repayment incentives. We present evidence that makes us question the efficacy of the "sanctions-reputation" debate, which we see as artificial and unproductive when trying to account for the variation in bargaining outcomes in different historical periods.[38] We establish an alternative theoretical basis for analyzing sovereign debt regimes in Chapter 3 and argue that if "sanctions" and "reputation" are analyzed instead as "compulsory" and "structural" power, it becomes clear that is not necessary to choose between them. They are *both* factors in the sovereign default calculus and tend to work in tandem to produce bargaining outcomes. In fact, our findings in our case studies (Chapters 4 though 7) indicate that since 1870, the compulsory power exercised by creditor governments in conjunction with structural (or credit-export) power, have been key drivers of negotiating results between debtor states and private creditors, reinforcing one another in the bargaining process. So, rather than debate the relative merits of sanctions vs. reputation, it appears to be far more useful to examine how compulsory and structural power interact to amplify one another in the same way across time. We maintain that these two forms of power have been principally responsible for the observed variation in bargaining outcomes in sovereign debt restructuring over the past

[38] Bulow and Rogoff (1989a); Bulow and Rogoff (1989c); Eaton and Gersovitz (1981).

135 years, meaning that the impact of private creditor representative bodies has been overestimated.

From a practical perspective, we believe that this research project will make a contribution to the public policy debate concerning reforms to the international financial architecture. As we noted earlier, the IIF has been extremely active in attempting to shape a new regime for sovereign debt management. The thrust of its agenda has been to improve communication and transparency on the part of sovereign debtors, but also to institute a debtor-funded private creditor representative body at the outset of each restructuring. Along with the IIF, other market practitioners and academics have called for the resurrection of bondholder councils.[39] This thesis argues that private creditors - even those that purportedly had capable representation – were much less powerful in a sovereign debt restructuring exercise than previously believed. Upon closer examination, the CFBH - the bondholder council viewed most favourably by economic historians – was highly dependent upon the sympathetic disposition of the British government toward its interests *and* the discipline of the London exchanges in restricting defaulters from accessing British capital markets. While the presence of the CFBH may have helped with administrative matters, bargaining results were not institutionally driven. Even the London Club, routinely praised as a model of effective creditor coordination, would not have held together as a negotiating body were it not for the coercion and control exercised by G-7 governments and the IMF. The cause of creditors in the 1980s was also advanced by the fact that private banks had been the principal suppliers of loans to emerging market countries since the 1960s. So, there was no alternative bond market for developing countries to tap. In short, the bargaining outcomes achieved by the commercial banks during the Latin American debt crisis flowed principally from the structure of the world credit markets and the active role played by the official sector, and not from the organizational features of the London Club. Given this analysis, it becomes clear that although we can establish a new bondholder council today, its results will not necessarily replicate those of the late 19th century or 1980s. Contemporary outcomes will be more dependent upon the attitudes of creditor governments and the configuration of modern global capital markets, neither of which bode well for today's investors.

[39] Portes (2004); MacMillan (1995a).

In terms of the broader sovereign debt management literature, most of it has tended to focus on a single period, country or region, while there are occasional examples of scholars seeking to compare two historical periods – for example, the 1980s and the 1930s or the 19th century and the 1990s.[40] Ours is the first study to investigate all four periods, beginning in 1870 and ending with the Argentine debt exchange in February, 2005. Also, since the early 1980s, the literature on financial crises has accorded a privileged position to the IMF. There is no doubt that the IMF has played a critical role in debt restructurings over the past twenty-five years, but the fact remains that private capital flows to developing countries dwarf official IMF lending.[41] We therefore intend to redress this imbalance in coverage by highlighting the importance of private banks and bondholders in the debt restructuring process.

We also believe that there is an important gap in the literature relating to the Foreign Bondholders Protective Council. This organization has been the least understood of the historical creditor institutions and also the least examined. Our research project addresses this gap by contributing a more robust picture of the FBPC (Chapter 5) through a careful review of its unprocessed archives and interviews with the Council's current President and former Deputy Treasury Secretary. We take issue with those who have branded it as an institutional failure, preferring instead to demonstrate how the FBPC was hampered by the same compulsory and structural regime elements that worked to benefit its predecessor, the CFBH.[42]

Our analysis begins in the next chapter with a review of the relative merits and shortcomings of economic theories related to sovereign repayment incentives. We will point out the important gaps that exist between formal economic models of debt and restructuring negotiations in practice, and suggest how our proposed analytical framework might help to bridge those gaps.

[40] Eichengreen and Lindert (1989); Bordo, Eichengreen et al. (1998).
[41] IMF World Economic Outlook, April 2007.
[42] Adamson (2002); Adamson (2005).

Chapter 2

Why Sovereigns Repay and Creditors Settle: An Assessment of Economic Theories of Debt

Since sovereign loans are owned by the governments of countries, repayment is not constrained by the net worth of the country, but by that component of net worth that the government can (or is willing to) appropriate.[43]

Eaton, Gersovitz and Stiglitz

2.1 Economic Theory: Why Do Sovereigns Repay?

In the absence of any formal, international bankruptcy framework, private creditors and sovereign states have had no choice but to negotiate mutually acceptable, post-default settlements through the ad hoc regimes that have emerged over time. Many economists consider these regimes to be "woefully inadequate" insofar as they lack the efficiency, fairness and predictability that we normally associate with well-designed domestic bankruptcy systems.[44] Yet, despite the aspirations of those contributing to the considerable body of prescriptive debt management literature, very little of what they have proposed has been implemented.[45] Supra-national bankruptcy schemes have never been adopted, and, as we will discuss later, only a diluted version of the collective action clauses ("CACs") first advanced by Eichengreen and Portes (1995) found their way into sovereign bond issues beginning in 2003. In fact, the way in which CACs were implemented fell far short of the standards advocated by Eichengreen and Portes and the G-10 (1996, 2002).[46]

If the machinery that has evolved over time to deal with sovereign debt crises has been less than optimal, then it is probably useful to ask: Why do sovereigns ever repay? After all, under conditions of anarchy in the international system, in which there exists no

[43] Eaton, Gersovitz et al. (1986), p. 500.
[44] Sachs (2002), p. 257.
[45] Rogoff and Zettelmeyer (2002); Oechsli (1981); Sachs (1995); Chun (1996); Cohen (1989); Schwarcz (2000); Clementi (2001); Cooper (2002); Cymot (2002); Miller (2002); Bossone and Sdralevich (2002); Griffith-Jones (2002); Miller and Zhang (2003); Ghosal and Miller (2003); Kroszner (2003); International Monetary Fund (2003a); Sharma (2004); Ghosal and Thampanishvong (2005); Miller and Thomas (2006b).
[46] See Drage and Hovaguimian (2004) for an analysis of the implementation of the G-10/Rey Report recommendations. See also Eichengreen and Portes (1995); Group of Ten (The Rey Report) (1996); and, Group of Ten (2002).

generally accepted supra-national authority to uphold or enforce the sovereign debt contract, what is it that compels states to honour their obligations to creditors?[47] The answer to this question is part of an ongoing theoretical debate in the economic literature, a debate that has been largely defined by Eaton and Gersovitz (1981) and Bulow and Rogoff (1989a, 1989c). While the former prioritize the importance of reputation, the latter privilege the potentially damaging effects of sanctions.[48]

2.1.1 Reputation vs. Sanctions

Eaton and Gersovitz argue that sovereign debtors repay because the act of default affects their reputation, thereby limiting or even prohibiting their access to capital markets.[49] Since the ability to borrow offers them consumption smoothing benefits in the future – permitting them to finance a balance of payments deficit and avoid domestic adjustment - they will refrain from default in order to maintain the entitlement of market access. Following this logic, Eaton and Gersovitz claim that lenders do not furnish sovereigns with an unlimited amount of credit; instead, a ceiling is reached at the level of indebtedness which makes a state indifferent between the loss of borrowing access in the future and the one-time gain associated with debt repudiation.

Eaton, Gersovitz and Stiglitz (1986) expand on this model by appealing to game theory. They argue that lenders infer the future behaviour of sovereign debtors according to their past behaviour. And, since states have an infinite time horizon, "their identity is remembered by their opponents" meaning that their "reputation as cooperative players can succeed in enforcing some degree of cooperation" regarding repayment.[50] In addition, the authors maintain that in order for the loss of market access to be seen as a credible sanction, not only do existing lenders need to withdraw credit; potential new creditors must abstain as well. Taking the 1980s Latin American debt crisis as their reference point, they assert that syndicate banks were successfully able to coordinate their

[47] The term "anarchy" is employed by international relations scholars to refer to the state of affairs between polities in which "unilateral power or cooperation may provide order" but where there is "no generally accepted authority or world government to settle disputes and enforce law." This differs from the commonly understood definition of the term "anarchic" which implies disorder. (Definition taken from *The Concise Oxford Dictionary of Politics* (2003), p. 15.) This is in part the reason that international law has never been able to match the precision of domestic law.

[48] Eaton and Gersovitz (1981); Bulow and Rogoff (1989a); Bulow and Rogoff (1989c).

[49] See Kletzer and Wright (2000) for additional support of the Eaton-Gersovitz position.

[50] Eaton, Gersovitz et al. (1986), p. 493.

responses to troubled debtors by withholding credit, since punishment within the syndicate would be meted out to any bank that did not play by the rules.[51] Also, whenever existing lenders refused to make incremental loans to a sovereign debtor, their informed refusal acted as a signal to potential new lenders to shun the debtor too.[52]

Kaletsky (1985) looks at debtor incentives to default from a cost-benefit perspective.[53] He maintains that since the enforcement of private legal sanctions by creditors is so difficult, they often do not represent the most significant costs of non-payment. He goes on to say that incentives to repay are driven more by a borrower's desire to enjoy the benefits that come from "advanced nation status, with...low risk premiums and full integration into international goods and capital markets."[54] Cline (1995) agrees and adds that many of the formal economic models do not sufficiently account for elements like "honour or national pride in the commitment to international rules of the game."[55] However, both Kaletsky (1985) and Eaton and Gersovitz (1981) are challenged to explain how, in the 1990s, the sovereign restructuring cases of Mexico, South Korea and Russia were all met with prompt renewal of market access.

In the competing theoretical camp, Bulow and Rogoff (1989c) claim that evidence in favour of a pure reputational argument is weak; they contend that industrialized country creditors can impose real, direct costs on borrowing countries, the most important being the blockage of trade credit. By interfering in the international goods market, creditors can force countries to conduct trade without letters of credit and in secret, roundabout ways to avoid the seizure of goods. So, by forcing a sovereign debtor to forego the gains from trade, creditors can incentivize recalcitrant states to repay. Although Bulow and Rogoff use trade interference as an example, direct sanctions could also include things like withholding international aid or even war. The authors find the reputational model to be so inadequate, that they argue in favour debt forgiveness whenever possible, since "debt that is forgiven is forgotten."[56]

---

[51] For additional support from the perspective of market practitioners, see Mudge (1984); Gibbs (1984); and, Hurlock (1984).
[52] Eaton, Gersovitz et al. (1986), p. 493.
[53] Kaletsky (1985).
[54] Cline (1995), p. 141.
[55] Cline (1995), p.141.
[56] Bulow and Rogoff (1989c), p. 49.

Those who found the sanctions argument compelling did not have to look far for empirical support. During the 1980s debt crisis, political pressure from creditor country governments, and most especially from the United States, carried the "implicit message that sanctions of a non-financial kind" would be imposed on any sovereigns that failed to service their debt.[57] The U.S. Treasury Secretary gave a grim description of what would happen in the event of default:

> The foreign assets of a country would be attacked by creditors throughout the world; its exports would be seized by creditors at each dock where they landed; its national airlines would be unable to operate, and its sources of desperately needed capital goods...virtually eliminated. In many countries, even food imports would be curtailed.[58]

In fact, the literature is replete with empirical studies that privilege either reputation or sanctions as the principal incentive for sovereign repayment. Arguing in favour of reputational incentives we find Cole, Dow et. al. (1995), English (1996), and Tomz (2001, 2004), among others.[59] Those finding strong evidence in favour of sanctions include Fernandez and Rosenthal (1990), Krugman (1989b), Lipson (1985b), O'Brien (1993), Ozler (1993), Klimenko (2002), and Weidenmier (2004).[60] Finally, when looking at the 1930's, Cardoso and Dornbusch (1989), Jorgenson and Sachs (1989), and Lindert and Morton (1989) all argue that defaulting sovereigns eventually settled with their private creditors in the absence of *either* sanctions or reputational considerations, undercutting the explanatory power of either model.[61] In Chapter 5, we will address this specific case and demonstrate how both structural and compulsory regime elements worked in tandem to produce the bargaining outcomes unique to the interwar and post-war periods. While sanctions and concerns about market access appear to have been absent from the sovereign default calculus in the 1930s and 1940s, this was not in fact the case. There was a market for capital; it was simply that this market was controlled by the official sector. Both the US government and its agencies, and later the multilaterals,

---

[57] Krugman (1989b), p. 292.
[58] O'Brien (1993), p. 100.
[59] Cole, Dow et al. (1995); English (1996); Tomz (2001); Tomz (2004).
[60] Fernandez and Rosenthal (1990); Krugman (1989b); Lipson (1985b); O'Brien (1993); Ozler (1993); Klimenko (2002); Weidenmier (2004).
[61] Cardoso and Dornbusch (1989); Jorgenson and Sachs (1989); Lindert and Morton (1989).

showed a willingness to lend to countries despite their record of default. Also, compulsory power was evident in the debtor-friendly role played by the American government. In many ways, American investors ended up being sanctioned by their own government in the settlement process. Given that both power elements worked in favour of debtor states during this era, sovereigns were able to dramatically scale down their debt obligations to bondholders with little residual damage. So, by recasting the debate in terms of structural and compulsory power, we have been able to surmount the puzzling question of sovereign repayment incentives during the interwar and post-war periods. In the next section, we have summarized some other empirical findings from the economic history literature in order to highlight the weaknesses of a pure "reputation vs. sanctions" debate.

2.1.2 Cases from Economic History: Shortcomings of the Reputation-Sanctions Debate

Cole, Dow et. al. (1995) and English (1996) examined the defaulting southern U.S. states in the mid-19th century, finding evidence in favour of reputational incentives, while Weidenmier (2004) looked at the *same* cases and argued that it was the presence of sanctions that drove repayment.[62] In support of the reputational argument, Cole, Dow et. al., and English argued that placing direct sanctions on a defaulting U.S. state was exceedingly difficult. It was not feasible to cut off trade with one state, since free trade within the U.S. allowed goods shipped to non-defaulting states to cross defaulting state lines. And, eliminating trade with the U.S. as a whole would have been extremely damaging for the British economy. The ultimate direct sanction, war, was out of the question, since war with one U.S. state would have provoked an immediate response from the federal government. However, even while the particular facts of mid-19th century America made sanctions unrealistic, English points out that most states eventually repaid their debts. He argues that this is because in the important years leading up to the Civil War, those states that repaid British bondholders were able to access European capital markets. So, reputation, and not sanctions, drove state behaviour.

[62] Cole, Dow et al. (1995); English (1996); Weidenmier (2004).

By contrast, Weidenmier (2004) asserts that sanctions were an important consideration in the Confederate default calculation.[63] Although leading investment houses in Britain might have been wary to "market war debt for a pro-slavery government with such a poor capital market reputation," the South did succeed in floating cotton bonds in England and the Confederacy did make payment on them, right up until March 1865, when Northern forces were at the gates of its capitol. Weidenmier argues that the South repaid mainly because of the "threat of trade and trade credit sanctions by gun manufacturers."[64]

Lindert and Morton (1989) conducted an analysis of bond lending from 1850 - 1970 and concluded that "defaulting governments have seldom been punished, either with direct sanctions or discriminatory denials of later credit", undercutting the theoretical positions of both Eaton-Gersovitz and Bulow-Rogoff.[65] While some countries that defaulted in isolation before 1918 were punished, Lindert and Morton found that credit rationing and trade retaliation in the 1930s was *not* targeted at defaulting countries but was instead indiscriminate and systemic. The U.S. and other credit exporters denied loans to virtually *all* developing countries, whether they had been faithful repayers or not.[66]

Jorgenson and Sachs (1989) reported results that were consistent with Lindert and Morton (1989) in their empirical study of all sovereign (and sovereign-guaranteed) bonds issued in the 1930s for five Latin American countries: Argentina, Bolivia, Chile, Columbia and Peru. What they found was that although Argentina was the only faithful repayer in the group, it was rewarded with exactly one new loan in the late 1930s, a loan that was issued for refinancing purposes only. Beyond that, Argentina received no special treatment. And, when Latin American countries returned to the capital markets in the 1950s, no systematic debt pricing differences between Argentina and other Latin American countries appeared.[67] Cardoso and Dornbusch (1989) provide further evidence

[63] Weidenmier (2004).
[64] Weidenmier (2004), pp. 8 & 19.
[65] Lindert and Morton (1989), p. 234
[66] Lindert and Morton (1989), pp. 231-232.
[67] Jorgenson and Sachs (1989), pp. 73, 74, 75 & 79.

of creditor amnesia by demonstrating that Brazil, a 1930s defaulter, had no more trouble borrowing in the 1960s than its more fiscally disciplined neighbour, Argentina.[68]

The only one to take exception to these findings was Ozler (1993). He concluded that borrowers were in fact penalized by past defaults, especially if those defaults occurred in the more recent past. His analysis found that the defaults of the 1930s had a small but statistically significant impact on borrowing terms, adding 20 basis points to future borrowing costs, while post-war defaults added 30 basis points.[69]

Although these two theoretical approaches to explaining sovereign repayment incentives - reputations vs. sanctions - are often painted as competing, they are not mutually exclusive. In fact, given the divergent results produced by many empirical studies on this issue, some involving the very same cases, we do not see a strong rationale for continuing to privilege either incentive. That is the reason we incorporate them both into our power-based framework and conceptualize them as involving distinct causal mechanisms that can be simultaneously operative.[70] In this way, we can make a determination as to how they might reinforce each other, or neutralize one another, in a given period. In translating the two incentives from economic theory to our power model, we consider sanctions to be a form of compulsory power, and reputation (or access to funding) to be a form of structural power. Also, our model will seek to go beyond the incentives debate and explain not only why sovereigns repay, but *why they repay more in some periods than in others.* Finally, our analysis will expand upon the contemporary debate by examining the potentially independent impact of private creditor representative bodies on bargaining outcomes.

2.2 Economic Theory: Why Do Creditors Settle - A Zero-Sum or Positive-Sum Game?

Can creditors ever view debt forgiveness as an act that will ultimately benefit them? As the 1980s debt crisis progressed, many economists began to theorize about the efficacy of debt forgiveness, trying to frame it as being mutually advantageous to the sovereign state and the private creditor group. The defining contributions in this regard were from Krugman (1988, 1989a, 1989b), who developed the concept of debt

[68] Cardoso and Dornbusch (1989).
[69] Ozler (1993), pp. 611-612.
[70] Tomz (2004), p. 2.

"overhang" and the "debt Laffer curve."[71] In his formulation, a condition of overhang exists when a country's debt grows to a level that makes full repayment unlikely. This is because overhang acts as a disincentive for investment and economic growth. Why? Because the larger a country's debt, the more likely it is that the benefits of good economic performance will accrue to creditors in the form of interest and principal payments, and not to the country itself. In other words, overhang undermines the normal pro-growth bias of a debtor state, which in turn affects the lenders' expectations for repayment. The debt Laffer curve graphically represents the point at which a debtor moves into an overhang position. Cline points out that the principal problem with Krugman's argument is that, despite being intuitively appealing, there were empirically very few countries that were on the wrong side of the debt Laffer curve; and, most importantly, none of them were in Latin America.[72] This meant that, in accordance with Krugman's theory, an offer of debt forgiveness on the part of creditors would not have resulted in a joint-gains outcome, but would have instead become a one-sided gift by private creditors to Latin American debtor states.

Apart from Krugman, other economists tried to make the theoretical case for a joint-gains outcome from partial debt forgiveness. Sachs (1986) and Sachs and Huizinga (1987) shared Krugman's conviction about the disincentives created by high levels of debt. However, they also faced a similar problem – their data suggested that very few sovereigns were on the wrong side of the debt Laffer curve, once again undercutting the notion that joint gains from debt forgiveness were possible in the case of Latin America.[73]

Offering an opposing view, Corden (1988) maintained that debt relief need not necessarily enhance the position of creditors by producing an incentive for debtor countries to adjust.[74] In his opinion, debt relief could also produce a *disincentive* for adjustment. He argued that, at the extreme, if a country were granted full debt relief, it would no longer find it necessary to adjust since it would not need to generate a higher level of resources to satisfy its foreign creditors. In fact, in his formal model, Corden

[71] Krugman (1989a); Krugman (1989b); Krugman (1988).
[72] Cline (1995), p. 162.
[73] Sachs (1986); Sachs and Huizinga (1987).
[74] Corden (1988).

locates the pro-incentive effects of debt relief only in a very exceptional case: where a country would be pushed to subsistence levels of consumption in the absence of debt forgiveness. Since such empirical examples were largely confined to sub-Saharan Africa, Corden's model did not have wider application to the debt problems of Latin America. In addition, countries that operated so close to subsistence levels of consumption did not generally have access to private capital markets. Their funding tended to come solely from bi-lateral governmental loans, multilateral institutions and aid agencies, putting them outside the remit of this research project.

In tackling the same issue, Helpman (1989) offered a highly qualified answer to the question of whether debt relief could ultimately benefit creditors as well as debtors:

> My results show that the desirability and likelihood of voluntary debt reduction depend on circumstances. Creditors benefit from a write-down of debt in some circumstances and lose in others.[75]

Helpman demonstrates that in the absence of capital mobility where there is a high degree of risk aversion in the debtor country, creditors do not gain from debt writedowns. This is because the gains from debt relief are used to fund consumption, not investment. However, the prospects for creditors improve as capital becomes mobile and the level of risk aversion drops, since, in this case, debt reduction leads to an increase in domestic investment. Yet, in Helpman's model, the possibility of a joint-gains outcome relied on circumstances that could be theoretically specified but were largely absent in the real world.[76] During the 1980s debt crisis, financial autarky was not the exception but the rule. Access to capital was both centralized and tightly controlled by the banking syndicates, and most of the "new money" was not available for investment since it was being used by debtor states to fund accrued interest owed to the banks; hence, capital movements were largely circular. So, while Helpman theorized about the conditions of capital mobility and risk tolerance that would spur domestic investment and increase a sovereign's repayment capabilities, it remained a challenge to apply his work to the specific cases of Latin America.

---

[75] Helpman (1989), p. 308.
[76] Cline (1995), p. 173.

As the crisis progressed, many of the models developed by economists were not able to provide the direction and clarity required by policymakers who were being increasingly forced to address the weaknesses of the multi-year rescheduling process as well as the coordination difficulties among private creditors. While scholars debated the circumstances under which debt forgiveness could produce a joint-gains outcome, those who tried to make the case for debt relief more forcefully, like Krugman and Sachs, ended up with models that ultimately excluded just those Latin American states whose debt burdens they were hoping to alleviate.

2.3 Debt Strategies in Practice

With the benefit of hindsight, one can more readily identify the shortcomings of the theoretical literature that evolved to address matters of sovereign repayment incentives and debt relief in the 1980s. First, empirical data could not be easily reconciled with formal models that forced a choice between reputational considerations and sanctions to explain repayment. Second, while economists were focused on trying to make the case for joint gains from debt relief, the applicability of their models to the specific cases of Latin America turned out to be rather limited. Their work was necessarily in a process of continual evolution as policymakers sought guidance to assess their strategic options. While formal models can contribute meaningfully to our understanding of certain aspects of the debt restructuring process, as a practical matter, what happens in a loan negotiation is often the result of a series of human decisions.[77] As Eaton, Gersovitz et. al. (1986) point out, while theoretical analysis is both valuable and appropriate in principle, it faces a number of limitations in practice. The most obvious is that questions of information are logically prior to analysis; and when these cannot be adequately addressed, it makes the endeavour of formal modelling that much more formidable.[78]

Dooley (1989) outlined four practical strategy options that were available to the banks and the sovereign debtors in the 1980s. All of these strategies were employed at

[77] Eaton, Gersovitz et al. (1986), p. 486.
[78] Eaton, Gersovitz et al. (1986), p. 503.

different times, although the unilateral, partial default option was exercised in a limited way only by smaller debtor countries.[79]

Table 2A: Commercial Bank Negotiating Strategies in the 1980s

Strategy	*Description*	*Effect*
Wait and See	Banks keep loans at book value and limit new lending to fund accrued interest. Hope that debtors "grow" out of problem.	Negative for debtor country
Creditors Share Expected Losses	Banks increase loan loss reserves, but maintain full contractual claim on debtor country.	Negative for bank earnings
Loss-Sharing and Debt Relief	Banks write-off loans and forgive contractual obligations of debtor.	Negative for bank earnings; positive for debtor states
Unilateral Partial Default	Debtor defaults.	Negative for bank earnings and for reputation of debtor states

Source: Dooley (1989)

What this table illustrates is that there was no obvious, positive-sum strategy for the banks and sovereign debtors to pursue. This observation not only helps to account for the lengthy negotiation process, but also highlights the importance of IMF/government-sponsored mediation, which allowed the parties to surmount both their collective action problems and their coordination deadlock.

We can conceive of a restructuring process more broadly as one that either brings a "solvent, willing-to-pay debtor through a liquidity crisis" or enables "an insolvent or unwilling-to-pay borrower to postpone the inevitable sanctions it will suffer when repayment ultimately is not made."[80] The question arises as to why a creditor would continue to acquiesce in the latter case. Generally, this is for one of three reasons: i) they hope that the problem will ultimately be proven to be one of illiquidity; ii) if this is not the case, then they will use the time to seek out other private or public lenders to assume their loans; iii) failing all else, they hope that by the time people recognize that the loan is uncollectible, those responsible for it will have long departed from the bank.[81] In other words, the 1980s debt crisis, like other financial crises in history, was managed by people who had imperfect information and were naturally worried about the potential damage to

[79] Dooley (1989), pp. 79-81.
[80] Eaton, Gersovitz et al. (1986), pp. 510-511.
[81] Eaton, Gersovitz et al. (1986), pp. 510-511.

their reputations and livelihoods. In addition, this characterization of the debt restructuring process identifies one of the most difficult assessments a creditor needs to make: is a sovereign debtor illiquid or insolvent? We will next discuss how this distinction has been made in international law and economic theory, as well as its wider implications for debt restructuring in practice.

2.4 Economic Theory and International Law: The Illiquidity-Insolvency Debate

From a legal perspective, Borchard (1951a) defines state insolvency as "the condition of affairs when the state or its government fails to perform its financial obligations to creditors, by non-payment in whole or in part of interest, principal, or sinking fund."[82] He goes on to explain that non-payment (or default) can be in good faith, when a clear inability to perform is present, or in bad faith, when a country is able but unwilling to honour its obligations. In practice, it is often difficult for creditors to determine the category into which the default falls, since even borrowers who are able to pay find it expedient to make claims of financial distress.

Some have denied that a state can, in theory, become insolvent. This is in part because of its unlimited taxing power, and, as Borchard, points out, the ability "to alienate even a part of its public domain for the benefit of creditors."[83] However, as a practical matter, there is a point at which taxation becomes economically and political unfeasible; also, it is hard to envisage a modern-day case where territory would be ceded voluntarily. Therefore, the net worth of a country, unlike that of a firm, cannot be easily measured in a simple "assets minus liabilities" equation.

Economists have suggested that we instead think of a country's net worth as the "discounted present value of its trade account."[84] In other words, the total value of a country's resources is not meaningful, because the only way the assets of a country can be transferred to foreign investors is through the trade account. This more restrictive net worth definition allows us to see how sovereign borrowers can reach a point where they are unable to service their external debt. Additionally, Krugman and Obstfeld (2003) discuss the concept of an intertemporal budget constraint which must be met by a

[82] Borchard and Wynne (1951a), p. 115.
[83] Borchard and Wynne (1951a), p. 118.
[84] Eaton, Gersovitz et al. (1986), p. 501. See also Diaz-Alejandro (1984).

government in each period. They assert that in cases where real interest rates on sovereign debt exceed a country's GDP growth rate, the debt to GDP ratio rises. Unless corrective action is taken by the government to reduce the debt, it will rise to the point where interest rates are too high or lenders refuse to roll over loans and call for repayment instead. This leaves the sovereign facing the prospect of default.[85] While some countries, like the U.S., appear to have had the ability to run chronic deficits since the 1930s, emerging markets countries are not accorded the same flexibility and therefore have less room to manoeuvre when their debt levels rise.[86]

Krugman (1988) dismissed the illiquidity-insolvency distinction on the grounds that "it is simply unknown whether the country can earn enough to repay its debt."[87] Cline (1995) argues that while it may be a difficult distinction, "that is why the public pays central bankers and IMF experts: to make such judgments."[88] It is interesting to note that even Paul Volcker, the Federal Reserve Chairman at the time of the 1980s debt crisis, stated that the distinction between insolvency and illiquidity is easier to make in a textbook than in the real world.[89] And, Robert Rubin, Treasury Secretary during the Asian financial crisis in the 1990s, commented that the two terms are "approximately useless" in any crisis context where a policy decision needs to be made.[90] We can deduce from these comments that the practical and even theoretical difficulty of assessing whether a country is illiquid or insolvent adds to the already uncertain atmosphere of a sovereign debt restructuring process. With such a critical aspect of the negotiation essentially indeterminate, it is not surprising that sovereign debt negotiations have been arduous, often disintegrating into redistributive bargaining exercises.

In the next chapter, we intend to build on this concept of redistributive bargaining and borrow from both international relations and IPE theory to construct a framework for analyzing sovereign debt restructuring regimes. More specifically, we will i) situate these regimes within the literature, ii) examine the theoretical lineage of our four "faces" of power, and, iii) tie each aspect of power to a key element of the debt management

[85] Krugman and Obstfeld (2003), p. 182.
[86] Hamilton and Flavin (1986), p. 809. See also Mosley (2000).
[87] Krugman (1988), pp. 256-257.
[88] Cline (1995), p. 161.
[89] Volcker and Gyohten (1992), p. 210.
[90] Rubin (2003b), p. 283.

process. Finally, we will argue our case for power as the most appropriate lens through which to analyze the variation in bargaining outcomes produced by sovereign debt regimes across time.

Chapter 3

The Four Faces of Power and Regime Theory: Building the Analytical Framework

Financial crisis occupies a place in international political economy analogous to that of nuclear war in international politics, implicit as a backdrop to much concern about maintaining habits of cooperation, but eventually unthinkable. [91]

Miles Kahler

3.1 Theoretical Explanations for Sovereign Debt Restructuring Regimes

As we discussed in Chapter 1, the goal of this research project is to explain the historical variation in bargaining outcomes between debtor states and private creditors in sovereign debt restructurings. In order to answer this question, we need to better understand the sovereign debt regime itself. What kind of regime is it and how can we best conceptualize it? What are its key features and how does it work?

The impetus for regime creation remains a subject of debate in the literature that breaks down roughly along realist, neo-liberal institutionalist, and constructivist lines. It is important to point out that the main research programs tend to be state-centric; even neo-liberal institutionalism, which started out by challenging the realist focus on states in regime creation, was eventually "redefined away from complex interdependence toward a state-centric version more compatible with realism."[92] However, we would argue that there is nothing about the commonly accepted definition of a regime that would exclude a purely private, or even a hybrid (public-private) structure. Private sector actors – like banks and investors – can establish international regimes, or join together with states to establish regimes of mixed "parentage."[93] In other words, the accepted definition should not limit our conception of the regime formation process to the interaction among states alone.[94] This provides the scope necessary to situate hybrids, like sovereign debt restructuring regimes, within the existing literature. Therefore, even though our

[91] Kahler (1986c).
[92] Cutler (2002), pp. 26-27.
[93] Haufler (1993), pp. 94-95.
[94] Haufler (1993), p. 97.

discussion of the literature will make frequent reference to states, we need to keep in mind that private or hybrid regimes can be substituted for state-sponsored ones.[95]

There is another characteristic of sovereign debt restructuring regimes that separate them from the descriptions commonly found in the literature: they tend to be "imposed" rather than "negotiated." What is the difference?

> A negotiated regime is one that arises from a conscious process of bargaining in which the parties engage in extended efforts to hammer out mutually agreeable provisions to incorporate into an explicit agreement...An imposed regime, by contrast, is an agreement that is favoured by a single powerful actor (or in some cases a small coalition of powerful actors) that succeeds in inducing others to accede to its institutional preferences.[96]

Sovereign debt management regimes are better characterized as imposed regimes, since their *content* is generally not a matter for negotiation between private creditors and sovereign states. In fact, it has customarily been the case that these regimes are established by creditor groups unilaterally.[97] While sovereign debtors implicitly recognize their authority when engaging them in a restructuring negotiation, they have typically not been a party to the regime's establishment.

3.1.1 Realists and the Power-Based Framework

Realists maintain that power plays a critical role in the formation, the content, and ultimately, the impact of international regimes. Some argue more specifically that regimes are structured by and reflect the distribution and configuration of power in the international system, casting doubt on the capacity of regimes to exert an independent influence on outcomes.[98] Even those who ascribe some causal significance to regimes maintain that "power is no less central in cooperation than in conflict between nations."[99] Carr (1964) cautioned that while regimes appeared to be antidotes to power, they were in fact "stealth weapons of domination."[100] Strange (1983) believed that even the concept of a regime was pernicious because it obscured the power relationships that were the

[95] Haufler (1993), pp. 95-96.
[96] Levy, Young et al. (1995), pp. 281-282.
[97] The only exception would be the Market-Based Debt Exchange which is a process that has been controlled by debtor states.
[98] Young (1983), pp. 248-249.
[99] Hasenclever, Mayer et al. (1997), p. 3.
[100] Barnett and Duvall (2005), p. 68. See also Carr (1964 [1981]).

proximate causes of behaviour in the international system.[101] Others see regimes as mobilizing bias, such that certain issues are organized "in" while others are organized "out."[102] For example, a self-interested player could use its power to create a regime that secured optimal outcomes from the system taken as a whole or even to enhance its preferred values.

Those with a realist orientation observe that regimes tend to be created at times of "fundamental discontinuity in the international system," finding a high degree of correlation between the distribution of power and regime characteristics.[103] In the case of sovereign debt restructuring regimes, we do observe a positive correlation between the outbreak of global economic crises and the establishment of private creditor representative bodies, organizations that were important elements of debt management regimes. In addition, these bodies tended to form around the dominant centres of capital export, linking them more closely to sources of material power.

3.1.2 Neo-Liberal Institutionalists and the Interest-Based Framework

In contrast to realists, neo-liberal institutionalists, most closely associated with the work of Keohane (1983, 1984), take their cue from microeconomics, explaining regime formation by the metaphor of supply and demand. This approach to the analysis of regimes has become the dominant paradigm, forcing other schools of thought to define themselves by making reference to it.[104] While the power-oriented research program focuses on issue-areas that are redistributive in nature, neo-liberals privilege the prospect of joint gains from cooperation. They argue that regimes are supplied by states "acting as political entrepreneurs who see potential profit in organizing collaboration."[105] The profits, or joint gains, arise when cooperative arrangements reduce transaction costs, increase transparency, and promote compliance through collective monitoring. Neo-liberals argue that we would expect to see regime formation whenever coordinated action has the potential to produce better outcomes for all parties than independent,

[101] Krasner (1983), p. 6; Strange (1983).
[102] Bachrach (1962), p. 949.
[103] Krasner (1983), p. 357.
[104] Hasenclever, Mayer et al. (1997), p. 23.
[105] Keohane (1993), p. 34.

uncoordinated action.[106] In other words, in many issue-areas, states can be seen to have mutual interests, so international politics need not only be about zero-sum games.

While Keohane helps to explain why states demand regimes, collective action theory sheds some light on the supply question. We cannot simply infer supply from demand, since the creation and maintenance of regimes involve costs. Even if each state in a group would obtain some benefit from the creation of a new regime, failures of collective action rest on the premise that "individual rationality is not sufficient for collective rationality."[107] As Olson (1965) pointed out: "it is not in fact true that the idea that groups will act in their self-interest follows logically from the premise of rational and self-interested behaviour."[108] Collective action problems are generally associated with the provision of public goods - goods whose benefits are both non-rival and non-excludable.[109] Olson believed that unless a group were small or some form of external coercion or selective incentive were present, rational and self-interested parties would not act to achieve the common good. In his view, small groups were qualitatively different from larger ones; the larger the group, the greater the chance of inefficient, uncoordinated (Nash) behaviour.[110] Olson identified a "privileged" group as one in which at least one (or some) of its members would be willing to provide a collective good, even if it were forced the bear the *entire* cost itself. A group that fits this description is likely to exist when the members are unequal in size or have a disproportionate interest in the public good.[111] In this same vein, Keohane invoked the theory of hegemonic stability to explain the supply of regimes.[112] A hegemon unilaterally supplies public goods, like an open trading system or a global currency, because it is in the interests of the hegemon to do so.

---

[106] Keohane (1983); Keohane (1984); Keohane and Nye (2001).
[107] Sandler (2004), p. 18.
[108] Olson (1980 [1965]), pp. 1-2.
[109] Sandler (2004), p. 17. Benefits are non-rival when a unit of a good can be consumed by one party without detracting from the consumption opportunity of the same unit that is available to other parties. Non-excludable goods , once provided to one, are available to all. Examples include such things as national defense and clean air.
[110] We observe a Nash equilibrium whenever two or more players in a game are unable to gain by a change in their strategies given the strategies being pursued by others. Such a non-cooperative equilibrium is usually not Pareto-optimal and could be improved upon by some form of cooperation.
[111] Reisman (1990), p. 150.
[112] Keohane (1984), p. 78. This theory accounts for the provision of global public goods by making reference to the distribution of power in the international system; in other words, hegemonic powers play an important role in the provision of public goods.

Given the divergent approaches taken by realists and neo-liberal institutionalists, which paradigm best captures the attributes of sovereign debt restructuring regimes?

3.1.3 Realists vs. Neo-Liberal Institutionalists: Locating Sovereign Debt Regimes in the Literature

Realists have taken aim at some of the central tenets of neo-liberal institutionalism. Grieco (1988), for example, believes that the research program overlooks the fact that states are concerned with relative and not absolute gains, emphasizing power not as a means but as an end of statecraft; Snidal (1991) replies that relative gains seeking only applies in special cases, meaning that this behaviour does not greatly diminish the chances for international cooperation.[113] He also argues that a hegemonic power structure is not a necessary pre-condition for international cooperation; the collective action of a small, like-minded group (defined as a "k" group") can substitute for a hegemon.[114]

Most relevant for our purposes is how one conceives of the sovereign debt restructuring process – as a redistributive or a joint-gains exercise. We would argue that redistribution is at the core of any negotiation in this issue-area, placing it more firmly in the power-based research program. While some degree of cooperation is necessary simply to enter into a negotiation exercise, once this threshold has been crossed, the process more closely approximates a zero-sum game. This is largely because creditors and debtors are negotiating over the allocation of a scarce pool of resources that resides within the debtor state. And, historical episodes of outright repudiation are rare, meaning that private creditors and debtor states have generally been able to muster the minimum level of cooperation necessary to permit a negotiation process to proceed.[115] Also, as we discussed earlier, the fact that these regimes are imposed rather than negotiated suggests an important role for power. And, since the power-oriented research program seeks to explain outcomes "in terms of interests and relative capabilities rather than in terms of institutions designed to promote Pareto optimality," it would seem to have better

[113] Grieco (1988), p. 486; Snidal (1991), p. 722.
[114] Hasenclever, Mayer et al. (1997), p. 101.
[115] Borchard and Wynne (1951a), p. 129.

application to the issue-area of sovereign debt management.[116] In other words, power-oriented analysis is relevant for analyzing those situations that fall outside the purview of neo-liberal institutionalism: zero-sum games.[117]

Although Keohane makes the argument in *After Hegemony* that both power and exchange are important in determining outcomes, the concept of power recedes into the background.[118] Instead, the book privileges the ways in which regimes can help to surmount problems of market failure and help states move to the Pareto frontier. By contrast, a power-oriented research program focuses on how power is used to promote a more favourable distribution of benefits, something that lies at the heart of many of the issue-areas of international politics – including national security and, we would add, sovereign debt restructuring. According to Krasner (1992):

> there are some issues in international politics, especially but not exclusively related to security, that are zero-sum. What is at stake is the power, that is, the relative capability of the actors. Market failure is never at issue here; one actor's gain is another's loss.[119]

Therefore, one cannot assume that all regimes arise to address questions of market failure; those that are intended to resolve distributional issues – like sovereign debt - belong to the power-based research agenda.

Given the orientation of their research program, it is not surprising that Keohane and Nye (2001) characterized the 1980s debt regime as a process that was designed to achieve joint gains. In their judgment, "when a country default seems likely, the common interest calls for a collective effort to save the system."[120] This interpretation, which was the minority view, was rather one-sided, especially since prioritizing the goal of saving the financial system had the effect of privileging the interests of banks over debtor states. Bulow and Rogoff (1989a, 1989b) examined the same period and adopted a decidedly more conflictual perspective on the negotiation between debtors and creditors, one in

---

[116] Krasner (1992), p. 362.
[117] The failure of economic theory to make a convincing case for a joint-gains outcome in the 1980s debt crisis has been discussed in Chapter 2. The case for a joint-gains outcome is more convincing for highly-indebted poor countries than it is for middle-income developing countries that have private market access.
[118] Keohane (1984). See Chapter 6.
[119] Krasner (1992), p. 364.
[120] Keohane and Nye (2001), p. 293.

which both parties focused on protecting their own interests.[121] Kapstein (1992) argued that "the international response reflected in large measure the distribution of power capabilities."[122] Biersteker (1993) concurred, seeing the 1980s global debt regime as one that evolved "with a clear distributive bias, one directed principally against the developing countries."[123] Devlin (1989) went even further, maintaining that:

> Formally, the banks present their committee structure as a public good, that is, an innocent mechanism of coordination among the hundreds of lenders, which facilitates the rescue of the borrower...But there is a potentially dark side to the committee structure as well: it can facilitate collusion and the formation of an effective cartel geared to skewing the distribution of the costs."[124]

As Devlin points out, while there is a public goods aspect to the committee – in the sense that it could attempt to overcome free-rider problems associated with the large number of lenders - by joining together in a committee headed by the world's largest financial institutions, the creditors created a formidable negotiating bloc, one whose power was derived from its monopoly control of credit flows.

Additionally, we would expect to see collective action problems arise in the creation of creditor committees because investor groups have historically been large, more closely resembling Olson's "latent" group than his "privileged" group. This implies that we should anticipate the presence of either coercion or selective incentives in the formation of private creditor institutions across time. However, to the extent that there is a hegemonic power structure, we might also see the establishment of such bodies eased by the willingness of certain creditor country governments to play a role in their creation. For instance, the CFBH was created with the support of the British Parliament and the FBPC was the progeny of the Roosevelt administration. Likewise, the London Club formed around the interests of G-5 governments and the IMF, since these official sector players were keenly interested in preserving the solvency of the global banking system.

---

[121] Bulow and Rogoff (1989a); Bulow and Rogoff (1989b); See also Yang (1999).
[122] Kapstein (1992), p. 268.
[123] Biersteker (1993), p. 2.
[124] Devlin (1989), p. 218.

3.1.4 Constructivists and the Ideas-Based Framework

Constructivists believe that regime formation is the result of shared values and beliefs as well as a common understanding of causal mechanisms.[125] They contend that "the building blocks of international reality are ideational as well as material."[126] Unlike their realist and institutionalist counterparts, constructivists argue that we cannot treat interests as exogenously given; their formation depends upon the body of accepted knowledge that shapes the perceptions of decision makers. Often, this knowledge is channelled through epistemic communities.[127] However, one important limitation of cognitive approaches is that they cannot predict the point at which consensual knowledge or shared values will result in cooperation.[128] Apart from this limitation, a number of scholars have successfully used an ideational approach to explain outcomes in the global political economy, including McNamara (1998), Finnemore and Sikkink (2001), Sinclair and Thomas (2001), Widmaier (2003, 2004), Best (2004, 2005), and Sinclair (2005).[129]

In an attempt to bridge the divide between realists and constructivists, critical constructivists argue that certain powerful groups play a privileged role in the process of idea formation. As a result, they "see a weaker autonomous role for ideas...because ideas are viewed as more tightly linked to relations of material power."[130] Adler (1997) maintains that power plays a critical role in the construction of social reality, especially since it enables an actor to define the underlying rules of the game while co-opting other players to commit themselves to those rules as part of their self-understanding.[131] We acknowledge the importance of both the creation of meanings and the control over knowledge in the process of sovereign debt restructuring, and we intend to capture these ideational components of the regime with the concept of productive power described in Chapter 1. However, we do not believe it is possible to de-link ideas and norms from material power considerations – either military or economic - in the issue-area of

[125] Young and Osherenko (1993), p. 250.
[126] Ruggie (1998), p. 879.
[127] Haas (1992), p. 3.
[128] Haggard and Simmons (1987), p. 510.
[129] McNamara (1998); Finnemore and Sikkink (2001); Sinclair and Thomas (2001); Widmaier (2003); Widmaier (2004); Best (2004); Best (2005); Sinclair (2005).
[130] Finnemore and Sikkink (2001), p. 398. See also Gordon (1980).
[131] Adler (1997), p. 336.

sovereign debt management. As a result, each of the case study chapters will argue that productive power is best seen as a by-product of material power.

3.2 IPE Theory: Hegemony and the Pattern of Sovereign Debt Settlements

One scholar has proposed an interesting linkage between the distribution of power in the international political economy and the patterns of debt settlement. Suter (1992) made one of the few attempts to bridge several historical periods - between 1820 and 1975 – in his examination of the recurring cycles of sovereign default and the variations in settlement terms. He argued that in periods of core rivalry, like the 1930s, creditors tended to be divided and poorly organized. This permitted peripheral debtors in the interwar period to get more favourable settlements than they could during periods of uncontested hegemony. By contrast, if we look at the last quarter of the 19th century, when the financial supremacy of Britain was unquestioned, debt settlements favoured creditors.[132] Suter's argument is both appealing and empirically supported for the timeframe under consideration in his study. However, one of the objectives of our analysis is to see how this argument fares if we extend it through the current period and if we look at it more deeply on an intra-period basis. When we do this, we find that the link between hegemony and debt settlements is not as straightforward as Suter originally hypothesized. For instance, the powerful creditors' cartel of the 1980s operated successfully in a period when U.S. hegemony was arguably in decline.[133] There is also conflicting evidence for the 1930s. Eichengreen (1991) maintained that although British bondholders may have been identified with a receding hegemon, they nevertheless obtained better results than their U.S. counterparts in negotiations with a number of 1930s defaulting states.[134] So, while the hegemony hypothesis may not work as well for our purposes, we do believe that the way in which Suter privileges power considerations

[132] Suter (1992), p. 39.
[133] Keohane (1984). International relations scholars like Keohane argue that the U.S. peaked in terms of its hegemonic power in the years immediately following World War II on several measures, including its share of world trade and the relative size of its economy. Since the 1970s, they argue that U.S. hegemony has been in gradual decline, leading to the rise of a multi-polar world with the U.S., the EU and China/Asia sharing power. In Keohane's work, he argues that regimes offer an alternative to maintaining order and cooperation among nations in the absence of a clear hegemonic power.
[134] Eichengreen (1991).

is worthy of further development, and, for this reason, we have decided to expand on his original power hypothesis in our research project.

3.3 The Four Faces of Power in Sovereign Debt Restructuring Regimes

Thus far, we have situated sovereign debt regimes in the power-based literature, and our next step is to catalogue the key features of these regimes. As we already discussed in Chapter 1, we have proposed using the power-based framework developed by Barnett and Duvall (2005) since it captures four types of power - **compulsory, structural, productive and institutional** - each of which has relevance to a key aspect of the sovereign debt restructuring process. It would be hard to deny that power is one of the most important organizing concepts in social and political theory. In fact, noteworthy taxonomies of power have been advanced by a number of scholars, including Weber (1968) and Mann (1986). For Weber, there were three principal types of power (or legitimate domination): i) rational; ii) traditional; and iii) legal.[135] Mann argued that there were four sources of power: i) ideological; ii) economic; iii) military; and, iv) political.[136] This highlights one of the drawbacks of using power an analytical tool: researchers are often unable to agree on a common definition or set of definitions.[137] The model developed by Barnett and Duvall (2005) owes a debt to this early scholarship since it has grown out of the broader literature on power. Its value as an analytical device, not unlike those which preceded it, is precisely its ability to integrate different conceptions of power rather than see them as competing. As Baldwin wrote:

---

[135] Weber (1968), pp. 215-253. Rational: rests on "a belief in the legality of enacted rules and the right of those elevated to authority under such rules to issue commands." Traditional: rests on "an established belief in the sanctity of immemorial traditions and the legitimacy of those exercising authority under them." Charismatic: rests on "devotion to the exceptional sanctity, heroism or exemplary character of an individual person, and of the normative patterns...revealed by him."

[136] Mann (1986), pp. 23-28. Ideological: power that is "wielded by those who monopolize a claim to meaning." Economic: power that "derives from the satisfaction of subsistence needs through the social organization of the extraction, transformation, distribution, and consumption of the objects of nature." Military: power which "mobilizes violence, the most concentrated, if bluntest instrument of human power." Political: power which "derives from the usefulness of centralized, institutionalized...regulation of many aspects of social relations."

[137] Hay (1997), quoting Ball, p. 45.

> it is time to recognize that the notion of a single overall international power structure unrelated to any particular issue-area is based on a concept of power that is virtually meaningless.[138]

In fact, by combining different aspects of power into a single framework, we are in a better position to examine how they might offset, or augment, each other in a sovereign debt bargaining exercise.[139] Our framework will also enable us to provide a more robust explanation for variations in bargaining outcomes, while at the same time permitting some generalizations across time.[140]

3.3.1 Compulsory Power

Each of the four "faces" of power that form our analytical framework has a specific provenance in the literature. The concept of **compulsory power** can be traced back to Max Weber, who defined it as "the probability that one actor within a social relationship will be in a position to carry out his own will despite resistance, regardless of the basis in which this probability rests."[141] A comparable interpretation of compulsory power can be found in the classic formulation by Dahl (1957): "A has power over B to the extent that he can get B to do something that B would otherwise not do."[142] Like Weber, Dahl conceived of power as agency-centred, inasmuch as he focused his analysis on the behaviour of actors within the decision-making process. Waltz (1979) treated power as a "fund of capabilities that enables the more powerful in general to work their wills with greater regularity than the weak."[143] Both Krasner (1981) and Strange (1999) used the term "relational" power when referring to this same ability to "change outcomes

---

[138] Kapstein (1992), quoting Baldwin, p. 265.
[139] Schneider (2005), p. 669.
[140] Fuchs (2005a). In a similar vein, Fuchs (2005) looked at the interaction of three aspects of business power - instrumental, structural, and discursive - to show how multi-national corporations have assumed increasing rule-making authority in regulatory matters as well as participation in public-private partnerships.
[141] Carlsnaes, Risse et al. (2002), p. 180. Weber argues that every genuine form of domination implies a minimum level of voluntary compliance and therefore enjoys a claim to legitimacy. Under this interpretation, it would be unlikely that Weber would use the term "compulsory power" the way it is used in this study. That is to say, he would be unlikely to support the view that compulsory power could include the use of military force. However, the other interpretations of "compulsory power" would support its use in this context. See Dahl (1957), Waltz (1979), Krasner (1981) and Strange (1999).
[142] Dahl (1957), p. 201.
[143] Waltz (1979). Also quoted in Lentner (2004), p. 6.

or affect the behaviour of others in the course of explicit political decision-making processes."[144]

Compulsory power in the sovereign debt restructuring process has largely been exercised by creditor country governments, since private creditors could not normally address their grievances *directly* to debtor states. If private creditors were not successful in appealing to their home governments for intervention, they customarily settled for indirect avenues to redress defaults - the private creditor representative bodies. For instance, in the period from 1821 – 1925, close to 20% of debt settlements involved creditor country governments taking some type of political or economic control over sovereign debtors.[145] Borchard and Wynne (1951b) chronicled the spectacular case of Egypt, in which gradually increasing involvement ended with Britain's military intervention in 1882.[146] The blockade of Venezuela in 1902 by Britain, Germany and Italy ended with the capitulation of that country's recalcitrant dictator and full repayment four years later.[147] Despite protests from Latin American countries, the Hague Peace Conference of 1906 legitimized the use of force in cases of debt disputes, but only if the defaulting states refused international arbitration.[148] While direct government intervention in the 19th and early 20th centuries is commonly believed to be more the exception than the rule, the fact of the matter is that most negotiations took place with the tacit understanding that the use of force remained a distinct possibility.

In the aftermath of the Great Depression, the U.S. State Department took an active role in the settlement of defaults with private creditors. However, the orientation of that intervention was decidedly different from what had gone before. Under the U.S.'s Good Neighbour Policy, there was little scope for applying pressure to Latin American debtors, and Wallich rightly concluded that when the government intervened, "the respective debtors [would] be treated very considerately."[149]

As the 1980s Latin American debt crisis unfolded, Kahler (1986c) argued that politics needed to be brought back into the discussion of the debt crisis, especially since

---

[144] Krasner (1981), p. 122; Strange (1999). Note that Strange used a definition that was similar to Dahl's. The quote is from Kranser (1981).
[145] Suter (1992), p. 93.
[146] Borchard and Wynne (1951b).
[147] Mauro and Yafeh (2003), p. 23.
[148] The Corporation of Foreign Bondholders (1873-1987), Report of 1907.
[149] Wallich (1943), p. 335.

political considerations were having an impact on the operation of the international financial system. He noted the emerging activism on the part of creditor country governments and the IMF, and he explored the important relationship between commercial banks and their home governments.[150] Some, like Wellons (1985), saw the governments of the G-5 playing a role as important as the London Club in the 1980s debt negotiations.[151]

The less visible role of creditor governments and the IMF since 1998 has in some ways been a reaction to the handling of the 1997 Asian financial crisis and the charges of moral hazard levied against the IMF for its large lending packages to countries like Thailand, Indonesia and South Korea. As the case of Argentina's 2001 default will demonstrate, creditor governments, most especially the U.S., have offered less overt support for private creditors since 1998, preferring "market-based" solutions instead. The effect has been to strengthen the hand of sovereign debtors in restructuring negotiations, especially when compared to the 1980s and the 19th century.

It is interesting to note that creditor country government intervention has been a common theme throughout the history of sovereign default. It took different forms – from military intervention in the 19th century to the imposition of IMF structural conditions in the 20th and 21st centuries – but it has remained an acceptable course of action. As a result, the potential for this type of intervention remains part of the sovereign default calculus, influencing the outcome of debtor-creditor negotiations.

We would expect to see compulsory power play an important role in the sovereign debt restructuring process in the following cases: i) where creditor country governments have overriding diplomatic or geo-strategic objectives with respect to a defaulting state; ii) when sovereign defaults have the potential to create systemic risks that would reverberate negatively on creditor country markets; iii) where the property rights of private creditors have been openly or unfairly abused and creditors have no alterative (legal) means of seeking compensation from a defaulting sovereign; and, finally, iv) where there is a close, collaborative relationship between a creditor country government and private creditor groups.

---

[150] Kahler (1986c).
[151] Wellons (1985).

3.3.2 Structural Power

While the concept of compulsory power was important in explaining outcomes in international relations, scholars soon pointed out that it was not the only aspect of power worthy of investigation. Bachrach (1962) argued that power is janus-faced, insofar as its complex nature is obscured if we focus narrowly on the decision-making process. In his view:

> power is also exercised when A devotes his energies to creating or reinforcing social and political values and institutional practices...To the extent that A succeeds in doing this, B is prevented, for all practical purposes, from bringing to the fore any issues that might in their resolution be seriously detrimental to A's set of preferences.[152]

So, while the first face of power - compulsory power - focused on the effect that one party can directly have over another in a negotiation, this second characterization - **structural power** - is more concerned with the larger context in which that negotiation takes place. Krasner (1981) called this second type of power "meta-power," or the capacity to structure the environment in which decisions are made. Gruber (2000) referred to it as "go-it-alone" power, meaning the ability to unilaterally alter the status quo.[153]

Similar themes of structural power run through Marxist theories which posit that workers offer their labour to private firms voluntarily, but only because the alternatives in a capitalist system – unemployment and impoverishment – would be far worse. World systems theorists also employ this notion of power when they argue that "structures of production generate particular kinds of states identified as core, semi-periphery and periphery."[154] In other words, structural forces embedded in the global economy are directly responsible for how states conceive of their identities and formulate their interests. Hurrell and Woods (1995) see structural power as responsible for a certain degree of path dependence for weaker states in the system. They maintain that not only

---

[152] Bachrach (1962), p. 948. See also Bachrach and Baratz (1963). See Strange (1999) and Gruber (2000) for treatments of agency-centered and context-centered approaches to power. Strange develops the concepts of "structural power" and Gruber discusses "go-it-alone" power, both of which describe a form of power that involves the strategic manipulation of alternatives. Also, see Gill and Law (1989) for a discussion of the structural power of capital.

[153] Krasner (1981), p. 122; Gruber (2000).

[154] Barnett and Duvall (2005), p. 54.

do these states have very little influence in defining the global agenda, their highly restricted choices "carry powerful political implications, not just because they submit to the will of larger states...but because, over the longer term, weak states' decisions constrain their future options."[155]

Strange (1999) used the term "structural power" to refer to this same agenda-setting, context-creating capability, and argued that structural power could be amplified by several things, including control over the supply and distribution of credit.[156] In fact, a number of scholars have argued that as the scope of the market began to widen in the 1980s, and as technology and communications have advanced, these factors have contributed to "the rising structural power of internationally mobile capital."[157]

Structural power is a critical aspect of the sovereign debt management process. Not only do the reciprocal roles of capital importer and exporter imply a certain set of privileges (or disadvantages), the structure and condition of the capital markets are also important determinants of the outcomes of sovereign debt negotiations. In various historical periods, the sovereign debt market could be described in one of three ways: i) highly centralized and controlled, ii) highly decentralized and promiscuous, or iii) collapsed.

In the last quarter of the 19th century, British investors were largely in control of the capital export markets. Foreign investment rose from £245 million in 1854 to £3.9 billion in 1913, giving the CFBH considerable leverage and credibility when it threatened debtors with loss of market access.[158] The same was true of the highly centralized debt markets of the 1980s, when the banks of the London Club were the sole source of private credit to Latin American debtor states. Carlos Diaz-Alejandro (1984) maintained that what could have been a serious but manageable recession turned into a major crisis mainly because of the abrupt change in the conditions and rules for international lending by the banks.[159] Highly centralized or controlled markets, therefore, tend to favour the interests of creditors in a restructuring process.

---

[155] Hurrell and Woods (1995), p. 456.
[156] Strange (1999).
[157] Gill and Law (1989), p. 480.
[158] Lipson (1985b), pp. 40-41.
[159] Diaz-Alejandro (1984).

The global macroeconomic situation of the 1930s had the opposite effect, with market collapse inviting sovereign default mainly because private creditors could not hold out the reward of new financing to those countries that honoured their debt obligations.[160] And, in the 1990s, we see that highly decentralized and liquid markets have had surprisingly the same effect on debtor incentives as collapsed markets. When sovereigns are able to return to the private debt market quickly after a default, they are more likely to consider the default/restructuring option. Mexico issued new debt in the capital markets within a year of its 1994/1995 crisis, as did Korea and Russia after their respective crises in 1997 and 1998.[161] Therefore, structural power can, at different points in history, accrue to the benefit of either sovereign debtors or private creditors. We would therefore expect to see structural power push outcomes in favour of creditors when private capital markets are highly controlled and centralized. On the other hand, structural power would benefit debtors when private markets are either i) highly liquid and promiscuous, or ii) collapsed.

3.3.3. Productive Power

In sharp contrast to compulsory and structural power, **productive** power concerns itself with discourse and the systems of knowledge "through which meaning is produced, fixed, lived, experienced and transformed."[162] Discourses can be conceived as sites of power since they help determine both the possible and acceptable courses of action in the international political economy. According to Bourdieu (1991), "the power of constituting the given through utterances" is an "almost magical power which enables one to obtain the equivalent of what is obtained through force."[163] As a result, particular discourses have played a role in the formation of sovereign debt restructuring regimes to the extent that they have rendered certain remedies on the parts of creditor states acceptable. Etymologically, the word default is derived from the Latin "de" which is a

[160] Armella, Dornbusch et al. (1983).
[161] Interview K.
[162] Barnett and Duvall (2005), p. 55; See also Gordon (1980) for a compilation of the writings of Foucault on this subject.
[163] Bourdieu (1991), p. 170. Bourdieu refers to this as symbolic power. He argues that "what creates the power of words and slogans, a power capable of maintaining or subverting the social order, is the belief in the legitimacy of words and those who utter them." See also Ives (2004), p. 173, for a discussion of Gramci's poltics of language. For Gramsci, "the production of meaning and language in the context of past linguistic pressures and understandings cannot be separated from any project of social change."

prefix denoting intensive force, and "fallere," meaning to deceive or cheat. Taken together, the meaning of default is "an utter and complete deception of a creditor by a debtor." According to Winkler (1933):

> Regardless of terms and definitions, the practise of disregard for creditors is held in abhorrence everywhere. Government default, irrespective of classifications and erudite definitions is...a breach of its obligations under domestic and international, and always, moral law.[164]

This conception of default led U.S. President Theodore Roosevelt in 1904 to include sovereign default among those actions which "loosened the ties of civilized society" necessitating the intervention of a "civilized" nation.[165] Such an interpretation helps us understand why creditor country governments might have chosen to intervene by force on behalf of their private creditors in the 19th and early 20th centuries. They also provide insights into the development of international anti-expropriation and international property law in the 19th century. It was widely accepted that the taking of an alien's property – including the refusal to honour a debt contract – required an offending sovereign to pay prompt and fair compensation.[166] At the time, these rules helped to maintain the economic and social order necessary for the conduct of international trade and capital export, and their development was closely linked to the rising importance of Britain as a capital exporter. Most critically for our purposes, they prescribed the boundaries of acceptable behaviour between defaulting sovereigns and their creditors. In this historical example, productive power worked to the benefit of creditors insofar as exceptions to the doctrine of sovereign immunity were allowed in cases where property rights were blatantly abused.

In the issue-area of sovereign debt management, productive power appears to be largely an attribute of capital exporters and the institutions and organizations connected to creditor country governments. These groups have generally been responsible for how default is perceived as well as the array of remedies that are deemed acceptable at different points in history. So, our focus will be on how and why this particular group of actors formulated and changed their views on default and how this impacted their

[164] Winkler (1933), p. 9.
[165] Rippy (1934), p. 195.
[166] Lipson (1985b), p. 38.

preferred policy measures for dealing with sovereign debt crises. We would expect to see productive power play a meaningful role in cases where an actor's ability to use other forms of power is severely restricted. Elsewhere, productive power is likely to operate in an auxiliary capacity, playing a subsidiary role to institutional, compulsory, and structural power.

3.3.4 Institutional Power

Institutional power is power that is mediated or diffused by the formal or informal bodies that operate between two parties. For the purposes of our analysis, the private creditor representative bodies - the CFBH, FBPC and London Club – as well as the Market-Based Debt Exchange are taken to represent sources of institutional power. They are analytically important and distinct from the capabilities directly possessed by individual debtors and creditors since they circumscribe behaviour through their decisional rules, delegation of responsibility and division of labour. However, the rules and decision-making procedures of institutions can also create "winners" and "losers."

By their very nature, institutions can influence outcomes in ways that favour some parties over others, unevenly distributing their collective rewards "long into the future."[167] For this reason, an independent analysis of the features of the private creditor representative bodies will enable us to ascertain how much autonomous influence they had on sovereign debt negotiations and what types of institutional bias are detectable.

The CFBH was widely judged to be an extremely effective organization in its own right. Aside from its ability to deny market access to defaulted states, it also coordinated its activities with fellow bondholder committees on the Continent and, eventually, in the United States. The institution commanded a great deal of respect from investors and debtor states alike. This was in part due to the fact that many CFBH board members were former British diplomats who, as a result of their position and experience, developed trusted relationships with foreign governments. Such relationships eased the way for difficult debt negotiations.[168] In addition, the CFBH's non-profit status removed

[167] Barnett and Duvall (2005), pp. 48 & 52. This concept of institutional power is different from the sociological view offered by Mills (1963). In Mills' work, societal power resides principally with the political, economic and military institutions that can shape history, while the institutions of family, education and religion are pushed to the side and largely subordinated to the "big three."
[168] Mauro and Yafeh (2003).

the prospect of pecuniary motivation from its recommendations to bondholders, recommendations which were largely seen as credible and nearly always accepted.

Although very little has been written about the FBPC, the principal verdict in the literature seems to be that it was much less effective than its British counterpart, with some even branding it a failure.[169] Since the FBPC was established only in 1933, it did not enjoy the longevity and experience of the CFBH, and yet it faced the prospect of negotiation in the midst of one of the most trying periods in economic history - the Great Depression. After just a few years of operation, Adamson (2002) argues that the U.S. State Department effectively supplanted the institution as chief negotiator with defaulted Latin American states. Observing the organization's intransigent insistence on full repayment of interest and principal, the State Department came to believe that the objectives of private bondholders were in direct conflict with America's geo-strategic preference for regional stability.

The literature on the London Club and the 1980s debt crisis more than makes up for the paucity of material devoted to the FPBC. There is wide agreement among those writing on the 1980s debt crisis that the risk of insolvency in the global banking system unified the interests of commercial banks (through the London Club), the IMF and creditor country governments, pitting a powerful creditors' cartel against a weak and divided set of debtor states. Devlin (1989) focuses on the bargaining process between commercial banks and Latin American debtors, suggesting that the banks made the most of their enhanced bargaining leverage by increasing their profits and capital bases while Latin American economies faltered.[170]

We would therefore expect to see creditors wield more institutional power in the following cases: i) where creditor groups are small, relatively homogenous, or share a common set of objectives; ii) where a creditor representative group is seen to have authority by virtue of its integrity and experience; and, iii) where the interests of private creditors are generally aligned with those of creditor country governments.

As indicated in the table below, the analytical framework discussed in this chapter has allowed us to link each regime element to an aspect of power from the Barnett and

[169] Adamson (2002).
[170] Devlin (1989).

Duvall (2005) taxonomy. It also expands on the table presented in Chapter 1 by identifying the actors that are most likely to wield each type of power.

Table 3A: The Four Faces of Power in Sovereign Debt Restructuring

Regime Element		*Aspect of Power*	*Locus of Power*
Creditor Representative Body	→	Institutional Power (Organization-Mediated)	CFBH, FBPC, London Club
Degree and Orientation of Creditor Country Government Intervention	→	Compulsory Power (Direct)	Creditor country governments, IFIs
Condition of Capital Markets and Structure of Sovereign Lending	→	Structural Power (Market-Determined)	Centres of capital export, commercial bank balance sheets, official sector "lending into arrears"
Default characterization and generally accepted standards of creditor behaviour towards defaulting sovereigns	→	Productive Power (Meaning-Determined)	Credit exporters, policymakers, international lawyers, macroeconomists, NGO's

3.4 Sovereign Debt Restructuring Regimes: Game Theory and Negotiation Analytics

Before we close, it is important to point out that there are a number of scholars who have employed game theory to analyze the process of sovereign debt restructuring. Most notable among them is Aggarwal (1996).[171] For decades, game theorists have been searching for a method that would allow them to predict the outcome of strategic, human interaction using only data on the order of events and a description of the players' preferences.[172] There are a number of unrealistic assumptions that need to be made by game theorists in their quest to create an effective model of strategic bargaining, and while this approach may have applicability in cases that involve repetitive, well-structured negotiations, their utility in the issue-area of sovereign debt negotiations is highly suspect.[173] For one thing, a fundamental requirement of game theory is that each player is aware of the rules as well as the preferences of the other players, a state of affairs that is rarely found in actual negotiations. This insistence on complete information

[171] Aggarwal (1996).
[172] Sebenius (1992), p. 347. Citing Ariel Rubenstein.
[173] Sebenius (1992), pp. 346-347.

appears prominently in Aggarwal's work on strategic interaction in debt rescheduling. His model assumes that each player knows the other player's payoffs as well as the rules of the game. To assume otherwise, would be to make the model unwieldy.[174] However, in the interests of parsimony and in an effort to create a more tractable analytical framework, Aggarwal edits out a critical element of reality. According to Tomz (2001), "one simply cannot understand international capital flows and debtor-creditor relations without putting imperfect information... at the center of the analysis."[175]

Aside from uncertainty, there is the important, and unpredictable, human element that we alluded to in Chapter 2. People tend to exhibit well-informed and purposive behaviour in a negotiation, but they are generally not pure utility maximizers that fit the descriptive categories of "imaginary, idealized, [and] super-rational."[176] In fact, it is in the more realistic world of bounded rationality and imperfect information that negotiation analytics attempts to make a contribution. Both Putnam (1988) and Odell (2000) have proposed negotiating models which do not aspire to the level of prediction, but do assume intelligent, goal-seeking behaviour on the part of participants within the larger context of incomplete information.[177] As an example, Kahler (1993) employed Putnam's two-level game to help illuminate a series of negotiations between developing countries and the IMF.[178] Given the unique and non-repetitive nature of sovereign debt restructurings, we would argue that negotiation analytics can deliver a more realistic assessment of these cases than game theory. That being said, we would also point out that both approaches are intended to be used when looking at *specific* instances of negotiation, and not at results produced by aggregating bargaining outcomes over decades. Since this project contemplates the latter, neither game theory nor negotiation analytics will play a role in our research.

We therefore trust that the analytical framework we have elaborated here will allow us to better illuminate the connections between power and negotiating outcomes in sovereign debt management across time. In the next chapter, we will use this framework

---

[174] Aggarwal (1996).
[175] Tomz (2001), p. 33.
[176] Sebenius (1992), pp. 348-349.
[177] Putnam (1988). Odell (2000).
[178] Kahler (1993).

to analyze regime formation and the resulting bargaining outcomes during the era dominated by the British Corporation of Foreign Bondholders.

Chapter 4

An Institutional Counterweight to Sovereign Power? The Corporation of Foreign Bondholders and Sovereign Debt Workouts in the 19th Century

The cause of the British bondholder is at last likely to be taken up with energy and skill. The British lender has been by some foreign borrowers so defrauded and oppressed that it is absolutely necessary some measures should be devised for his protection.

Observer
November 7, 1868

That an association which is, after all, only a combination of private individuals, should have acquired so great an influence, and should have dealt with [sovereign] debts amounting to [an] enormous total... seems almost fabulous – almost like a fairy tale of finance.

Sir John Lubbock,
Corporation of Foreign Bondholders, 1890

4.1 The Corporation of Foreign Bondholders and the Four Faces of Power

Accounts of the sovereign debt restructuring regime of the late 19th century have largely privileged the role of the British Corporation of Foreign Bondholders ("CFBH"), arguing that its establishment in 1868 was responsible for enhancing the efficiency of sovereign debt workouts and improving bargaining outcomes for private bondholders. In many ways, the CFBH was considered to be an institutional counterweight to sovereign power and received much of the credit for improvements to the private investor-sovereign state negotiation process. For instance, Borchard (1951a) extols the CFBH for having "the great advantage of operating under an excellent constitution," attributing its achievements to the "character and capacity of the men" who carried out its policies.[179] Esteves (2005) argues that the institutional innovation of the CFBH was chiefly responsible for shortening default durations and increasing bondholder recoveries in the period from 1870 to 1914.[180] Eichengreen (1991) and others give the CFBH credit for

[179] Borchard and Wynne (1951a), pp. 211-212.
[180] Esteves (2005), p. 32. According to Esteves, efficiency improved insofar as default durations were reduced and bondholder recovery rates were increased.

being a more effective organization than its continental European and American counterparts, while Suter (1992) contends that the ability of bondholders to "enforce hard terms of debt settlements against the interests of debtor countries" would have been severely impeded had it not been for strong investor networks like the CFBH.[181] Finally, Mauro and Yafeh (2003) argue that "while similar bondholder associations were established in other countries at various times in history, the CFBH was the longest-lived, best known, and most important of these institutions."[182]

Much of what we have come to believe about the efficacy of the CFBH can be summarized in the table below.[183]

Table 4A: Bargaining Outcomes in Sovereign Debt Restructuring

Time Period	*Dominant Creditor Representative Body*	*Average Time from Default to Settlement*	*Debt Forgiveness*
1871-1925	Corporation of Foreign Bondholders	6.3 years	12% (15.9%)*
1926-1975	Foreign Bondholders Protective Council	10.1 years	23.2% (55.9%)*
1980-1997	The London Club	8.5 years	35%
1998-2005	Market-Based Debt Exchange	1.19 years	48.67%

Sources: Suter (1992); Cline (1995); Singh (2003); Sturzenegger and Zettelmeyer (2005a).

*Bracketed results for the periods beginning in 1871 and 1926 also take into account the forgiveness of accrued interest and reductions in contractual interest rates. This provides a more comparable result with the periods that begin in 1980.

The data suggest that, prior to 1998, the period marked by the dominant operation of the CFBH held the most impressive record for efficiency of settlements (6.3 years on average). Of equal importance is the fact that this era required the smallest concessions on the part of private creditors for debt forgiveness over the past 135 years (12%).

This chapter intends to challenge the conventional wisdom about the role of the CFBH. Using the power-based analytical framework outlined earlier, we will demonstrate how the institutional capabilities of the CFBH, although not insignificant,

[181] Suter (1992), p. 86; See also Eichengreen (1991), p. 164; Eichengreen and Portes (1989), p. 21.
[182] Mauro and Yafeh (2003). Other private creditor representative bodies included: the Association Belge pour la Défense des Détenteurs de Fonds Public (Belgium); the Association Nationale de Porteurs Français de Valeurs Mobilières (France); the Caisse Commune des Porteurs des Dettes Publiques Autrichienne et Hongroise (France); the Committee of the Amsterdam Stock Exchange (Netherlands); the Conseil de la Dette Publique Repartie de l'Ancien Empire Ottoman (France); the Foreign Bondholders Protective Council (U.S.); and the League Loans Committee (Britain). See Winkler (1933), pp. 156-178.
[183] Suter (1992); Cline (1995); Singh (2003); Sturzenegger and Zettelmeyer (2005a).

were largely overshadowed by compulsory and structural regime elements that favoured private creditors and contracting houses beginning in 1870. We intend to show how the "accomplishments" of the CFBH were attributed incorrectly to the institution simply because it operated coincidentally with these other forms of power in the international system. Our analytical framework will also dispute the practice of equating – or confusing – the CFBH with the sovereign debt restructuring regime of the late 19th and early 20th centuries. Instead, we believe it to be more accurate to portray the institution as just one element of that regime.

This chapter will therefore present a systematic examination of the power capabilities - institutional, compulsory, structural and productive - that drove the sovereign debt restructuring process of the late 19th century. Our goal is to better illuminate how the 19th century debt regime came into being, how it produced the observed bargaining outcomes presented above, and which aspects of the regime were most responsible for driving those outcomes.

4.2 The World Before the CFBH

For most of the 19th century through the beginning of World War I, London enjoyed a pre-eminent role as the "money capital of the world."[184] From the 1820s to the 1860s, the British were considered to be one of the five major powers in the world system, eventually rising to "a position of international economic hegemony."[185] Britain was home to two of Europe's largest contracting houses, Baring Brothers and N.M. Rothschild. These houses were principally intermediaries who earned their fees by placing loans with private investors. For reputational reasons, they were keenly interested in underwriting bonds of high quality, since defaults reflected poorly on their judgment. However, as time passed, smaller and more short-sighted competitors joined the fray, hoping to participate in the highly profitable underwriting opportunities presented by international debt. These second-tier banks were less discerning about quality than the more visible Barings and Rothschild, thereby driving down underwriting standards and increasing the risks of default.

---

[184] Jenks (1927), p. 5; See also Aggarwal (1996); Aggarwal and Granville (2003).
[185] Aggarwal (1996), p. 19. The other four major powers were France, Prussia, Russia and Austria.

Prior to the establishment of the CFBH in 1868, the two most significant default episodes occurred in Latin America (1820s) and the United States (1840s). The newly established Latin American states had borrowed heavily in the 1820s to finance their wars of liberation from Spain as well as to smooth domestic consumption. In fact, between 1821 and 1825, they borrowed close to £48 million.[186] The purposes to which these loans were devoted - war and consumption - did little to enhance Latin America's longer term debt service capabilities. As a result, starting with Columbia in 1826, widespread defaults ensued.

While Latin America was falling into disrepute in the 1820s, the State of New York had borrowed successfully in the British markets for the construction of the Erie Canal; this project returned a handsome profit to bondholders who consequently showed an even greater interest in new issues of U.S. municipal governments. Both the southern and mid-western U.S. states were particularly eager to borrow so they could compete with New York, and set out ambitious targets for infrastructure projects and the internal development of state banking systems. The states' debt grew dramatically from $13 million in 1820 to $170 million in 1838.[187] When the Bank of England stopped accepting American paper for discount over concerns about creditworthiness, trade credits disappeared altogether. The first state to default was Pennsylvania in 1840. Widely considered to be one of the wealthiest states in the nation, the default came as a shock to British bondholders.

How were these default episodes addressed by bondholders? In Latin America, default settlement was sporadic. While Chile came to an agreement in 1842, agreements with other Latin American states were reached only in the 1850s, 1860s and 1870s, with the last agreement completed with Mexico in 1888. In the U.S., the defaulting states lost access to the British capital markets and therefore had to rely on internal resources to fund development. While the majority of states settled within the decade in order to regain British market access, other defaults dragged on into the 1860s and 1870s; Mississippi, which repudiated its debt, remains in default to this day.[188]

---

[186] Aggarwal (1996), p. 22.
[187] Aggarwal (1996), p. 23.
[188] Borchard and Wynne (1951b); McGrane (1935).

In response to the spate of pre-1870 defaults, the London financial press did allude to rumours about the establishment of a bondholder representative committee. However, this committee never materialized.[189] Instead, private creditors were forced to rely on temporary representative bodies to persuade sovereign debtors to settle. There were a number of evils associated with these private committees. According to Borchard and Wynne (1951a), they tended to:

> spring into being at the initiative of persons seeking to profit from the bondholders' need of having organized representation but who have otherwise...no connection with the defaulted issue, own no bonds, have little or no experience in the field, enlist a few distinguished names for façade, and then impose onerous and oppressive conditions on the bondholders...Aside from the desire to share in fees, membership in such committees is induced by a desire for public recognition, publicity, [and] inside information.[190]

In addition, it was often the case that the different creditor committees competed with one another, a state of affairs that did not always work to the advantage of private creditors.

Britain's experience with the defaults of the 1820s and 1840 helped the idea of a formal and permanent bondholder committee to gain wider acceptance. And, if this permanent body were accredited in some way, it would have greater political and financial authority to undertake negotiations with debtor states. Finally, as the early papers of the CFBH attest, the structure of the temporary committees:

> deprived them of such influence with either the home or foreign governments as would produce any practical result. The present purpose is to have a standing committee or council, the permanency of which will be an element of *power*, and composed of men of indisputable eminence in the financial world.[191]

4.3 The Creation of the CFBH and Institutional Power

What was it that finally prompted the creation of the CFBH? The literature provides several possible motivations. Some argue that it was the desire of issuing houses to

---

[189] McGrane (1935), p. 52. The British press discussed a permanent representative committee as early as 1843.

[190] Borchard and Wynne (1951a), p. 184.

[191] Archives of the Corporation of Foreign Bondholders (hereinafter, the "CFBH Archives") (1868-1869). Guildhall Library, City of London. File Ms34827. Extracts relating to the establishment of the CFBH. *Italics* mine.

assuage their conscience. They see the institutional innovation arising from a sense of obligation on the part of the bankers who were responsible for selling the bonds to the investing public, calling the CFBH the "conscience of the loanmongers."[192] Others maintain that the issuing houses wanted to see defaults cleared as quickly as possible so they would be free to issue new bonds for a previously defaulted state. In this narrative, the CFBH arose from the self-interest - not the conscience – of the private banks. In fact, the interests of the issuing houses have been cited as reasons for why, despite the widespread defaults of the 1820s and 1840s, the CFBH was not created earlier. Esteves (2005) argues:

> The intention to constitute a self-standing organization of bondholders met with the objections that it might be perceived as thwarting the action of the great financial houses and that foreign governments may react adversely, again damaging the position of the issue houses. As a result, the latter had to be co-opted into the Council.[193]

Jenks (1927) agrees and documents that the majority of the Council that ran the CFBH was composed of bankers or members of the brokerage houses.[194]

Lastly, there are arguments that detect the hand of the British government at work, hoping that a permanent body would provide sufficient incentives for British capitalists to continue to lend overseas, a practice that had an enormously positive effect on the British economy through the City of London.

4.3.1 The CFBH: The Progeny of British Bankers and Politicians

The founder and first president of the CFBH, Isidor Gerstenberg (1821-1876) has largely been forgotten in the secondary accounts that narrate the origins of this private bondholder representative body, despite the fact that he was singularly responsible for bringing it about.[195] It is helpful to recount some of Gerstenberg's story, since it serves to illustrate the proximate motivations for the establishment of the CFBH.[196]

---

[192] Jenks (1927), p. 288.
[193] Esteves (2005), Appendix I.
[194] Jenks (1927).
[195] Gerstenberg's name appears only once in the account of Borchard and Wynne (1951a), and does not appear in any other secondary sources concerning the CFBH. We are able to recount his contribution from archival sources only. Ironically, Gerstenberg was a close friend of Ferdinand Lassale, who later became a German socialist leader with ties to Marx. Lassale sent Marx to Gerstenberg for financial help when Marx

Gerstenberg was born in Breslau, Germany in 1821, and was sent to his uncle in Manchester in 1841. There he represented Abraham Bauer, a textile merchant of Hamburg. He was quickly singled out for his talents and abilities, and, at the age of 20, he was relocated to London to become the representative of Abraham Bauer & Co., an acceptance house, in the City.[197] As a banker, Gerstenberg was a well-known figure in the city and had first-hand knowledge of the defaults of foreign governments which involved, in his view, great losses to the investing public. He had been identified with several of the temporary bondholder committees which had dealt with the aftermath of defaults in Latin America, most notably Venezuela.

In his earliest attempts to gain support for a permanent bondholder representative body, he tried to creatively enlist the support of Baring Brothers, the leading contractor of foreign loans in the City. To get their attention, he wrote:

> the ad hoc committees in their unsuccessful endeavours to protect the interests of bondholders had allowed the excellent opportunity to escape of acquiring the territory of California for [Britain].[198]

According to Gerstenberg, California had been offered by the Government of Mexico, to whom it then belonged, in part payment of its defaulted debt to British bondholders. But "the opportunity, he deplored, was missed."[199] He hoped that his appeal to a sense of national self-interest in an age of imperial ambition would bring Barings on board. Gerstenberg further argued that the plan he was proposing was "one calculated to supply

---

was living in London. So, the intellectual progenitor of socialism received assistance from one of the earliest champions of the rights of global capitalists. See CFBH Archives (1950-1952). File Ms34603, Vol. 2, Document 327/1163R. Isidor Gerstenberg biography.

[196] CFBH Archives (1821-1876). File Ms34829. Presidents of the Council. There are a few reasons why Gerstenberg may have been written out of the history of the CFBH. His contribution could have been underestimated since he had to resign his leadership position of the CFBH quite early (in 1875) due to poor health. He then met an untimely end in an unexpected accident on a ferry crossing from Ostend to Dover in 1876. However, the more likely reason is that he disagreed with his successor, Sir John Lubbock, on the institutional form of the CFBH. Gerstenberg supported a profit-making CFBH, and in its original form the Corporation did make considerable profits. Its conversion in 1873 into a non-profit organization was due to the fact that the majority of its leaders supported Lubbock in his view that it was unseemly that an institution charged with representing British capital before foreign debtor governments should be motivated by pecuniary interests.

[197] He became a naturalized citizen in 1847 and a member of the Stock Exchange in 1852. At the age of 38 (1860), he married Bauer's youngest daughter.

[198] CFBH Archives (1938). File Ms34828. Reprint from the *Transactions of the Jewish Historical Society of England, Vol. XVIII.*

[199] CFBH Archives (1938). File Ms34828. Reprint from the *Transactions of the Jewish Historical Society of England, Vol. XVIII.*

a great public want and likely confer a boon upon the Bond-holding community" of Britain.[200]

Baring Brothers indicated that they could not get directly involved in Gerstenberg's project since they underwrote a large proportion of these bonds and perceived a conflict of interest. In other words, they were concerned that their good relationships with sovereign issuers might be threatened if Barings openly supported a committee to assist private bondholders.[201] However, Gerstenberg did not leave empty-handed; Thomas Baring offered him a number of useful contacts through which to pursue his idea. One such person was Frances Levien of the London Stock Exchange. After two years of exploration and negotiation, they called the now historic meeting at the London Tavern on the 11th November, 1868, at which "the foundation of the Council was laid."[202] It was presided over by the Right Hon. George Goschen, statesman and financier. Goschen, of the firm Fruhling and Goschen, and also a cabinet minister, adopted the proposition forwarded by Gerstenberg. The motion was seconded by Charles Bell, MP, also of the financial firm Thomson, Bonar, and Co. The men agreed that "watching over and protecting the interests of holders of foreign capital is extremely necessary and desirable."[203]

It is important to point out that the majority of the founding members of the CFBH had existing - or previous - associations with private or merchant banking firms as well as brokerage houses. Since many of these firms were also large underwriters of sovereign bonds, they were interested in maintaining as open a market as possible for these bonds. And, because they appeared to have interests that were aligned with bondholders – to settle defaults expeditiously and maintain sovereign debtor access to the capital markets – their motivations were not initially questioned.[204]

---

[200] CFBH Archives (1938). File Ms34828. Reprint from the *Transactions of the Jewish Historical Society of England, Vol. XVIII.*

[201] The conflict of interest perceived by Barings is not one that investment banks acknowledge today. Today's firms accept that they can both underwrite bonds and then act as a settlement advisor if those bonds end up in default, earning fees for both services.

[202] CFBH Archives (1938). File Ms34828. Reprint from the *Transactions of the Jewish Historical Society of England, Vol. XVIII.*

[203] CFBH Archives (1950-1952). File Ms34603, Vol. 2, Document 327/1163R. Isidor Gerstenberg biography.

[204] Jenks (1927), p. 289.

Gerstenberg suggested that the "none but gentlemen of position and influence ought to be invited to form the Council." It was to be composed of men that would inspire great confidence in the bondholders. The Members of Parliament for the City of London were seen as being the most desirable, since their governmental influence would be of great assistance to the institution. The Chairman of the Stock Exchange was also invited.[205] In fact, of the first batch of eleven members of the Council, there were four MPs, all of whom had strong ties to the City of London.[206]

At the founding, Gerstenberg noted how the CFBH had received the support of "some of the great houses, such as those of Louis Cohen and Sons, Thomson, Bonar and Co., Horsman and Co., and G. and A. Worms."[207] The CFBH boasted that it was "vitally connected with the trading and financial interests of the City of London, the centre of all loan operations in the world."[208] In fact, Mr. Charles Bell, of the firm Thomson, Bonar and Co., reported at the CFBH's inaugural meeting:

> no greater proof of the vast importance of the question and the interests involved could be afforded than the attendance of the heads of so many eminent banking firms and financial houses at that meeting.[209]

Bell had no doubt that a council composed along the lines suggested by Gerstenberg would carry great weight with the British government. However, in light of the close connection between the CFBH and important financial houses like Balfour, Grenfell and Hambros, there were legitimate concerns that the institution would be particularly liable to pressure from City financiers.[210]

4.3.2 Institutional Form and Funding of the CFBH

When the CFBH was first formed in 1868, the body was initially called the Association of Foreign Bondholders. It was capitalized with £60,280 at 5% interest, with the funds coming principally from loan contracting houses. Only one bond at £100 each

---

[205] CFBH Archives (1869). File Ms34827, Clipping from the *Morning Post*, February 3, 1869.
[206] CFBH Archives (1869). File Ms34827, Clipping from the *Times*, February 3, 1869.
[207] CFBH Archives (1868). File Ms34827, Clipping from the *Morning Herald*, November 12, 1868.
[208] The Corporation of Foreign Bondholders (1873-1987), Report of 1876, p. 9.
[209] CFBH Archives (1868). File Ms34827, Clipping from the *Morning Post*, November 12, 1868.
[210] Platt (1960), p. 25.

was offered to each permanent member. However, these bonds were transferable (and perpetual) certificates of membership that would survive the repayment of the original £60,280 of capital.[211] Operating expenses were normally reimbursed by the payment of a moderate commission by the foreign government with whom the CFBH arranged a debt settlement. And, where that condition could not be met, the bondholders would be asked to assume the payment on a pro-rata basis. In practice, however, it was very rare for the bondholders to assume the payment of commissions.[212]

The organization was renamed the Corporation of Foreign Bondholders when it was transformed into a not-for-profit organization in 1873 under License from the Board of Trade pursuant to the 23rd Section of the Companies Act. This process also permitted it to enjoy limited liability without having the word "limited" in its title. Since the CFBH was no longer focused on profit-making activities, any original subscribers who wanted to be paid out were permitted to withdraw. However, most remained and were eventually paid out in full in 1885. Once the CFBH had achieved non-profit status, any commissions that were earned were directed to supporting the public work of the organization. If a surplus remained after defraying the expenses of the CFBH, it became part of the General Fund of the institution, which was held in trust for the benefit of British investors; none of the official members of the CFBH had any interest in the surplus funds beyond the sums that were fixed for their remuneration by Parliament.[213]

It is important to remember that when the CFBH was first established, its mission was twofold: to protect the rights of bondholders *and* to maintain the public credit of foreign governments.[214] By pursuing the latter goal, the issuing houses were to be assured a steady stream of business.

As Jenks (1927) reminds us, the activities of the City of London at this time were more individual than corporate:

> Sixty odd merchants and bankers competed in ever shifting combinations to derive their maximum advantage from public needs...In the rapidly growing caste of "made men," bankers and brokers found themselves aristocrats. Politicians sought their favors and bestowed them with honors...The Barings,

[211] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, pp. 6-7.
[212] CFBH Archives (1890). File Ms34828. Memorandum from Sir John Lubbock, February 24, 1890.
[213] The Corporation of Foreign Bondholders (1873-1987), Report of 1924, p. vi.
[214] CFBH Archives (1880). File Ms34587, Rules and Regulations of the CFBH, February 19, 1880.

> who had migrated from Germany two generations before blossomed into the baronetage with an Anglo-Saxon pedigree.[215]

As time progressed, there were allegations that the banks and brokers "sometimes enjoyed a majority, or, at least, a blocking position in the organizations set up to protect the interests of the principals [the bondholders] during the settlement of defaulted bonds."[216] In fact, in 1897 the *Economist* reported:

> a powerful influence is exercised upon the bondholders by the issuing houses, who find it practically impossible to do fresh business with the borrowers while the default lasts, and who are, therefore, naturally anxious that some sort of settlement be arrived at, more especially as settlements of the kind, yielding substantial pickings in the way of commissions, are frequently followed by new loans.[217]

Since the CFBH meant to protect the rights of bondholders and maintain the credit of foreign governments, it was vital for sovereign defaults to be cleared in order that debtor states could renew their capital market access. The second objective indirectly benefited the large issuing houses in London, who were precluded from doing new issue business with a defaulted sovereign. The CFBH did eventually draw criticism for being too willing to settle quickly. There were also charges that the organization agreed to settlements that were not as favourable to bondholders as they should have been due to the excessive influence within the CFBH of the contracting houses.[218] Others have pointed out that it was not only the contracting houses that pushed for settlements, but also the CFBH, since it did not get paid its fees on issues that remained in default.[219]

Borchard and Wynne (1951a) note the growing public opprobrium in the 1880s and 1890s over allegations that the CFBH was serving limited interests at the expense of the bondholders.[220] As these allegations grew, the permanent certificate holders of the CFBH began to look covetously upon the substantial fund - around £100,000 - that the

---

[215] Jenks (1927), p. 19.
[216] Esteves (2005), p. 6.
[217] The *Economist*, Vol. 55, 1897.
[218] Mauro and Yafeh (2003), p. 14.
[219] Lipson (1985b), p. 46.
[220] Borchard and Wynne (1951a), p. 206. See also Esteves (2005), Appendix I: "the British Corporation of Foreign Bondholders was repeatedly accused in its first two decades of existence of yielding excessively to pressure from the issue houses. In 1898, the Corporation was reorganized by an act of Parliament that took heed of these problems by ruling for a minority of representatives of issue houses in the governing body of the Corporation."

organization had amassed by 1896. Two years later, many of these same members were agitating to return the CFBH to a profit-making body.[221]

To avert a potential standoff with the investing public on this issue, the management of the institution requested that it be reincorporated under a special act of Parliament. In 1898, the Corporation of Foreign Bondholders Act was passed, creating a quasi-public body and entrusting it with the duty of watching over and protecting the interests of foreign bondholders.

While many of the functions of the CFBH were retained, the management of the operation was materially reconfigured so as to reduce the influence of the private loan houses in the decision-making process. This in part helped to address some of the public concerns about the power of the banks within the CFBH and to give bondholders more direct management oversight. Beginning in 1898, control of the CFBH was vested in a council that consisted of twenty-one members.[222] Within this group, representation was apportioned as follows:

- six members were nominated by the British Bankers Association;
- six members were nominated by the London Chamber of Commerce;
- and, nine members were chosen from the bondholding public.[223]

The new structure gave private bondholders a seat at the management table along with powerful firms in the City of London as well as a larger voice in decision-making. It is interesting to note that the CFBH viewed itself as only the first step in protecting bondholder interests and had ambitions for a global network of protective institutions:

> This Council deems it of importance to the interests of bondholders and the maintenance of public credit in general, that institutions similar to ours should gradually be formed in most, or if possible, in all financial centres, and that

[221] Borchard and Wynne (1951a), p. 206. See also CFBH Archives (1970). File Ms34603, Vol. 9, Document 327/1708. Letter from CFBH to Bank of England. In 1970, an internal document appears which sheds light on how the CFBH was funded after most of the defaulted debts had been settled. The CFBH received a £15,000/year subsidy from the Bank of England, as well as unofficial contributions from the clearing banks, the British Insurance Association, and the Association of Investment Trust Companies.
[222] CFBH Archives (1898). File Ms34587, Master Copy of the Corporation of Foreign Bondholders Act, 1898.
[223] The Corporation of Foreign Bondholders (1873-1987), Report of 1924, p. v.

whilst acting locally for their immediate constituents, they should co-operate with each other for the common cause.[224]

In fact, some measure of cooperation was achieved with the Continental and U.S. representative bodies that developed between 1898 and 1933. These included the Association Belge pour la Défense des Détenteurs de Fonds Publics (Belgium); the Association Nationale de Porteurs Français de Valeurs Mobilières (France); the Caisse Commune des Porteurs des Dettes Publiques Autrichienne et Hongroise (France); the Committee of the Amsterdam Stock Exchange (Netherlands); and, the Foreign Bondholders Protective Council (U.S.).

4.3.3 The Operational Rules of the CFBH

How did the CFBH work? The earliest handwritten minutes (1873-1877) provide an excellent overview of the operation of the institution. Meetings were generally concerned with appointing individuals to various sub-committees which were ostensibly dedicated to country-specific negotiations. Some of these committees had a status that was more or less permanent, especially if they were dedicated to covering a serial defaulter. The minutes show that up to 20 committees were active at any point in time.[225]

4.3.3.1 The Negotiation and Default Management Process

The President and Vice-President of the CFBH were *ex-officio* members of all committees. They also monitored the progress of each negotiation and would often adopt legal measures, like granting powers of attorney to various representatives, so that they would be authorized to act for the CFBH with foreign governments. Committee members would travel to the defaulting country and meet with the finance minister or even the country's chief executive. They would conduct their own negotiations and then return to London. In consultation with the Council, they would present a proposed restructuring plan to the membership, usually in a general meeting of bondholders. The minutes also reproduced various texts of telegrams from overseas negotiators updating the CFBH on their progress.[226] Technically, the CFBH had no power to legally bind investors; it could

[224] CFBH Archives (1874). File Ms34589, Vol. 1.
[225] The Corporation of Foreign Bondholders (1873-1987), Report of 1903.
[226] CFBH Archives (1873-1877). File Ms34589, Vol. 1.

only make a recommendation. However, given the limited avenues of recourse available to bondholders, CFBH recommendations were generally accepted. According to the organization's management, "dissentients were ultimately convinced."[227]

4.3.3.2 Bondholder Meetings

In order to help with investor persuasion, the CFBH would organize bondholder meetings for the purpose of communication, education, and decision-making on a particular offer of settlement. A permanent headquarters was established at 25 Moorgate to facilitate these processes. The table below illustrates the manageable size of most bondholder meetings, averaging between 50 and 200 individuals.

Table 4B: Sample Size of CFBH Bondholder Meetings[228]

Defaulting Country	*Date of Bondholder Meeting*	*# of Bondholders Present*
New Granada	1872	70
Santo Domingo	1873	143
Santo Domingo	1874	83
Costa Rica	1874	200
Santo Domingo	1875	60
Venezuela	1880 (January, 27)	103
Venezuela	1880 (September 2)	48

Source: CFBH Archives: Files Ms15806, Ms15801; Ms15779; and, Ms15772.

4.3.3.3 The Role of the Financial Press and the CFBH Library

The role of the CFBH reading room was important. The CFBH subscribed to a host of English language newspapers globally, and was diligent in clipping from those papers any item which would be of interest to British bondholders, especially those which had to do with finance, commerce, railways, public works and political economy. Sometimes, there would be multiple clippings in a single day, and it was often the case that an interested party could follow a single country's political and economic progress over the course of years. The level of detail was also impressive. For example, the

[227] The Corporation of Foreign Bondholders (1873-1987), Report of 1874.

[228] CFBH Archives (1880). File Ms15806, Vol. 2. Venezuelan Committee Minute Book; CFBH Archives (1873-1874). File Ms15801, Vol. 1. Santo Domingo Committee Minute Book; CFBH Archives (1869-1880). File Ms15801, Vol. 2. Santo Domingo Committee Minute Book; CFBH Archives (1874-1885). File Ms15779. Costa Rica Minute Book; CFBH Archives (1872). File Ms15772. New Granada and Columbia Minute Book.

Economist (1874) provided its readers with a full accounting of the finances of Egypt. All sources of revenue were accounted for, including tithes on land and date trees, taxes on industry and commerce, and receipts from the Egyptian railway administration.[229] The *Financier* (1873) lists amounts received on the external debt of Turkey broken down by type: tobacco, salt and spirits taxes, land taxes, tithes, and sheep taxes.[230] Appendix 4A provides a detailed list of all publications that appeared in the clippings files for selected countries. Over sixty periodicals could be found in our samples on a regular basis in country-specific volumes. In many cases, the clippings followed events on a daily basis, demonstrating the interest and depth of knowledge of the British investing public in the status of CFBH negotiations. The CFBH also arranged lectures and discussions on subjects of interest to its members on a periodic basis in the Hall of the Councilhouse. And, it placed at the disposal of bondholders very valuable and often confidential information that it received from its agents operating in various countries. It is likely that the availability of such information helped facilitate coordination among creditors.

4.3.3.4 Answering Bondholder Queries

The CFBH soon became the focal point for all inquiries from British bondholders regarding overseas loans. This meant that the organization had to be sufficiently staffed to receive and respond to requests from the British investing public, as well as from other national bondholder associations and interested parties in the British government. By way of illustration, a file containing Santo Domingo loose correspondence from 1900-1918 contained approximately 675 letters from individual bondholders making queries about the status of the negotiations. This file also contained correspondence from French and Belgian bondholder associations. Finally, there were letters from seemingly helpful contributors who were visiting Santo Domingo and trying to offer "on the ground" intelligence to the CFBH. This file gives one a sense of the enormity of the paperwork that the staff of the CFBH had to deal with on an ongoing basis.[231]

[229] CFBH Archives (1874). Clippings File, Egypt, Vol. 1. *Economist*, June 27, 1874.
[230] CFBH Archives (1873). Clippings File, Turkey, Vol. 2. *Financier*, September 6, 1873.
[231] CFBH Archives (1900-1918). File Ms34780. Loose correspondence regarding Santo Domingo.

4.3.3.5 Rules for Preventing Inter-creditor Inequity

While inter-creditor inequity is a problem that has become increasingly common in today's sovereign debt restructurings, in 1877, the CFBH established a rule that "no settlement with foreign creditors would give preferential treatment to any class of investors."[232] This resolution grew out of problems encountered with the Turkish settlement in the 1870s, when those creditors that had easily accessible collateral (in the form of Egyptian tribute payments held at the Bank of England) pursued their own negotiations and fared better than fellow bondholders whose collateral was held in Turkey.

4.3.3.6 CFBH Ethics

The CFBH exhibited a high degree of ethics. No archival evidence pointed to any accusations of wrongdoing or bribery. The rules and regulations of the Council did include the power to remove an official for taking any personal benefit for the relief of bondholders and also prohibited him from engaging on his own account in any trade or profession, unless special permission were given by the CFBH. He was also prohibited from any "insider trading" of securities under negotiation.[233] It seems that the CFBH was designed to be as far above reproach as possible.

4.3.4 Bondholder Incentives to Accept CFBH Settlement Offers

Why were bondholders so compliant when it came to CFBH settlement recommendations? The record shows that in virtually all cases, bondholders agreed to accept the terms of settlements negotiated by the institution on their behalf, despite the fact that it had no power to legally bind individual investors.[234] While the institution was clearly proficient at bondholder education and organization, we would argue that the willing acceptance of settlement proposals is better explained by two, historically-specific reasons, both of which restrained bondholders from successfully launching autonomous action against defaulting states: i) strict adherence to the doctrine of sovereign immunity, and ii) the need to manage complex, international collateral pools.

[232] Borchard and Wynne (1951a), p. 419.
[233] CFBH Archives (1880). File Ms34587, Rules and Regulations of the CFBH, February 19, 1880.
[234] We even find examples where bondholders accept settlements which the CFBH does not recommend.

i) Lack of Commercial Carve-outs to the Doctrine of Sovereign Immunity: In the 19th century, the doctrine of sovereign immunity made it virtually impossible for private creditors to sue sovereign states, and in the rare instances where they tried, judgments were largely uncollectible.[235] For example, in the case against the state of Virginia, bondholders brought their claims to the U.S. Supreme Court, and even though they succeeded in getting a favourable judgment, they failed to collect on it. And, to make the process even more difficult for the aggrieved investors, local bar associations made sure that any lawyers attempting to represent British bondholders ran the risk of losing their license to practice.[236]

It wasn't until the 1970s that we saw any formal reinterpretation of the doctrine of sovereign immunity with respect to government borrowings. In 1976, under the U.S. Foreign Sovereign Immunities Act and in 1978, under the U.K.'s State Immunity Act, governmental activities that could be construed as commercial could also be subject to the standard precepts of commercial law. This permitted individual creditors to bring suit against a defaulting state in the country of issue (usually New York or London) freeing them from the vagaries of local courts.

ii) Predominance of Collateralized Bonds: Bonds in the 19th and early 20th centuries were often secured by tangible assets, such as railways or even tax or customs revenues. Railway finance bonds alone accounted for more approximately 40% of British overseas investments in the 1870-1914 period.[237] Taking control of and administering a railway or a customs house required significant resources and therefore benefited from centralized organization. And, if creditors felt they had no other option than to request their government to intervene by use of force to foreclose on collateral, a respected organization with close governmental ties was better positioned to execute this task than an individual creditor. In fact, most collateralized bond examples come from the 1870-1914 period.

[235] Borchard and Wynne (1951a).
[236] Mauro and Yafeh (2003), p. 23. Other attempts at legal redress included Costa Rica (1874), Brazil (1897), and New Zealand (1901).
[237] Bordo, Eichengreen et al. (1998); Fishlow (1986); Eichengreen and Fishlow (1996).

Table 4C: Sample Collateral Offerings from Sovereign Debt Instruments (1854 – 1909)[238]

Borrower	*Date(s) of Loan*	*Collateral*
Egypt (Daira Loans)	1870; 1877	Hypothecation of real estate owned by Khedive of Egypt
Columbia	1854	Revenue from tobacco monopolies
Columbia	1861	Thirty hectares of land
Costa Rica	1872	Revenue from liquor and tobacco monopolies
Ecuador	1908	Revenue from salt monopolies
Nicaragua	1909	Revenue from tobacco monopolies
Costa Rica	1871; 1872	State-owned railways (enterprise)
Honduras	1867	National forests (enterprise)
Santo Domingo	1869	National forests (enterprise)
Greece	1881	State domains
Honduras	1870	State domains
Peru	1909	Salt tax
Tunisia	1864	Olive tree tax
Turkey	1863 – 1908	Sheep tax
Turkey	1854; 1871; 1877	Tribute payment from Khedive of Egypt paid to an account at the Bank of England

Source: Borchard and Wynne (1951a)

Prior to the outbreak of hostilities in World War I, the CFBH was able to boast the settlement of all defaulted sovereign bonds with only two exceptions: Honduras, which had been in default since 1873, and the intractable U.S. State of Mississippi, whose 1840s default remains to this day.

The CFBH survived as an institution until 1988, when, after arranging for the settlement of in excess of $1 billion in foreign bonds, the decision was taken to liquidate it. Spurred by agreements to settle pre-1917 claims against the Soviet Union and pre-1949 claims against China,[239] Mr. Eric French, the council's manager, said: "The outstanding defaults were not large enough to justify keeping the organization going."[240]

4.3.5 Assessing Institutional Power

The CFBH was a useful institutional innovation insofar as it centralized bondholder negotiations with defaulting sovereigns, educated the bondholding public,

[238] Borchard and Wynne (1951a), p. 90.

[239] CFBH Archives (1988). File Ms34618. Clipping from the *Guardian,* April 21, 1988. The CFBH was furious with the terms of the Chinese deal, since the British government accepted an inferior deal so as to open up the London bond markets to China, which had been banned by the Bank of England since the default in the 1940s.

[240] CFBH Archives (1988). File Ms34618. Clipping from the *Financial Times,* April 21, 1988. The unsettled debts included the State of Mississippi ($7 million) as well as the City of Dresden and the Free State of Saxony, then part of East Germany (£800,000).

offered assurances of equitable treatment, performed important administrative services, and operated with a high degree of integrity. However, despite these characteristics, we would argue that its effectiveness was largely tied to aspects of the sovereign debt restructuring regime that lay outside the institution - most notably the structural power of British capital and the willingness of Britain to use compulsory power in ways that often benefited bondholder interests. In other words, it was not the rules, staffing, funding and procedures of the CFBH that were chiefly responsible for producing bargaining outcomes in the 19th and early 20th centuries. Instead, these outcomes can be attributed to the dominance of the British capital markets and the use of a wide range of sanctions on defaulting states - from moral suasion to military intervention – by the British government and its representatives. The role of the CFBH largely consisted of leveraging these elements of power - elements that were external to the institution but part of the regime for sovereign debt management. In the discussion which follows, we will examine the important contributions of structural and compulsory power to bargaining outcomes in this period and attempt to answer the question: How successful would the CFBH been without them?

4.4 Structural Power

After the Napoleonic Wars and for most of the nineteenth century, Great Britain assumed a hegemonic position as a result of its supremacy in production and commerce. As the leading centre of international capital accumulation, British markets were the main source of long-term borrowing for developing states.[241] The sheer size of British foreign investment was compelling, quadrupling between 1854 and 1874, and then quadrupling again before World War I:

Table 4D: Pre-World War I British Foreign Investment[242]

Total British Foreign Investment (1854-1913)	*£ (millions)*
1854	245
1874	1,104
1894	2,155
1913	3,990

Source: Lipson (1985b)

[241] Suter (1992), pp. 26-39.
[242] Lipson (1985b), pp. 40-41.

In fact, during the period 1870-1913, only four countries accounted for 85% of the entire stock of international investment: Britain, at 44%, had a market share that was more than double that of France, its closest competitor. Germany lagged at 13%, and the United States, employing most of its capital domestically, exported an anaemic 8% of the global total.[243] Britain's highly visible position as chief capital exporter in the 19th century was therefore an important structural reason why a private bondholder representative body emerged there first.

Table 4E: European and U.S. Shares of Foreign Investment Stocks (1870-1913)

Country	*Britain*	*France*	*Germany*	*United States*	*All Other*
Share of Foreign Investment (1870-1913)	44%	20%	13%	8%	15%

Source: Fishlow (1986)

Another structural variable appears to determine the timing of the establishment of the CFBH: the onset of the first Great Depression of the 1870s. This crisis more than doubled the number of default cases from the previous era – from 25 to 52. Since the private bondholders most affected by the sharp rise of state insolvencies were British, it is not surprising that the CFBH was formally licensed by Britain's Board of Trade in the early 1870s.[244]

Table 4F: Number of Sovereign Defaults (1821-1975)[245]

Default Settlement Periods	Number of Cases
1821 – 1870	25
1871 – 1925	52
1926 – 1975	37
Total: 1821 – 1975	Total Cases: 114

Source: Suter (1992)

What role did structural power play once the CFBH had been established? There are two key aspects of structural power that emerge in the literature concerning the

[243] Fishlow (1986). Today's markets are more highly dispersed as follows: English law (41%); New York law (35%); Japanese law (10%); German law (7%). See Becker, Richards et al. (2001).
[244] Borchard and Wynne (1951a), p. xxiii.
[245] Suter (1992), p. 91.

CFBH. First, many have argued that the CFBH's principal sanction was its ability to withhold credit.[246] In other words, governments that defaulted on debt to British bondholders would be denied fresh access to the British capital market until such time as an acceptable settlement had been agreed with bondholders.[247] The second aspect of structural power concerns the coordination between London, Continental and American exchanges to ban defaulting states from issuing new debt globally. This is an activity which Lipson (1985b) referred to as a "self-interested manipulation of the centralized, transnational financial system."[248] We will examine each of these aspects of structural power in turn.

4.4.1 Withholding Credit

That the CFBH acted as a 19th century gatekeeper for the most liquid capital market in the world is a power ascribed to the institution by virtually all secondary accounts. Even the CFBH itself makes this connection. In its Annual Report of 1873, CFBH management writes:

> The very association of Bondholders brings with it elements of independent influence, the full value of which is little appreciated. It does not lend money like the great financial establishments and parties of bankers...but the negative power of withholding money...exercises its own influence when applied at a proper time.[249]

Lispon (1985b) agrees, arguing that "short of active government intervention, [the CFBH's] most powerful weapon was the denial of further credit."[250] And, Esteves (2005) writes:

> The main contribution of bondholder's organizations was their ability to...align the sovereign's incentives through a reputational mechanism, making it harder for a defaulting government to refinance itself in the

[246] Platt (1960), p. 32.
[247] Platt (1960), p. 33. And, even more draconian sanctions were reserved for debtor states refusing good faith negotiations with the CFBH; they could find all of their existing debt de-listed from the London exchange.
[248] Lipson (1985b), p. 46.
[249] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, p. 60.
[250] Lipson (1985b), p. 46.

> international capital market before it had settled its old debt with its creditors.[251]

While there is wide agreement in the literature that the power of withholding market access from a defaulting sovereign resided with the CFBH, it was actually the case that this rule was adopted independently, by the London Stock Exchange in 1827, well before the CFBH came into existence. According to *The Law and Customs of the Stock Exchange*:[252]

> The Committee will not recognize new bonds, stock or other securities issued by a foreign government that has violated the conditions of any previous public loan raised in this country, unless it shall appear to the Committee that a settlement of existing claims has been consented to by the general body of bondholders.[253]

Even Judge Snagge, the chief counsel of the CFBH confessed that "the Corporation would be *powerless*, and the Council would be *paralyzed*, if it were not for the assistance it received from the Stock Exchange."[254] In other words, the power to control market access resided not with the CFBH, but with the Stock Exchange. And, the power of the Stock Exchange was in turn defined by the size and scope of the British money markets. The CFBH's role in this instance was confined to nothing more than notifying the Stock Exchange of a default or a settlement.

The ability of structural power to trump institutional power in this instance can be illustrated simply. If the CFBH or Stock Exchange were based in Belgium in the 19th century rather than Britain, the rules excluding defaulters from market access would have had little impact on the behaviour of defaulting states. The rules were only powerful because these institutions were located within the world's largest and most liquid capital market.

Can we find empirical support for the efficacy of the rules banning defaulters from obtaining new credit in the British markets? Empirical research credits the

---

[251] Esteves (2005), p. 2.; See also Tomz (2001) and Tomz (2004) for arguments in favor of maintaining a reputation that ensured continued capital market access as the principal incentive for sovereign debt repayment.
[252] Lipson (1985b), p. 154.
[253] *The Law and Customs of the Stock Exchange* (1905). Rule 63, p. 179.
[254] Platt (1960), p. 34. *Italics* mine.

settlements of many mid-19th century U.S. state defaults with the ability of the Stock Exchange to successfully withhold market access until a mutually agreed settlement was concluded. This is instructive because these defaults occurred in the period prior to the establishment of the CFBH. Cole, Dow et. al (1995) and English (1996) argue that it was virtually impossible to punish a defaulting U.S. state with trade embargoes, since free trade within the U.S. would allow goods shipped to non-defaulting states to cross defaulting state lines. Even more important, eliminating trade with the U.S. as a whole would have been extremely damaging for the British economy. The ultimate direct sanction – war - was out of the question since any military campaign waged against a single U.S. state would have provoked an immediate response from the federal government. English (1996) argues that even though these more aggressive tactics were impractical, most states eventually repaid their debts. He maintains they did so because in the important years leading up to the Civil War, those states that settled with British bondholders were rewarded with access to British and European capital markets.[255] It was therefore this incentive that drove repayment.[256]

It was also the case that British bondholders did not distinguish between the credit of the U.S. federal government and that of its constituent states. This meant that as long as U.S. state defaults continued, the U.S. federal government would have a difficult time issuing debt in Europe. In fact, in the summer of 1842, when agents for the United States Treasury came to London to solicit a loan, they got an unexpectedly chilly reception from bankers:

> 'You may tell your government,' said the Paris Rothschild to [the United States representative] Duff Green, 'that you have seen the man who is at the

[255] English (1996), pp. 259-268. For example, neither Mississippi nor Florida (non-payers) issued new bonds in the period before the Civil War. Also, the British press frequently connected market access with prosperity: "The repudiator denies that credit will restore prosperity...but the history of the world shows that, with all nations, sound credit has resulted in prosperity. Pennsylvania and Maryland both made an experiment in repudiation...Their industries languished, their affairs...sank down to the bottom. Imbecility, peculation, maladministration, and ignorance ruled both States, until, when, at the worse, the people rose in their might, with returning good sense, and gave their affairs into the hands of their best men, saying to them, settle this matter honestly and fairly and it was settled. From that very day they began to progress, and their prosperity has exceeded that of most States of the Union." See CFBH Archives (1880). Clippings File, Arkansas, Mississippi, Tennessee, Vol. 1. *Financial Chronicle*, October 2, 1880.

[256] Cole, Dow et al. (1995), p. 365; English (1996).

> head of the finances of Europe, and that he has told you that they cannot borrow a dollar, not a dollar.'[257]

It was not only in the case of the U.S. that attempts were made to regionalize otherwise isolated instances of default. The same tactic was used in the case of Venezuela in 1874 to encourage neighbouring states to pressure the offending government into a settlement:

> The treachery displayed by the Government of Venezuela is without parallel in the financial history of the world, and ought to stand as a beacon warning the public against investing in South American Securities...Unfortunately, the injury done by Venezuela is not limited to her own Securities, but will have a blighting influence on all other South American Stocks, whether deserving or not.[258]

Of course, withholding market access was only a useful sanction so long as a debtor state needed to raise foreign capital. The objectives of the CFBH were consistently thwarted by those defaulters that "neither wished nor wanted to regain access to the London capital markets or to Europe more generally."[259] Once again, this implies that structural factors were more salient in determining the outcomes of the default settlement process than the institutional rules and procedures of the CFBH.

On this same point, the financial press was quick to point out how a defaulted borrowers' need for fresh capital affected the bargaining leverage of the CFBH:

> The Council's task in the future may be more formidable than ever before...If debtors no longer need, or choose, to borrow afresh, or if the British capital market is no longer free, by choice or necessity, to meet their needs, the Council's task may call for almost superhuman skill and tact.[260]

Certainly, the keener a country's desire for new loans, the more cooperative its posture toward the CFBH.[261] And, during the 19th and early 20th centuries, most settlements were followed by a "prompt return of the outcast to the foreign capital markets almost as soon as the ban on exclusion was withdrawn."[262]

---

[257] Jenks (1927), p. 106.
[258] CFBH Archives (1874). Clippings File, Venezuela, Vol. 1. *Financier*, August 18, 1874.
[259] Mauro and Yafeh (2003), p. 13.
[260] CFBH Archives (1938). File Ms34828. Clipping from the *Economist*, April 2, 1938, pp. 16-17.
[261] Borchard and Wynne (1951a), p. xxiv.
[262] Borchard and Wynne (1951a).

4.4.2 Coordination Among British, Continental and U.S. Exchanges

In attempts to further improve its bargaining leverage, the CFBH established informal ties with bondholder representative bodies in Europe, and eventually, the U.S. While the British organization recognized the "power of withholding money" in its own capital markets, it saw the potential to consolidate power more generally by engineering global bans on capital access for defaulting sovereigns. According to the CFBH, the success of such an endeavour depended upon "a real and cordial union with our friends in Holland, Germany, France and Belgium; and [was]...greatly promoted by that disposition to maintain public credit in the United States."[263]

The CFBH reported that it was "in friendly relations with the presiding bodies of the Continental money-makets," making specific references to them in the Annual Report of 1873:[264]

> The Council finds a strong disposition [in France] to cooperate as before...Also, the relations of the Council with the Bourses of Amsterdam and Rotterdam are constant because Holland for centuries has taken part in financial operations in various countries abroad...and still maintains her high position in this respect....[and] the spirit of cooperation is being most effectually manifested by the Bourse of Frankfort.[265]

As time passed, conferences of the various associations of bondholders from different countries were held twice a year in London or Paris.[266] And, CFBH correspondence was routinely copied to bondholder associations in Switzerland, Belgium and the Netherlands.[267] Finally, after the U.S. established its bondholder representative body in 1933, the head of the CFBH wrote:

> you know from experience that value which we here all set on the liaison between our two councils and the very happy personal relations which you have yourself established.[268]

---

[263] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, p. 61.
[264] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, pp. 49-50.
[265] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, pp. 11-12.
[266] CFBH Archives (1938). File Ms34828. Clipping from the *Economist*, April 2, 1938, pp. 16-17.
[267] CFBH Archives (1949). File Ms34603, Vol. 1, Document 327/1062. Letter from Butler (CFBH) to Rogers (FBPC).
[268] CFBH Archives (1949). File Ms34603, Vol. 1, Document 327/1077A. Letter from Butler (CFBH) to Rogers (FBPC).

Did the cooperation work? It was not always effective, as there are a number of examples where national interests took precedence over the procedures of private bondholder associations. For example, despite being blacklisted on the London Exchange, Ecuador was able to secure credit from the French and later the Americans.[269] And, Guatemala was able to obtain credit from Germany and the U.S. despite the fact that it was in default to British bondholders.[270]

Other empirical studies that favour structural forces over institutional ones in settlement outcomes include Kelly (1998) and Rose (2002). Kelly argues that incentives to repay came not from the existence of the CFBH but from a country's trading relationship with Britain. Given Britain's unique position as "the world's dominant military, industrial, commercial and financial power, these trade and financial links were more than likely central factors in determining repayment throughout the period."[271] Overall, she finds that the successful borrowers' share of trade with Britain averaged 35.5% while the unsuccessful borrowers' trade shares with Britain were quite a bit less, at 24.3%. Her analysis suggests that trade ties with England determined a country's willingness to pay during the age of Pax Britannica.[272] For instance, states like Argentina viewed Britain as a key trading partner and settled with British bondholders, despite its geographic location in the Western Hemisphere. By contrast, smaller Central and Latin American countries evaded Britain but settled with American creditors.[273] This implies that structural forces were in fact more critical than investor representative bodies. Rose (2002) also highlights the correlation of trade links and debt repayment, since his empirical analysis concludes that sovereign default leads to an 8% decline in trade that persists for 15 years.[274] His study attempts to quantify the costs of default as well as highlight the strong incentives debtors have to repay their principal trading partners.

[269] The Corporation of Foreign Bondholders (1873-1987), Report of 1911; Kelly (1998), p. 42.
[270] The Corporation of Foreign Bondholders (1873-1987), Reports of 1895 and 1908.
[271] Kelly (1998), p. 41; See also Rose (2002).
[272] Kelly (1998), p. 44.
[273] The Corporation of Foreign Bondholders (1873-1987), Report of 1911, p. 26.
[274] Rose (2002).

4.5 Compulsory Power

While the literature recognizes the existence of compulsory power in the sovereign debt restructuring process in the 19th and early 20th centuries, it is widely agreed that the use of such power was the exception rather than the rule. As a consequence, these activities are never systematically addressed, and where they are acknowledged, their effect is minimized because they are believed to have occurred in isolated instances.[275] We intend to argue that this was not, in fact, the case. A closer examination of empirical data suggests that compulsory power attached to over 30% of the cases of sovereign default in this era. And, the percentage rises to 40% if one considers the face amount of the defaulted debt rather than the number of default cases.[276] Therefore, far from being the exception to the rule, compulsory power helped to materially shape bargaining outcomes between sovereign states and private creditors in the pre-WW I era.

In our analysis, the term compulsory power has normally been exercised by creditor country governments over debtor states. This is because private creditors had limited ability to *directly* coerce debtor states and needed to rely on the good offices and cooperation of their own governments to take action. That is to say, sanctions can be most effective when they are applied to defaulters by creditor country governments and not by banks or private creditors.[277] From a legal perspective, Borchard and Wynne (1951a) observe that "diplomatic protection is not a right of the bondholder but a privilege of his government, in its discretion, to extend."[278] The concept of diplomatic protection has a long history in international law, tracing its origins back to the clan theory of human society. Reflecting a more primitive form of social organization, it was commonly believed that "an injury to any member of the clan was deemed an injury to the clan itself, to be avenged by group sanctions."[279] Vattel then replaced the concept of "clan" with "nation," and by so doing, he argued that intervention by a government was

---

[275] Lindert and Morton (1989); Eichengreen and Lindert (1989); Mauro and Yafeh (2003); Suter (1992).
[276] The measurable aspects of compulsory power include the assumption of control over the fiscal affairs of a debtor state and military intervention (otherwise labeled "super-sanctions"). Lower levels of compulsory power (including use of the good offices of the British government by the CFBH) are harder to empirically measure, although they did occur with great frequency.
[277] Kaletsky (1985).
[278] Borchard and Wynne (1951a), p. 230; See also Lieberman (1989).
[279] Borchard and Wynne (1951a), p. 230.

justified on the grounds that an injury to a citizen is also an injury to his state. This interpretation implies that in certain cases, creditor country governments would not only have the right, but perhaps even the obligation, to intervene and vindicate the injustice done to a nation's bondholders by a defaulting foreign state.[280] Others have argued that in deciding whether to use compulsory power:

> it makes a great difference whether prevalent attitudes regard capitalists in general as benefactors or scoundrels, capital placement abroad as good or bad for the nation, property rights as special privileges in the interests of an exploiting class or as eternal and unchangeable absolutes at the foundation of law and morality.[281]

This implies that the prestige of the merchants and financiers of the City of London insured them careful attention from their government, especially in an era when much of society found itself re-organized around pecuniary pursuits and British national wealth was bound up with their success.[282]

Historical accounts of 19th century sovereign debt negotiations tend to underplay the role of compulsory power and creditor country government intervention. This is in part due to the fact that the British government produced some well-known statements for public consumption that served to distance H.M. Government from the interests of private bondholders. For example, there is the often cited public statement by Lord Palmerston, British Foreign Secretary, that "the losses of imprudent men who have placed mistaken confidence in the good faith of [debtor] governments would provide a salutary warning to others."[283] In other words, British government intervention was not to be expected for the bail-out of private bondholders who knew the risks they were taking when they purchased foreign government securities. This was in keeping with the spirit of Herbert Spencer's remark: "The ultimate result of shielding men from the effects of folly is to fill the world with fools."[284]

In his public statement, Lord Palmerston was narrowly defining the risks that the state would assume on behalf of foreign investors. However, it is important to point out

---

[280] Shea (1955), p. 9.
[281] Staley (1967), Chapter 8.
[282] Staley (1967), Chapter 8.
[283] Aggarwal and Granville (2003), p. 68. The quote is taken from Palmerston's 1848 circular.
[284] Lipson (1985b), p. 45.

that in practice, Palmerston was more flexible. He later said that the question of whether the matter of non-payment of private debt should be taken up by diplomatic negotiation "turns entirely on British domestic considerations."[285] And, "should the loss become so great 'that it would be too high a price for the nation to pay for such a warning...it might become the duty of the British Government to make these matters the subject of diplomatic negotiations.'"[286] So, if the national interest happened to coincide with the interests of bondholders, the latter might expect some assistance.

There are also more dramatic examples of the constructive ambiguity practiced by British politicians on the matter of sovereign default. The same Lord Palmerston who preached non-intervention publicly, stated privately to a Caribbean government that:

> the patience and forbearance of H.M. Government...have reached their limits, and that if the sums due to British Claimants are not paid within the stipulated time...H.M.'s Admiral commanding on the West India station will receive orders to take such measures as may be necessary to obtain Justice from the nation in this matter.[287]

We intend to demonstrate how the sovereign debt restructuring process of this era was much more politicized than the laissez-faire characterization of nineteenth century capitalism would have us believe. In fact, we have been able to categorize, and in some cases measure, the broad range of action that constituted compulsory power in this era. The least visible was the tacit permission the British government gave the CFBH to leverage the power of the global British consular network. For example, bondholders were allowed to access the diplomatic or consular services of the government to obtain confidential information, deliver messages to defaulting sovereigns, or receive payments on behalf of bondholders. In some cases, the British government even facilitated the collection of pledged revenues. At the other extreme, we see active creditor country government interventions in the domestic affairs of foreign states, which most often consisted of assuming control over a debtor's finances. Some examples of compulsory foreign economic control included Turkey, Greece, Egypt, Tunis, Morocco, Haiti and Santo Domingo. Finally, in the cases of Mexico (1861) and Venezuela (1902), we find

[285] Borchard and Wynne (1951a), p. 234.
[286] Jenks (1927), p. 125.
[287] Borchard and Wynne (1951a), p. 240.

debtor countries that ended up on the receiving end of armed intervention. We intend to examine each of these three activities – leveraging the British consular network, assuming economic control over a foreign debtor state, and armed intervention – in the sections which follow.

4.5.1 Leveraging the British Consular Network and Government Institutions

At the founding of the CFBH in 1868, the management of the Council stated that it would press its claims "on the notice of Her Majesty's Government, and would seek for its aid an authority" which isolated creditors lacked.[288] The founders believed that "the duties of the Council...[could] be used to great effect by exercising a moral power...over our own Government by inducing them to interfere if their good offices can do anything."[289]

Members of Parliament for the City of London, many of whom served on the governing Council of the CFBH, proved to be useful intermediaries with the government. For example, Isidor Gerstenberg, Chairman of the CFBH, was able to enlist the support of three City parliamentarians on the matter of Venezuela (Lionel de Rothchild, G. J. Goschen and R. W. Crawford). They urged the Foreign Secretary, Earl Russell, to consider "the justice and necessity of Government intervention on the bondholders' behalf."[290]

Archival correspondence reveals an active and regular communication between the CFBH and the British Government. In fact, copies of CFBH correspondence were routinely sent to the following: Permanent Under-Secretary of State, Foreign Office; Secretary to H.M. Treasury; and, the Chief Cashier of the Bank of England.[291] This close connection was reported by the financial press, as this summary from the *Economist* attests:

---

[288] CFBH Archives (1868). File Ms34827, Clipping from the *Morning Herald,* November 12, 1868.
[289] CFBH Archives (1868). File Ms34827. Clipping from the *Standard*, November 12, 1868.
[290] Platt (1960), p. 26.
[291] CFBH Archives (1963-1964). File Ms34666, Document 211/7. Additional recipients also included the financial community and other bondholder associations as follows: Secretary of the Share and Loan Department of the Stock Exchange; Secretary, British Bankers' Association; Secretary, Accepting Houses Committee; Secretary, Issuing Houses Committee; FBPC-New York; and French, Belgian, Swiss and Dutch bondholder protective councils.

> Although the Council is in no way under official control...[c]ontact between the Council and the Departments [H.M. Treasury and H.M. Foreign Office] is continuous...Representations are frequently made by the Government at the Council's request through diplomatic channels. Except where questions of policy intervene, such requests are nearly always granted.[292]

Platt (1960) goes further, arguing that:

> British legations and consulates acted on occasion almost as agencies for bondholder interests, and British diplomats were constantly engaged in forwarding the bondholders' representations to the various governments, transmitting the governments' answers to the bondholders, [and] arranging for the equitable divisions of debts.[293]

The CFBH also tended to use the British consular network as a data collection network. For example, in Santo Domingo, the British Vice Consul reported the 1901 Annual Budget of Santo Domingo to the CFBH: "I received orders some time ago from H.M. Consul General at Port-au-Prince to furnish the Foreign Office with certain data requested by the Corporation of Foreign Bondholders."[294] In addition, the Foreign Office was asked by the CFBH to procure a copy of the arbitration agreement between the U.S. and Santo Domingo from the U.S. ambassador in London.[295]

Why was the CFBH so successful in engaging the British government on its behalf? Archival documents relating to the establishment of the CFBH credit the "statutory character and complete independence" of the organization, maintaining that these attributes allowed the CFBH to always engage "the sympathy and collaboration of H.M. Treasury and H.M. Foreign Office." Information which would otherwise be impossible to disclose to a body without these attributes was frequently made available to the Council. And, in cases of outright default, the record maintains that "His Majesty's Government always follow such negotiations very closely and give to the Council their fullest support."[296]

It is not clear how "completely independent" the officers of the CFBH were from the British government. CFBH Council members and government officials shared similar

---

[292] CFBH Archives (1938). File Ms34828. Clipping from the *Economist*, April 2, 1938, pp. 16-17.
[293] Platt (1960), p. 41.
[294] CFBH Archives (1902). File Ms34780. Letter from British Vice Consul at Santo Domingo to the CFBH.
[295] CFBH Archives (1903). File Ms34780. Letter from H.M. Foreign Office to the CFBH.
[296] CFBH Archives (1938). File Ms34828. Memorandum on History of CFBH.

social backgrounds, and in many cases, senior CFBH staff had either held respectable positions with H. M. Government (in Parliament, Treasury or the military) or were former diplomats. In the period 1895-1905 there were no less than 13 MPs either serving in the management of the CFBH or on one of its Committees.[297] In fact, the 1938 Annual Report has a complete list of those who served as members of the Council since inception: of the 107 members, 13 had Lord as their main title; 12 Honourables or Rt. Honourables; 12 Sirs; 9 high-ranking military officers or judges, and 6 Earls or Viscounts.[298]

As time elapsed, the two groups became so close that the CFBH even took to interviewing ambassadors before they assumed their overseas posts, especially when the foreign country in question was an important capital importer. In a letter to Sir Jeffrey Wallinger, the proposed new British ambassador to Brazil, the head of the CFBH writes:

> [we] hope of being able to meet...before you take up your appointment at Rio de Janeiro...we are normally able to have such meetings with our Ambassadors before they take up appointments in countries with whose foreign debts we may have to deal.[299]

The close connection between the CFBH and H.M. Government also extended to those cases where the British government took responsibility to "receive payments or to supervise the collection of securities."[300] Often, this role fell to the Bank of England, an institution that developed a special expertise in the administrative aspects of private debt collection. For example, the Turkish loan of 1854 was secured by the Egyptian tribute payment, an amount which the Khedive of Egypt agreed to pay the Sultan of Turkey. The funds for the tribute were paid directly into a special account at the Bank of England for the benefit of bondholders.[301]

---

[297] Platt (1960), p. 25.
[298] The Corporation of Foreign Bondholders (1873-1987), Report of 1938; Mauro and Yafeh (2003), p. 21.
[299] CFBH Archives (1958). File Ms34603, Vol. 4, Document 327/1347. Letter from Butler (CFBH) to Sir Geoffrey Wallinger (new British Ambassador to Brazil). See also CFBH Archives (1944). File Ms34620, Document 391/32. Letter from H.M. Treasury to Lord Bessborough (CFBH); CFBH Archives (1963-1964). File Ms34666, Document 211/1A. Letter from Sir Otto Niemeyer's office (British Government) to Dana Munro (FBPC).
[300] The Corporation of Foreign Bondholders (1873-1987), Report of 1873, p. 49.
[301] CFBH Archives (1874). Clippings File, Turkey, Vol. 2. *Daily Telegraph*, April 9, 1874. The amount was paid to Turkey in consideration of the fact that the Turkish ruler agreed to allow the Khedive's son to

While many have marginalized the importance of these activities, we maintain that they had a decidedly positive effect on the position of bondholders. When a request from British bondholders is delivered to a defaulting state's finance minister from the British Consul General, its impact and significance is far greater than if the same message were delivered by the head of a private bondholder body. In fact, in sworn public testimony to the Securities and Exchange Commission, J. Reuben Clark, President of the CFBH's American counterpart, the Foreign Bondholders Protective Council, maintained that the British Government went further in its diplomatic support of the CFBH – especially with respect to allowing its foreign service to act as agents of the CFBH – than the State Department ever did.[302] This support lent an element of compulsory power to the process that benefited British bondholders at the expense of American ones.[303] Also, the fact that there are so many instances in which the CFBH petitioned the British government to intervene in difficult cases highlights the limitations of the institutional body in effectively regulating defaults.

4.5.2 Super-Sanctions: Economic Control and Military Intervention

Despite historical interpretation to the contrary, Britain has seldom remained completely indifferent to the treatment of its nationals by a defaulting foreign government. In a number of cases, government intervention went far beyond "diplomatic

---

succeed him as ruler of Egypt. Also, The Bank of England was not a public entity at this time, although it maintained close ties to the British government.

[302] Borchard and Wynne (1951a), p. 251.

[303] See also Eichengreen and Portes (1989), p. 21; Eichengreen (1991), p. 164. While some credit the CFBH with the fact that British bondholders received more favourable treatment in their interwar negotiations with Germany than their U.S. counterparts (due to its experience, organization, etc.), compulsory and structural power were more far more salient than institutional power in this instance. The British Foreign Office was intimately involved with the negotiations, sometimes allowing them to be conducted by Embassy officials. The British Treasury even made it quite clear that the status of private debts would be taken into consideration when making a decision on whether to extend official credit to Germany. Finally, since Britain was running a trade deficit with Germany in the 1930s, it threatened to offset that trade balance for the benefit of private bondholders. A 1934 Act of Parliament was to create a clearing office to recover, out of the proceeds of German trade with Britain, a sufficient amount in sterling to pay interest on the British tranches of the 1924 Dawes Loan and the 1930 Young Loan. By contrast, the U.S. did not have a trade position with Germany that would allow it to sequester funds for its bondholders. In addition, President Roosevelt urged U.S. bondholders to settle to cement good economic relationships and asked his ambassador to Berlin to "lend what personal, unofficial aid you can, but no more." The different political approaches taken by the U.S. and Britain explains why Germany treated its British bondholders more favourably than its U.S. counterparts. The nominal rate of return realized on German issues purchased in the 1920s was 3.6% annually for sterling bondholders, but only 1.1% for dollar bondholders.

exhortation" and led to "the establishment of alien control over the part or whole of the finances of a defaulting state, or even over its entire administration."[304] The decision of the British government to come to the aid of bondholders in a more overt and forceful way was largely dependent upon a few key variables. First, it was generally the case that that the more blatant the abuse of British property rights, the more emphatic the response.[305] Second, governmental intervention was more likely to be forthcoming in circumstances where the bondholders had a specific pledge of assets. This is because the British government could more easily justify active diplomatic protection when it was linked to the safeguard of contractually-agreed security arrangements.[306] Finally, most scholars agree that exceptions to the public stance of non-intervention were often made for strategic purposes.[307]

These variables are often cited in the most spectacular cases of forceful foreign intervention for the benefit of private bondholders. In 1861, Great Britain, along with France and Spain, undertook a military campaign in Mexico, with France ultimately installing its own emperor, Maximilian.[308] Egypt's default in 1875-1876 led Britain to take increasing economic control over the financial affairs of the Egyptian government. And, at the Congress of Berlin, the leading powers of Europe signed a declaration which created the Ottoman Debt Administration in 1881, a vehicle whose role was to collect and administer the collateral that secured the Ottoman public debt. In 1902, Britain, Germany and Italy established a blockade around Venezuela, successfully forcing the country's recalcitrant dictator, General Cipriano Castro, to settle its defaulted foreign debt. And, the U.S. government intervened militarily in Santo Domingo (1905) by sending gunboats and establishing a customs receivership to ensure the repayment of European and American bondholders.[309] All of these measures were draconian enough to

---

[304] Borchard and Wynne (1951a), p. xxv.
[305] Lipson (1985b), pp. 49-50.
[306] Borchard and Wynne (1951a), p. 98. As we saw earlier, collateralized bonds were much more common in the late 19th and early 20th centuries than in any other period.
[307] Platt (1960); Lipson (1985b).
[308] This project was less than successful, with Maximilian I, a brother of the Austrian emperor Franz Joseph, killed in a coup in 1867. Following the execution, the Mexican government repudiated the Maximilian debt of £20 million.
[309] Dammers (1984), p. 80; Borchard and Wynne (1951a), p. 242. A second objective of the U.S. intervention in Santo Domingo was to repel any possible European military adventure in the Western

serve as a warning for other would-be defaulters. In fact, Fishlow (1989) points out that the memories of the resolution of the Turkish and Egyptian defaults of the 1870s, which led to foreign economic control and loss of sovereignty, lingered for quite some time and "cast a shadow of fear over all subsequent negotiations."[310]

Before discussing individual cases, it is important to first examine the broader historical record on intervention during the period from 1870 to World War I. If we believe that creditor country government interventions were important drivers of debt settlements in this particular era, we need to offer empirical grounding for that position. Two important studies have attempted to measure the effects of super-sanctions on the sovereign debt restructuring process. Mitchener and Weidenmier (2005) and Suter (1992). For purposes of this analysis, super-sanctions will be defined as either armed military intervention and/or the taking of external fiscal control over a country's finances.

Mitchener and Weidenmier (2005) find strong evidence to support the case that super-sanctions were not only effective but also a commonly used enforcement mechanism over the period 1870-1913. While these sanctions were applied selectively, often based on the geo-strategic importance of a defaulting state, the authors conclude that any nation that defaulted on sovereign debt "ran the risk of gunboats blockading their ports or creditor nations seizing fiscal control of the country."[311] They discovered that, conditional on default, the probability that a country would be "sanctioned...was greater than 40% during the period 1870-1913."[312] This figure is much higher than previously believed, and suggests that such sanctions served as a credible threat to deter future default. The authors also found that approximately two-thirds of these sanctions took the form of "gunboat diplomacy or the loss of fiscal sovereignty by the defaulting country."[313] The remainder involved some type of seizure of property in the defaulting state, usually connected to collateral foreclosure.[314]

Hemisphere; the U.S. agreed to do its part to enforce debt contracts in Central and South America in the Roosevelt Corollary to the Monroe Doctrine.

[310] Fishlow (1989).

[311] Mitchener and Weidenmier (2005), pp. 2-7.

[312] The authors find that super-sanctions were employed 30% of the time during this period but on more than 40% of the defaulted debt. The 30% finding with respect to the number of cases would be consistent with Suter (1992).

[313] Mitchener and Weidenmier (2005), p. 2.

[314] Mitchener and Weidenmier (2005), p. 7.

One of the interesting findings of their study was that after the implementation of super sanctions, on average, "*ex ante* default probabilities on new debt issues fell by more than 60 percent, spreads declined by almost 800 basis points, and defaulting countries experienced almost a 100 percent reduction of time spent in default."[315] In fact, only countries that surrendered their fiscal sovereignty had the ability to issue meaningful levels of new, post-default debt on the London exchange.

While Suter (1992) maintains that super-sanctions were rare, his conclusion is based on the measurement of sanctions across a longer time horizon: 1821 – 1975.

Table 4G: Creditor Country Government Intervention (1821-1975)[316]

Default Settlement Periods	*Number of Interventions*	*Number of Cases*
1821-1870	4	25
1871-1925	15	52
1926-1975	1	37
Total: 1821-1975	Total Interventions: 20	Total Cases: 114

Source: Suter (1992)

He argues that creditors took some form of political or economic control of debtors in 20 out of a total 114 settlements in the period from 1821 - 1975, which is only 18% of the time. This result coincides with the conventional wisdom about interventions. However, 15 of these 20 cases occurred in the 1871-1925 period, meaning that in the period under examination in this chapter, compulsory power played a role close to 30% of the time. This figure, based on the number of cases, matches the one used in Mitchener and Weidenmier (2005).[317]

In addition, while Suter concludes that investors suffered a reduction of principal in this period of 12%, this amount is arrived at after adjusting for instances where creditors enhanced their position by taking political or economic control of debtor property. Backing out these values, principal reduction would have been approximately

[315] Mitchener and Weidenmier (2005), p. 3.
[316] Suter (1992), p. 91.
[317] Suter (1992), pp. 92-93. According to Suter (1992), only 4 interventions took place in the 1821-1870 period and just one took place in the 1926-1975 period. In addition, in 9 debt arrangements, debtors ceded property rights to creditors in return for a partial scaling down of the face amount of the debt. The preferred assets tended to be land or railways. Some examples are: Columbia (1861 and 1873, land); Costa Rica (1885, railways); Ecuador (1885, land; 1897/1898 railways); El Salvador (1899, railways); and Paraguay (1855, land). Once again, 7 out of 9 cases (close to 80%) of ceded property rights occurred during the 1871-1925 period.

22.8%. Therefore, compulsory power had a material impact on bargaining outcomes in the late 19th and early 20th centuries: it helped to reduce the average time a sovereign debtor spent in default and also the amount of principal that bondholders were required to forgive. The implication of this analysis is that compulsory power was a far more critical factor than previously thought in determining the outcomes of sovereign debt negotiations in the age of *Pax Britannica*.[318]

In Appendix 4B, we provide four illustrative case examples of super-sanctions in the 1875 – 1914 period. Two of these cases (Turkey and Egypt) involve the usurpation of domestic fiscal management by foreign European powers, another involves a European military operation to coerce repayment (Venezuela), and the last case involves both military intervention and fiscal management by the U.S. for the benefit of European bondholders (Santo Domingo). In all cases we find that compulsory power led directly to a reduction of time spent in default, and in the cases of fiscal intervention, the improvement of a country's credit standing in the global capital markets.

4.6 Productive Power

In the issue-area of sovereign debt restructuring, productive power has played a role; however, we believe that its role was subservient and closely linked to structural and compulsory power in the 19th century. That is to say, capital exporters were largely able to define what it meant for a sovereign to default as well as the array of remedies that could be justified to cure it. These remedies were eventually enshrined in an evolving framework of international law. And, as we have discussed earlier, the material resources of capital exporters gave them an advantage in seeking redress from the more intransigent cases, like Turkey, Egypt, Venezuela and Santo Domingo. In addition, we hope to show how productive power was used quite effectively to supplement structural power, especially in the case of the defaulted U.S. states in the mid- to late 19th century. With the use of compulsory power ruled out by Britain in this instance, the combination of

[318] Lipson (1985b), p. 54. Platt found at least forty examples of British armed intervention in Latin America between 1820 and 1914. "Twenty-six of these episodes were to enforce claims of British subjects for outrage and injury or to restore order and protect property." Weidenmier (2004) argues that trade sanctions were effective in promoting debt repayment by Confederate borrowers in British markets.

structural and productive power pushed most of the defaulted States – with the exception of Mississippi- into a settlement with British creditors.

What is the origin of the word "default"? Etymologically, it derives from the Latin, *de fallere. De* is a prefix signifying intensive force, and *fallere*, means "to deceive" or "to cheat." Taken together, the word suggests a debtor's thorough and complete deception of his creditor. "Repudiation" is also from the Latin, *re*, indicating repetition, and *pudere*, to be ashamed of. The significance of this combination is that anyone who repudiates a debt is to be "ashamed only of himself."[319] This idea that default represented a moral failing on the part of a sovereign state was very much accepted during the 19th century and continued through the time of the Great Depression of the 1930s.

4.6.1 Productive Power and the Evolution of International Law

While international law, despite its ambitions, has never been able to match the precision of domestic law, a body of rules relating to foreign investment and sovereign default began to evolve at the beginning of the 17th century.[320] Hugo Grotius advanced the position that an unpaid debt owed by one monarch to another was a "just cause for war" and that, in the event the debtor monarch refused to pay, his properties, or those of his subjects, could be confiscated for compensation under the law of nations.[321]

Emmeric de Vattel was of the opinion that "an injury to an alien was actually an injury to the state of that alien and thereby justified measures by the state to seek redress and compensation."[322]

It was not until the nineteenth century that the pecuniary claims of individual foreign creditors were addressed by international law:

> Where the contract is between a state and a foreign individual the matter becomes one of international law in the strict sense if and when the state of the individual makes his case its own and addresses itself diplomatically to the contracting state.[323]

---

[319] Winkler (1933), p. 8.
[320] Lipson (1985b), p. 57; See also Buchheit and Gulati (2002); Buchheit (2003); Borchard and Wynne (1951a), p. 14.
[321] Williams (1923), pp. 7-8.
[322] Shea (1955), p. 9. Quotes Emmeric de Vattel (1758). The Law of Nations, Book III. (Carnegie Classics of International Law, Edition III), p. 136.
[323] Borchard and Wynne (1951a); Williams (1923), p. 8.

In 1868, the Argentine diplomat, Carlos Calvo, formulated what came to be known as the Calvo Doctrine. He argued that armed intervention in Latin America by the European powers could not be justified by appealing to international law. Instead, he believed that it represented the opportunistic use of force by the strong over the weak. Calvo believed that international law did not sanction military intervention on the part of creditor country governments for the purposes of recovering debts owed to private investors, and in the specific case of Latin America, he believed these actions to be discriminatory. He instead put forward the case that international law provided private foreign creditors with legal remedies, such as those that were offered by the courts and tribunals of the debtor state, and that only after all of these remedies had been exhausted could some form of peaceful, diplomatic intervention be permissible.[324]

The Venezuelan military intervention of 1902 by the European powers prompted Argentine Foreign Minister, Dr. Luis M. Drago, to supplement the Calvo Doctrine. In the communique which he forwarded to Washington, D.C., Drago echoed his predecessor's concerns that military interventions were being used by powerful states as a cloak for domination and colonization. He further asserted that sovereign bonds held by private investors were not valid contracts and therefore not subject to intervention on the basis of international law. The Drago Doctrine rested on the tenuous legal grounds that when a state issued a bond it was an act of sovereignty, thereby offering the state full rights of repudiation and immunity from civil remedies. In other words, the bonds issued by a sovereign state were not contracts in the commonly accepted legal sense of the term.[325]

The Drago Doctrine was widely disputed in international legal circles and even Borchard (1951a) noted that there were certain circumstances where the use of creditor country government intervention was justified to collect private bondholder debt, especially in cases where the sovereign debtor acted in bad faith by expropriating collateral meant to secure external debt.[326] In fact, prior to World War I, there appeared to be a consensus among the major capital exporters of the world that the expropriation of an alien's property required the host state to pay prompt and adequate compensation.[327]

---

[324] Hershey (1907), pp. 26-28; Lieberman (1989), p. 134. See also VanHarten (2005).
[325] Hershey (1907), pp. 26-28.
[326] Borchard and Wynne (1951a).
[327] Lipson (1985b), p. 38.

However, as a practical matter, it was often difficult to determine the level of "just compensation;" this ambiguity gave credit exporters much more room to manoeuvre in negotiations with defaulting sovereigns, leaving the door open for fiscal or military intervention.[328]

As American power increased, President Theodore Roosevelt became "a dedicated internationalist" who believed in the "civilizing mission of the United States."[329] Part of this mission involved upholding the Victorian ideals of self-control and self-mastery, both of which had evolved in 19th century Britain. These traits were said to define a man's strength of character and were eventually extended to define the character of an entire nation. According to this doctrine, men were required to exercise restraint in monetary matters, meaning that they should save and plan for the future instead of spending recklessly and defaulting on debt obligations. It was only through this self-mastery that they would be elevated to a higher status. Once there, they had the responsibility to protect those who were "weaker, self-indulgent, and less rational."[330] Included in this unfortunate category were women and children, as well as the inhabitants of less developed countries. According to Roosevelt, it was only by enforcing these ideals within the U.S. sphere of influence that civilization would advance. Rosenberg (1999) cites this norm as the one which made U.S. intervention permissible under the 1904 Roosevelt Corollary to the Monroe Doctrine. In that pronouncement, Roosevelt said that "when the nations of the Western Hemisphere conducted their economic affairs irresponsibly...the United States would assume the role of 'international police power.'"[331]

Some clarity on the issue of intervention was finally achieved at the Hague Peace Conference of 1907. The *Convention Respecting the Limitations of the Employment of Force for the Recovery of Contract Debts* was adopted and ostensibly expressed that

---

[328] "The symbolic role of international law is particularly noteworthy, since it can sometimes turn questionable claims into approved obligations or prerogatives...legal symbols, by abstracting from and disguising material relations, can serve to authenticate them ethically across nations and social classes. The law, Bentham once said, 'shews itself in a mask.' The best known symbol in international property law is the requirement on 'just' compensation. Its meaning is not to be found in some exegesis of Plato. It refers to full, prompt, convertible repayment for expropriations. It is, in essence, a cloak for the interests of foreign investors." See Lipson (1985b), p. 55.

[329] Rosenberg (1999), p. 32.

[330] Rosenberg (1999), p. 33.

[331] Rosenberg (1999), p. 41.

armed force would not be used to collect private debts, but would remain an option in the event that the debtor state refused to reply to an offer of arbitration, or, after arbitration, failed to submit to the judgement. By 1914, this convention had been ratified by all of the powers that were creditor states.[332]

Some have argued that the norms and rules regarding the protection of foreign investment evolved with a certain purpose during the 19th century. Lispon (1985b) maintains that the rules on expropriation and just compensation were created and enforced so as to ensure the expansion of capital investment overseas. More specifically, they were linked to the changing international role of Britain. According to Lipson, since the "rules defined the minimum conditions for the internationalization of capital...they became deeply embedded in the foreign policy of the largest capital exporter."[333]

Therefore, the evolution of international law with respect to the protection of international capital needs to be understood within the political and economic context of the 19th century. Rules were created and sustained by the great European powers who also happened to be the world's principal capital exporters. Their goal was to maintain "a unified economic and social order for the conduct of international trade and intercourse among independent political units of diverse cultures and stages of civilization, different legal and economic systems, and varying degrees of power and prestige."[334] So, productive power was tied very directly to structural power in this period. And, the success of these rules can be measured by the vast transfer of wealth from developed to developing countries in the years leading up to World War I.

4.6.2 Productive Power and U.S. State Defaults

Between 1841 and 1843, eight U.S. states and one territory defaulted on their external debt to British bondholders.[335] Some states defaulted and then repudiated their

---

[332] Scott (1915), pp. 89-90.
[333] Lipson (1985b), p. 38.
[334] Lipson (1985b), p. 38.
[335] Although these defaults occurred prior to the start date of this study, we believe that they help illuminate the role of productive power when compulsory power is highly constrained. The municipalities in question were Arkansas, Illinois, Indiana, Louisiana, Maryland, Michigan, Mississippi, Pennsylvania and the territory of Florida. By 1873 – 1874 only Indiana, Louisiana, Florida and Mississippi remained. However, new U.S. states were added to the roster of defaulters in 1873-1874: Virginia, Georgia, North Carolina, South Carolina, Tennessee, Alabama, Minnesota.

debt, while others defaulted but sought to settle with creditors. Shock and disappointment echoed throughout the British investing community:

> To any man of real philanthropy who received pleasure from the improvements of the world, the repudiation of the public debt of America and the shameless manner in which it has been talked of and done, is the most melancholy event which has happened during the existence of the present generation.[336]

Wallis, Sylla et. al. (2004) argue that repudiation was rooted in a feeling by the citizens of a state that they had been the victims of corruption. States that did not repudiate their debt viewed the financial crisis as emanating not from corruption, but instead from the general incompetence of state officials.[337] In addition, some of the repudiating states believed they had a legal right to disown the foreign debt, especially where statutory requirements had been violated.[338]

The British press was extremely active in publicly condemning the actions taken by the U.S. states. They hoped that the states would "deem it a not disadvantageous transaction to lay out ten or twenty millions...in purchasing a restoration of their forfeited respectability."[339] And, referring to Indiana, the London *Times* asserted: "Sooner or later the people of Indiana will find themselves rich enough to buy a character and wise enough to know that it is worth the price."[340] According to one English gentleman:

> I never met a Pennsylvanian at a London dinner without feeling a disposition to seize and divide him. How such a man can set himself at an English table without feeling that he owes two or three pounds to every man in the company, I am at a loss to conceive...If he has a particle of honour in his composition, he should shut himself up and say, 'I cannot mingle – I must hide myself - I am a blunderer from Pennsylvania.'[341]

In fact, it was so embarrassing to be an American in London in the early 1840's that it was reported that "at least one American of irreproachable antecedents was barred

---

[336] CFBH Archives (1984-1985). File Ms34628.
[337] Wallis, Sylla et al. (2004).
[338] McGrane (1935), p. 8. A number of state legislatures required bonds to be sold at par and did not allow foreign currency clauses. Where the state's agents and bankers violated these requirements, it was used as a legal basis for repudiation.
[339] McGrane (1935), p. 166. Quote taken from London *Times,* December 3, 1846.
[340] McGrane (1935), p. 382. Quote taken from London *Times,* April 29, 1847.
[341] Winkler (1933), p. 10.

admission to a London Club, specifically because he belonged to a republic which did not fulfil its engagements."[342]

From Europe's perspective, the entirety of America was disgraced because certain states had openly repudiated their obligations.[343] No matter how much non-defaulting states protested and tried to explain the federal character of their government, they were still regarded as a "nation of swindlers."[344] While the British found it difficult to view the defaulting states as legally or morally unconnected, the Americans possessed a stunning lack of national consciousness. They firmly believed that the actions of a few states would not injure their credit so long as they continued to meet their debt obligations.

In framing the debate about American state defaults, the British did not limit themselves to complaints of moral failing and weakness of character; they saw the defaults as reflecting in the most negative way on the very institutions of American democracy:

> The Americans who boast to have improved the institutions of the old world have at least equalled its crimes. A great nation, after trampling under foot all earthly tyranny, has been guilty of a fraud as enormous as ever disgraced the worst king of the most degraded nation of Europe.[345]

In an attempt to rally public support for fiscal probity among Americans in 1840, Daniel Webster argued that lurking at the bottom of British aspersions was "a strong desire to disparage free institutions, by representing them as unworthy of reliance on the part of foreigners and unsteady in the sacred obligations of public faith."[346] Therefore, by championing debt repayment, Americans could serve the higher purpose of validating the American democratic experiment.

The use of productive power by Britain went far beyond efforts to shape opinion in the press. For example, Barings, along with five other banking houses, subscribed to a £2,000 fund in June, 1843 for the express purpose of appointing agents to Pennsylvania to represent foreign creditors. These agents would not only be expected to write press

---

[342] Jenks (1927), p. 104.
[343] The Senate of the United States adopted resolutions on March 6, 1840 which expressly disclaimed the federal government's responsibility for defaulted state debts. See Jenks (1927), p. 100.
[344] McGrane (1935), p. 56.
[345] London *Times*, May 19, 1843.
[346] McGrane (1935), p. 43.

accounts urging debt repayment; they also organized meetings of domestic holders of state debt hoping that these Americans would feel some solidarity with their European counterparts. Of most interest was the fact that the agents were instructed "to endeavour to enlist clergy to point out from the pulpit" the "moral wrong and danger to the people of not acting honourably."[347]

While productive power proved to be a useful supplement to structural power in these cases, those American states that eventually settled with British bondholders did so mainly because of structural power; that is to say, they wanted or needed renewed access to the British and European capital markets. In fact, all of the American states, except one, settled with their British bondholders in the absence of any exercise of compulsory power. The case of Mississippi remained an outstanding, unsolved case on the books of the CFBH when it wound up its operation in 1988, with the institution reporting that "the chances of anything being achieved must be next to nil."[348]

4.7 Power and the Production of Bargaining Outcomes in the 19th Century

The sovereign debt restructuring regime of the 19th century does resonate with today's debates about how to improve the international financial architecture, especially in matters of crisis resolution. Parallels are often drawn between today and the 19th century since the latter is commonly considered to be the first era of globalization - a time when open capital accounts allowed western European investment to flow liberally to capital-poor developing countries in the Americas, southern and eastern Europe, Egypt and Turkey.[349] Given the similarities between the 19th century and today, there have been discussions about the possible revival of an organization like the CFBH on a global basis to coordinate the interests of disparate bond investors in sovereign debt workouts.[350] And, since sovereign debt restructuring is considered to be a highly redistributive process, any

[347] Baring Archives. Letters from Ward to Baring, May 14 and 15, 1843; Letter from Baring to Ward, June 19, 1843 and July 3, 1843. Also, see McGrane (1935), p. 73.
[348] CFBH Archives (1969-1970). File Ms34603, Volume 9. Memorandum on status of Mississippi default. The debt was valued at $6.9 million in 1970. According to the *Financial Times* on April 21, 1988, the total face value was $7 million but the past-due interest was calculated at $42 million as far back as 1929.
[349] Esteves (2005), p. 1; See also Bordo, Eichengreen et al. (1998).
[350] MacMillan (1995a). See also Institute of International Finance, International Primary Markets Association et al. (2003) and Portes (2004).

improvements in the international financial architecture[351] that would make it more predictable, fair and efficient would have far-reaching benefits for debtor states and investors alike.

However, we believe that the recommendation to resurrect the CFBH rests on an important misconception: that the CFBH was singularly or even largely responsible for driving the success of the 19th century sovereign debt restructuring regime. As we have argued in this chapter, the power of the CFBH as an institution was overshadowed by the structural power of British capital and the willingness of Britain and other powers to enforce debt contracts using compulsory power.

On the matter of structural power, it would be difficult to deny the hegemony of the British capital market during the age of *Pax Britannica.* The county's capital export grew sixteen times between 1854 and the eve of World War I, accounting for just under half of the world's total. And, while the power to refuse market access to defaulting sovereigns is often ascribed to the CFBH, it was in fact the Stock Exchange that instituted that rule in 1827, more than forty years prior to the establishment of the CFBH. However, the origin of the rule is not as critical as the source of its power, a source that was structural and not institutional.

In examining compulsory power capabilities in this era, we have found that the CFBH would routinely use the British consular network as if it were an agency of the bondholders. British diplomats would deliver messages, collect sensitive information, and arrange payments. Even more compelling is the finding that sanctions involving the assumption of economic control or outright military force were much more common than previously believed. Interventions occurred in close to 30% of default cases - and on 40% of the face amount of outstanding debt. These actions directly impacted bargaining outcomes by materially reducing the time spent in default and increasing recovery rates. And, longer-term improvements in a debtor country's fiscal outlook are correlated with

[351] The term "international financial architecture" was coined by Robert Rubin, U.S. Treasury Secretary during the Mexican and Asian financial crises of 1994/1995 and 1997/1998 respectively. Rubin was referring to the rules which governed global capital flows and debt restructuring in emerging markets. The Mexican and Asian financial crises spurred policymakers to focus on ways to reduce financial contagion and respond in a more fair and predictable manner to sovereigns in financial distress. This initially involved the expansion of IMF lending programs to countries experiencing liquidity crises and better IMF surveillance and reporting with respect to the banking sector in emerging markets countries.

activist foreign debt administrations, drawing comparisons to modern day IMF structural adjustment programs.

It is likely that history has mistakenly credited the institution of the CFBH with achieving bargaining outcomes that in fact resulted from the exercise of structural and compulsory power. If so, then this finding has important implications for today's reforms to the international financial architecture. Because, while the institutional body of the CFBH may have reflected, leveraged, or even taken credit for this power, it did not produce it. This means that the establishment of an institutional twin to the CFBH in today's markets would not, on its own, re-create the regime of the 19th century; nor would it be likely to reproduce its bargaining outcomes.

Appendix 4A
Sample Periodicals and Journals from CFBH Archives

Egypt (1870-1875): 17 Money Market Review Bondholders' Register Financier Bullionist, Ways and Means Economist Times Daily News Monetary and Mining Gazette Evening Standard Daily Telegraph Echo Globe Gazette de Paris Hour Morning Post **Argentina (1882): 16** Buenos Aires Standard Times Financial News Financial Times Bullionist Standard Daily News Economist Statist Money Market Review Money & Trade Morning Post Daily Telegraph South American Journal Herapath's Railway & Commercial Journal Capitalist	**Virginia (1872-1875): 28** Richmond Enquirer Journal of the Royal Society of the Arts Times Wall Street Journal Bullionist Bondholders' Register Money Market Review Anglo American Times Richmond Whig Journal of Commerce Weekly State Journal (Richmond) Richmond Dispatch Financier New York Times Standard Cosmopolitan Vindicator Evening Standard Echo Daily Picayune Morning Post Daily Recorder Daily Dispatch Daily News Investors' Guardian Herapath's Railway & Commercial Journal New York Herald Daily Telegraph	**Arkansas, Mississippi, Tennessee (1875-1883): 17** New York Times Anglo American Times Advertiser and Mail New York Herald. Manchester Guardian The Sun Richmond Enquirer Standard Financier New York Herald Echo Pall Mall Gazette McCulloch's Circular Money Market Review Wall Street Journal Herapath's Railway & Commercial Journal.	**China and Japan (1870s): 25** Times Economist Standard Investors' Guardian Money Market Review Bondholders' Register Pall Mall Gazette Bullionist Financier Echo Herapath's Railway & Commercial Journal South Pacific Times Pacific Mail Hour News of the World Daily Telegraph Monetary Gazette Mining Journal Financial Reformer Morning Post Morning Advertiser Iron Daily News Truth Panama Star and Herald	**France (1870s): 23** Standard Financier Times Bullionist Bondholders' Register Globe Echo Money Market Review Economist Daily News Hour Monetary Gazette Daily Telegraph Gazette de Paris Herapath's Railway and Commercial Journal Whitehall Review Morning Post Capital and Labour World Pall Mall Gazette Financial Opinion Semaine Financiere France Financiere Statist	**Europe (1930s): 16** Times Financial News Financial Times Morning Post Daily Telegraph Message d'Athenes Board of Trade Journal Stock Exchange Journal Stock Exchange Gazette Hansard New York Herald Tribune Evening Standard New York Times Agence Economique et Financiere Glasgow Herald

Appendix 4B
Compulsory Power Case Studies

Turkey

From Europe's perspective, one of the principal reasons for placing the fiscal administration of a country under foreign supervision was to preserve it as a political entity. By stabilizing its finances and ensuring the adoption of sound budgetary methods, this strategy would prevent the debtor country from weakening and perhaps falling prey to another foreign power. Therefore, European fiscal management had two goals: to maintain an acceptable balance of power and improve the returns that European nationals could earn on their foreign investments. Borchard and Wynne (1951a) contend that "the benefits accruing to the debtors were a welcome, but by no means essential, by-product of its operation."[352]

During the 1860s, Turkey borrowed extensively in the British and Continental markets, largely to support military expenditures as well as for the construction of a host of imperial residences for the Sultans. Loans were generally secured, typically by revenues derived from monopolies on local commodities. For the added protection of investors, a Commission was based in Constantinople, consisting of six members, three of whom were named by the Turkish government and three by the agents of the loan. The Commission had the duty of collecting the hypothecated revenues and transmitting them at fixed intervals to the Bank of England for the semi-annual interest and sinking fund payments.[353]

Unfortunately, even with this added measure of protection, the fiscal administration in the Turkish government was poor. Tax receipts were kept at artificially low levels through evasion or the corruption of tax officials. Bribery and graft were not uncommon, especially in light of the subsistence salaries paid to the overstaffed civil service. In addition, there was no program in place to centralize control over the national budget. Given these problems, widespread defaults ensued during the 1870s which eventually brought about the imposition of foreign fiscal management.[354] The Ottoman

[352] Borchard and Wynne (1951a), p. 287.
[353] CFBH Archives (1862). File Ms34801, Volume 1. Notice of Imperial Ottoman Loan.
[354] Borchard and Wynne (1951a), p. 148.

Debt Council was established in 1881 as the part of a comprehensive settlement between Turkey and her foreign creditors.

The Council of Administration, or more simply, the Debt Council, was organized under the Decree of Mouharrem. It was comprised of foreign bondholder representatives and was careful to exclude any "persons with positions in - or official connections to - the Turkish government."[355] The Debt Council was initially charged with "the administration, collection, [and] direct encashment...of the revenues and other resources" ceded to it.[356] Some British investors believed that Turkey had been deserted because she could no longer afford to pay her English bondholders, and because the construction of the Suez Canal freed Britain from its dependence on the integrity of the Ottoman Empire for its trade route to India. However, this was not, in fact, the case.[357]

The Debt Council, far from being indifferent on the matter of Turkey's fiscal fate, was a large and pro-active organization. It established its own revenue-collection service, employing over 3000 agents. Yet, the Debt Council was not satisfied with the limited remit of collecting what the Turkish government was able to pay. Instead, it slowly began to expand its role so that it could improve government revenue more broadly. It established more efficient and centralized procedures for revenue administration, and even began to look at how the government's principal industrial interests could be improved. In this regard, it adopted measures to combat phylloxera, advanced an export trade in salt, and championed better agricultural techniques. It was widely agreed among investors that Turkey's fiscal outlook improved markedly after it allowed its creditors to manage its customs revenues.[358] The Debt Council was even commended on the substantial improvement in the country's debt standing, something which directly profited the Turkish Government.

It is interesting to note that the Debt Council remained in place for more than 47 years. After a series of protracted negotiations, an agreement to replace the Decree of Mouharrem was finally reached between the Turkish Government and its foreign

[355] Borchard and Wynne (1951a), p. 284.
[356] Borchard and Wynne (1951a), p. 284.
[357] CFBH Archives (1875). Clippings File, Egypt, Vol. 1. *Times*, November 26, 1875.
[358] The Corporation of Foreign Bondholders (1873-1987), Report of 1876, pp. 33-34; Report of 1904, p. 26.

creditors in June, 1928. It was only with this agreement that the Turkish Government regained full financial sovereignty.[359]

Egypt

Like Turkey, Egypt began to borrow extensively in the foreign capital markets in the 1860s. For the better part of this decade, a series of loans were arranged that carried high interest rates as well as large discounts; eventually, incremental borrowings were required simply to redeem the mounting level of floating rate debt. And, like Turkey, Egypt's fiscal condition gradually weakened given the lethal combination of poor economic administration and extravagant expenditure.

In order to stave off default, the British press reported that the Khedive "ha[d] applied officially to England to send him two gentlemen competent to undertake full charge of Egyptian finances" insofar as the Khedive believed in the need for "certain reforms in an administration not...wholly free from the vices that have brought Turkey to its present pass."[360] In fact, the dispatch of Stephen Cave, the British Paymaster General, was widely regarded as confirmation that the British government would help the Khedive put his finances in order.[361] The relationship between the Khedive and the British financial experts was a tenuous one. By the summer of the following year, the Khedive was reported as saying that he "thought England would have sent him a man to counsel and enlighten him, but that he found it was intended to subject him to a syndicate."[362]

The British purchase of the Khedive's half interest in the Suez Canal was seen in the financial press as a "bold stroke of political genius." On the one hand, it allowed the holders of Egyptian bonds to be to "some degree compensated for their late anxieties," improving the outlook for Egyptian finances and clearing the away the fiscal burdens that had been an embarrassment to the Khedive. However, while the influx of £4 million to the Khedive helped to avert a financial crisis, political interests were even more salient insofar as half-ownership of the canal was seen as a way to secure Britain's roadway to India.[363]

---

[359] Borchard and Wynne (1951a), pp. 284-285.
[360] CFBH Archives (1875). Clippings File, Egypt, Vol. 2. *Times*, November 29, 1875.
[361] CFBH Archives (1875). Clippings File, Egypt, Vol. 2. *Echo*, November 30, 1875.
[362] CFBH Archives (1876). Clippings File, Egypt, Vol. 2. *Standard*, June 4, 1876.
[363] CFBH Archives (1875). Clippings File, Egypt, Vol. 2. *Bullionist*, November 27, 1875.

Even with these measures designed to hold back default, the situation in Egypt finally reached a crisis point in 1876 when new loans could no longer be floated in foreign markets. Initially, a readjustment of the debt was organized under the direction of French and British advisors. However, in 1882 this consortium was supplanted entirely by Great Britain, which assumed responsibility for "reconstructing and strengthening the Egyptian financial system."[364] Britain was, in effect, "given control of Egypt's purse strings for the remainder of the gold standard period."[365]

The British administration in Egypt had managed to mimic the success of the Turkish Debt Council. They inaugurated an efficient tax collection system and restored fiscal discipline. In order to accomplish this, they limited the power of the Egyptian assembly to authorize spending. As a result, Britain was able to conclude a debt settlement with Egypt by 1883. "Nearly a decade after the debt workout, the ratio of government debt to tax revenue had been cut in half (from 10:1 to 5:1)."[366] According to Ferguson and Schularick (2004):

> In many ways, there was a modern quality to what happened. The British administration of Egyptian finances had much in common with an International Monetary Fund mission or rather the way an IMF mission would operate if it could call on the Royal Navy to enforce its prescriptions. Evelyn Baring, later Lord Cromer, ran Egypt's finances much like a modern structural adjustment program.[367]

Venezuela

Venezuela experienced a series of debt service suspensions during the 19th and early 20th centuries and is best placed in the category of serial defaulter. Stoppages occurred for long periods on six occasions between 1834 and 1905.[368] These numerous and prolonged disturbances could be attributed to recurring revolutionary activities which

---

[364] Borchard and Wynne (1951a), p. 149.
[365] Mitchener and Weidenmier (2005), p. 17.
[366] Mitchener and Weidenmier (2005), p. 19.
[367] Mitchener and Weidenmier (2005). Quoting Ferguson (2004). *Colossus: The Price of American Empire.* New York: Penguin Press. Also, Ferguson and Schularick (2006) point out how British colonies were able to borrow in the London market at much better terms than non-colonies, with the "Empire effect" providing a discount of around 100 basis points on borrowing rates.
[368] Periods of Venezuelan default: from 1834 to1841, from 1847 to 1859, from 1864 to 1876, from 1878 to 1880, from 1892 to 1893, and from 1897 to 1905.

depleted the country's wealth, slowed economic development, and prompted claims by European nationals for injuries to both persons and property.

During one of the default episodes in 1865, the Committee of Venezuelan bondholders - of which Isidor Gerstenberg was Chairman - sought the intervention of the British Government, backed by letters from Baron Rothschild, Mr. Goschen, and Mr. Crawford, three of the City's MP's. In his letter, Goschen says:

> I have no hesitation in saying that the case of the Venezuelan bondholders is a very hard one, fully deserving of the active and energetic interference of Her Majesty's Government...By such action, not only the rights and just claims of the British bondholders will be protected, but a signal service will be conferred upon the people of Venezuela, whose interests will be considerably benefited by the observance of public arrangements on the part of their Government.[369]

At the time, Earl Russell, Foreign Secretary to H.M. Government agreed to make a strong representation to the Government of Venezuela with respect to their poor treatment of British bondholders. In fact, when Senor A.L. Guzman, the father of the President of Venezuela, arrived in Britain, Earl Russell refused to receive him until "Messrs. Baring and the other British holders of Venezuelan bonds shall have received redress for the wrongs which they have suffered at the hands of that Government."[370]

In addition, a meeting was arranged with the Committee of the Stock Exchange to ensure that the sovereign debt of Venezuela as well as the "shares of any company connected with Venezuela" would be refused admission to the London market until debt service resumed.[371]

The Committee of Venezuelan Bondholders reported its confidence that "should Venezuela persist in her disregard of British claims...the time will soon come when the British Government will proceed to active and energetic measures."[372] There were even reports that United States government would employ force to "correct the dishonesty of the Republic of Venezuela."[373]

---

[369] CFBH Archives (1865). Clippings File, Venezuela, Vol. 1. *Morning Post*, March, 1865.
[370] CFBH Archives (1865). Clippings File, Venezuela, Vol. 1. *Morning Post*, March, 1865.
[371] CFBH Archives (1865). Clippings File, Venezuela, Vol. 1. *Daily Telegraph*, March, 1865.
[372] CFBH Archives (1865). Clippings File, Venezuela, Vol. 1. *Report of the Committee of Venezuelan Bondholders* (pamphlet), 1865.
[373] CFBH Archives (1871). Clippings File, Venezuela, Vol. 1. *New York Times*, May 19, 1871.

In 1898, Venezuela experienced a revolution which lasted for more than two years. During this time, foreign investors suffered a substantial loss of property and the country ceased payment once again on its external debt. In response to this event, and using the pretext of property damage for British government involvement, Britain, Germany and Italy blockaded the ports of La Guiara and Puerto Cabello and seized customs houses in December 1902. Germany proceeded with a unilateral bombardment of the fort at San Carlos, forcing General Cipriano Castro to acquiesce to the demands of the European powers in February, 1903.[374] The foreign bonded debt was eventually readjusted after negotiations between representatives of the Republic and of the bondholders, with the settlement coming into effect in 1905, just three years after the intervention.[375]

Santo Domingo

While the objectives of the European powers that assumed economic control over defaulting debtors were to i) preserve the existing balance of power, ii) ensure the integrity and continued independence of the debtor state, and, iii) improve the chances of remuneration for European bondholders, the U.S had a slightly different motivation for taking economic control over Central American and Caribbean republics - namely to avoid the possibility of European intervention in its hemisphere. The U.S. felt "a moral obligation to prevent American republics from defaulting on their bonds, thus eliminating a source of legitimate grievances on the part of European bondholders and their governments."[376]

However, like their European counterparts, American customs administrations were not strictly limited to revenue receipt and the straightforward application of these revenues to interest and sinking fund obligations. There were instances where the powers were more comprehensive and included control over customs rates (Santo Domingo, Haiti, Nicaragua), the supervision of internal revenues (Haiti, Nicaragua), the imposition

[374] Mitchener and Weidenmier (2004), pp. 7-8.
[375] Borchard and Wynne (1951a), p. 147.
[376] Borchard and Wynne (1951a), p. 294.

of public debt ceilings (Cuba, Santo Domingo, Haiti) and the oversight of public expenditures (Cuba, Haiti, Nicaragua, Panama.).[377]

In the case of Santo Domingo, efforts at securing a debt settlement by British bondholders were first made through diplomatic channels. The CFBH requested that the foreign office, through its Consul General in Haiti, deliver a memorial from the bondholders to the President of Santo Domingo.[378] Later, the Consul General reported back that he had delivered the memorial directly to the President and had "recommended the claims of the British Bondholders to the attention of his Excellency."[379]

In December, 1901, the CFBH applied to H.M. Government to request Lord Paunceforte of the British Consulate in Washington, to "enter into communication with the United States Government with the object of taking joint action, so as to put pressure on the Dominican Government."[380] The CFBH wanted Paunceforte to stress that American as well as British bondholders could benefit from the effort.[381]

Rippy (1934) argues that British bondholders were in large measure responsible for President Roosevelt's declaration of the Corollary to the Monroe Doctrine, the act which immediately preceded the U.S. initiation of a customs receivership in Santo Domingo in April 1905. This Corollary was formulated in May, 1904 in a letter by President Roosevelt to Secretary of War, Elihu Root:

> If a nation shows that it knows how to act with decency in industrial and political matters, if it keeps order and pays it obligations, then it need fear no interference from the United States. Brutal wrong doing, or an impotence which results in a general loosening of the ties of civilized society, may finally require some intervention by some civilized nation, and in the Western Hemisphere the United States cannot ignore the duty.[382]

This seems to be confirmed by the CFBH's Annual Report of 1908: "the British Bondholders who exerted their influence to secure Roosevelt's backing...may be in a

---

[377] Borchard and Wynne (1951a), p. 294.
[378] CFBH Archives (1874). Clippings File, Santo Domingo, Vol. 2. *Daily Telegraph*, July 22, 1874.
[379] CFBH Archives (1874). Clippings File, Santo Domingo, Vol. 2. *Money Market Review*, October 24, 1874.
[380] Rippy (1934), p. 197.
[381] CFBH Archives (1902). File Ms34780. Letter from H.M. Foreign Office to the CFBH.
[382] Rippy (1934), p. 195.

measure responsible for the intervention of the United States in the Dominican Republic and the promulgation of the 'Corollary' occasioned by that intervention."[383]

From the perspective of President Morales of Santo Domingo, the possibility of ceding economic control to the Americans was not entirely unwelcome. He was well aware that customs revenues were the "the prize for which revolutions were principally fought" and in the event they were "safeguarded against seizure by insurgents, the danger of rebellion would be considerably lessened."[384] According to Borchard and Wynne (1951b), "a Dominican revolution might be briefly defined as the attempt of a bandit guerrilla to seize a custom-house."[385]

The U.S. sent gunboats to Santo Domingo in 1905 and immediately assumed the customs collections process, diverting the funds collected to the American and European bondholders of Santo Domingo's defaulted debt. Mitchener and Weidenmier (2004) argued that once this happened "recalcitrant debtors in Central America and around the Caribbean were *willing* to enter into negotiations with creditors ...because of the threat of gunboat diplomacy and lost sovereignty (U.S. seizure of foreign customs houses) – a threat that was made credible by earlier U.S. intervention in Santo Domingo."[386]

"Big stick" diplomacy was not confined to the seizure of customs houses. The U.S. navy toured Central and South America to exhibit its military prowess and U.S. officials undertook high-level diplomatic missions throughout the region. U.S. actions sparked settlements with Columbia and Venezuela in 1905, Nicaragua in 1910, Costa Rica in 1911, and Guatemala in 1913.[387] The Roosevelt Corollary could very well be seen as a turning point in American foreign policy, since prior to its formulation, Roosevelt had a different interpretation of European intervention in the Western hemisphere: "If any

[383] The Corporation of Foreign Bondholders (1873-1987), Report of 1908.
[384] Borchard and Wynne (1951b), p. 240.
[385] Borchard and Wynne (1951b), p. 240.
[386] Mitchener and Weidenmier (2004), pp. 5-6. *Italics* mine.
[387] The Corporation of Foreign Bondholders (1873-1987). In the case of Nicaragua, the debt settlement took place under the Dawson Pact, a contract which gave New York bankers and the British CFBH the right to petition the U.S. government for direct assistance in the event that Nicaragua did not honour its obligations to creditors. In addition, the New York firm of Speyer Brothers (also of London) put legal text into their agreement with Costa Rica in 1905 that holders of the bonds "should be entitled to apply to the United States of America for protection against any violation of, and for aid in the enforcement of, the Agreement." See Platt (1960), p. 9.

South American state misbehaves towards any European state, let the European country spank it."[388]

The Corollary also had the intended effect on bond prices in Europe. On average, Central and South American bond issues listed on the London Exchange rose 75% after one year and 91% after two years, reducing the threat of European intervention in the hemisphere.[389] Market sentiment reflected this boom in bond prices. "London stockbrokers are driving a roaring trade in South Americans, which have become a subject of lively, speculative interest on the theory the President Roosevelt has practically guaranteed all South American obligations. They bear the endorsement of 'big stick' so to speak."[390] And, "stock exchange speculators have read in the recent utterances of President Roosevelt...a hint that the United States is disposed to go gunning in Central America on behalf of British and other European investors."[391]

[388] Mitchener and Weidenmier (2004), p. 9.
[389] Mitchener and Weidenmier (2004), p. 4.
[390] The Corporation of Foreign Bondholders (1873-1987), Report of 1905, p. 186. Quote from the *New York Times*, May 5, 1905.
[391] The Corporation of Foreign Bondholders (1873-1987), Report of 1905, p. 173. Quote from the *Daily Mail*, January 5, 1905.

Chapter 5

Pushing on a String? The Foreign Bondholders Protective Council and Sovereign Debt Restructuring from the 1930s to the 1950s

When you men negotiate there in the [State] Department, you have not only the prestige of our government behind you but you also have the potential power of the government to bring to bear measures of coercion and force... We poor fellows sit here absolutely naked of prestige or potential coercive power... I wonder whether or not you men in the Department... do realize what a helpless, unarmed, impotent organization this Council is.

J. R. Clark
President of the Foreign Bondholders Protective Council
April 15, 1937

We have no clout unless we get some support from the State Department. The State Department looks at us as an annoyance, and without them, it is like we are pushing on a string.

John Petty
President of the Foreign Bondholders Protective Council
June 27, 2006

5.1 The Foreign Bondholders Protective Council and the Four Faces of Power

Accounts of the sovereign debt restructuring regime of the late 19th century have largely credited the institutional innovation of the British Corporation of Foreign Bondholders ("CFBH") with enhancing the efficiency of sovereign debt workouts and improving bargaining outcomes for private bondholders. By contrast, accounts of the interwar and post-war regime of the 20th century have delivered a different verdict: that the U.S. Foreign Bondholders Protective Council ("FBPC") was a failure.[392] Among other things, it has been charged with being ineffective, inappropriately staffed, resource-constrained, and intractable, all of which served to produce poor results for private

[392] Adamson (2002). See also Eichengreen (1991); Eichengreen and Lindert (1989); Eichengreen and Portes (1986); Eichengreen and Portes (1989). Adamson argues that the FBPC failed and was supplanted by the State Department before the onset of World War II. Eichengreen's position is that the CFBH produced better results for bondholders than the FBPC since it was a more experienced and capable organization, operating under the auspices of a more activist government. It should be noted that secondary accounts of the FBPC's performance are limited.

investors. These observations are even more significant since the FBPC was designed - with the benefit of experience - to be institutionally identical to its British counterpart.

In Chapter 4, we challenged the conventional wisdom about the British CFBH and argued that its achievements were less a product of its institutional capabilities and more the result of structural and compulsory regime elements that were external to the institution and favoured private creditors. We concluded that bargaining outcomes between private bondholders and defaulting states in the late 19th century were chiefly driven by two things: the structural power of a centralized, hegemonic, British capital market, and the willingness of the British government to use a wide array of coercive actions - ranging from diplomatic moral suasion to outright military force - to benefit bondholders.[393] In our view, the favourable historical judgments about the CFBH derived from its ability to successfully reflect – and sometimes even take credit for - these other forms of power.

This chapter will examine the FBPC using the same power-based analytical framework. We intend to argue that just as the CFBH was not the institutional triumph that it was portrayed to be, neither was the FBPC a picture of abject failure. We will demonstrate that, once again, structural and compulsory factors were more relevant to determining bargaining outcomes between sovereign states and private creditors. However, in the interwar and post-war periods, they tended to work in the opposite direction - to the detriment, not the benefit, of American creditor interests.

Since secondary source material concerning the FBPC is limited, our analysis has relied heavily on archival research. The FBPC's records, which were only recently donated to Stanford University, were an invaluable source. The archives remain unprocessed and generally inaccessible to researchers, so much of the institutional analysis which appears in our discussion is taken from records that have been opened for the first time.[394]

---

[393] It was often the case that these actions were not undertaken solely for the benefit of bondholders, but for much of the 19th and early 20th century, it seemed that British national interests coincided rather closely with the interests of its bondholders. They were therefore the beneficiaries of coercive exercises of power such as debt administrations and military action.

[394] The author is grateful to the curators of the Green Library at Stanford University, Anthony Angiletta and William O'Hanlon, for agreeing to open the unprocessed archives for the first time – and on an exceptional basis - for the completion of this chapter. As the archives have yet to be processed, each citation includes as much detail as possible about the document in question.

These source materials have enabled us to demonstrate how the FBPC was undermined, almost from the beginning, by its own government in ways that diminished its credibility and virtually eliminated its funding base. In certain default cases, the U.S. State Department even supplanted the FBPC as chief negotiator, forcing U.S. bondholders to accept sub-standard settlements. In addition, the U.S. government and the World Bank made decisions to offer bi-lateral and multi-lateral funding to Latin American and Eastern European governments that remained in default to U.S. bondholders, an undertaking that seriously compromised the negotiating leverage of the FBPC.[395] In short, the political expediencies of the interwar and post-war periods - keeping fascism and communism in check - led the U.S. government to prioritize broader national interests over the interests of private bondholders. With its bargaining leverage so eroded and its institutional capacity under constant siege, it is surprising that the FBPC managed to continue operating. In fact, we propose that the bargaining outcomes that were achieved by the FBPC were delivered to bondholders *despite* the enormous weight of structural and compulsory power arrayed against it.

This particular historical period of sovereign debt restructuring - from the 1930s to the 1950s - provides fertile ground for research for several reasons. First, we see the establishment of an institution – the FBPC – that was virtually identical in structure to the CFBH, but which produced bargaining outcomes that were markedly different. As a result, this epoch allows us to hold the institutional element constant while evaluating the effect that structural and compulsory regime elements had on negotiation. Second, even though the FBPC was responsible for handling the largest share of defaults during this period, both the FBPC and the CFBH found themselves operating simultaneously in certain default cases. Historical data reveal that even in the same negotiation, American and British bondholders fared differently, with the latter achieving higher *ex post* returns. This suggests that the CFBH continued to outperform the FBPC, an outcome which merits further explanation. Whereas secondary accounts of the period tend to credit the more capable and experienced CFBH with these results, we continue to dispute this view.

[395] While the U.S. government was initially sensitive to any situations which required it to "lend into arrears" it gradually softened this policy to the point that any government which showed that it was making an effort to negotiate with the FBPC was eligible for Exim or World Bank financing.

Instead, we maintain that British bondholders benefited once again from the non-institutional sources of regime power in the 1930s and beyond.

5.2 The Performance of the FBPC: Default Cases and Bargaining Outcomes

Before proceeding to our discussion of the key features of the 1930s sovereign debt restructuring regime, it is important that we first establish the context within which sovereign state/private creditor negotiations took place. Between World War I and the stock market crash of 1929, the U.S. had effectively replaced Britain as the single largest creditor nation. In fact, the six-fold increase in U.S. lending activity between the wars had brought total American foreign investment levels within reach of those of Britain; by 1929, America's total foreign investment was £3 billion and Britain's was £3.8 billion.[396] Carr credits the rise of the U.S. as a political power "to [its] appearance in the market as a large-scale lender, first of all to Latin America, and since 1914 to Europe."[397]

Most of the consequential sovereign defaults occurred between the years 1931 to 1940 and totalled $7.039 billion, although more than half were concentrated in just fourteen countries. Among these, the most significant were in Germany ($2.2 billion) and Latin America ($2.5 billion).[398]

Also, we find a greater incidence of default on dollar – not sterling – bonds during this period. Eichengreen and Portes (1989) argued that this was principally because the London capital market was much more adept at discriminating between good and bad credit risks. Moreover, London prioritized loans to Empire governments, including Australia and Canada, which accounted for 75% of all British overseas government issues, "not one of which slipped into arrears."[399] This left American investors holding the "lion's share" of the German and South American bonds that lapsed into the most serious defaults.[400] For these reasons, the overall bargaining outcomes during this period

---

[396] Lipson (1985b), p. 66. As we recall from Chapter 4, the U.S. only had an 8% share in global foreign investment in 1913, while Britain's share was 44%. See also Fishlow (1986).
[397] Carr (1964 [1981]), p. 114.
[398] Suter (1992), p. 69. The major countries in default (or involved in debt reschedulings) were Germany $2.2 billion; Brazil, $1.267 billion; Romania, $580 billion; Mexico, $500 million; Greece, $380 million; Chile, $376 million; Austria, $325 million; Yugoslavia, $320 million; Poland, $300 million; Hungary, $250 million; Colombia, $151 million; Turkey, $140 million; Uruguay, $130 million; and, Peru, $120 million.
[399] Eichengreen and Portes (1989), p. 38.
[400] Eichengreen and Portes (1989), p. 39.

are more attributable to the regime anchored by the American FBPC than by the British CFBH, although both institutions were operating simultaneously.

Table 5A: Bargaining Outcomes (1871-1975)[401]

Time Period	*Dominant Creditor Representative Body*	*Duration of Defaults*	*Capitalization of Interest Arrears*	*Reduction in Interest Rates*	*Reduction in Principal*
1871-1925	Corporation of Foreign Bondholders	6.3 years	71.6%	16.3%	12.0%
1926-1975	Foreign Bondholders Protective Council	10.1 years	35.2%	34.5%	23.2%

Source: Suter (1992)

This table illustrates the very different results produced under the British CFBH as opposed to the American FBPC. In the late 19th and early 20th centuries, defaults were settled by the CFBH 37% faster than they were by the FBPC. In addition, the CFBH regime offered bondholders a greater recapture of interest arrears and principal, while requiring them to take a much smaller haircut on interest rates. Overall, the record suggests much better bargaining outcomes for creditors during the 19th and early 20th centuries than during the interwar and post-war periods.

Several scholars have ventured explanations for these results. As we discussed earlier, Suter (1992) ties the results of default settlements to the balance of power in the international system. He maintains that creditors achieved better results in debt negotiations during periods of uncontested hegemony than they did during periods of core conflict. In other words, since the post-1930s settlements "coincided with the [uneasy] transition from British to U.S. hegemony," the situation favoured the debtor states because they could offer poorer terms to the "old and decaying hegemonic power (i.e., Britain)." In addition, Suter argued that the United States did not prioritize British interests, but instead preferred to "integrate debtor countries at the periphery into its own

[401] Suter (1992), p. 94. Although the period of measurement extends to 1976, the bulk of settlements were reached by the early 1950s. The cut-off date of 1976 is relevant because it signifies the creation of the London Club, the successor regime for private creditor-sovereign state negotiations.

hegemonic power system by granting substantial concessions at the expense of Britain."[402]

While we agree with Suter's premise that power matters in sovereign debt negotiations, we take issue with his contention that American action undercut British bargaining positions. In fact, in work undertaken by Eichengreen (1991) and Eichengreen and Portes (1986, 1989) we find that the "old and decaying hegemon" did a remarkable job in holding its own against the rising power of America, delivering returns to British bondholders that were ultimately superior to those achieved by the American investors.

Table: 5B: Internal Rates of Return for Dollar and Sterling Bonds Issued 1923-1930[403]

Internal Rates of Return	*Government Bonds Only*	*All Bonds*
Dollar Bonds	3.25%	0.72%
Sterling Bonds	5.31%	5.31%

Source: Eichengreen and Portes (1986)

Table: 5C: Internal Rates of Return for Dollar and Sterling Bonds Issued 1920-1929[404]

Internal Rates of Return	*Government Bonds Only*	*All Bonds*
Dollar Bonds	4.64%	3.99%
Sterling Bonds	5.18%	5.18%

Source: Eichengreen and Portes (1989)

The tables above illustrate the results of two separate studies on the comparative *ex post* returns achieved by British and American bondholders. In the first table, the internal rate of return on sterling issues surpasses that of dollar issues and, in fact, is quite close to the statutory rate under the original sterling bond covenants. By contrast, the smaller return

[402] Suter (1992), p. 96.
[403] Eichengreen and Portes (1986). The bond sample includes 50 dollar bonds for foreign issuers floated in the U.S. in the period 1924-1930, and 31 colonial and foreign government bonds offered in the U.K. in the period 1923-1930. Note that the sample for the U.K. includes government bonds only.
[404] Eichengreen and Portes (1989), pp. 26-29. This updated sample includes 250 dollar bonds and 125 sterling bonds issued during the period 1920-1929. Once again, in the British sample, no corporate issues were listed; we find government obligations only.

on the full sample of dollar issues is only around 10% of the average contractual rate for the period, a decidedly substandard result for the American regime.[405]

However, in the second, updated study, a larger bond sample was used and we find that the realized returns of 4.64% and 5.18% on dollar and sterling bonds respectively were, although closer, still much lower that those promised *ex ante*, which were in the range of 7% - 8%. Even though the gap is smaller, British bondholders still fared better.[406] U.S. investors lost an average of 75% of interest while British investors lost only 30% - 50%.[407] As a result, the overall returns to U.S. investors during this period tend to pull down the average. And, even if we single out the largest sovereign default case of the period – Germany - the same pattern emerges. British bondholders still manage to achieve better returns than their American counterparts.

Table 5D: Bargaining Outcomes for FBPC vs. CFBH on German Government Bonds[408]

Nominal Rate of Return on U.S. Dollar Bonds	1.1%
Nominal Rate of Return on U.K. Sterling Bonds	3.5%

Source: Eichengreen (1991)

To sum up, this chapter will examine the four aspects of the sovereign debt restructuring regime of the interwar and post-war periods – institutional, structural, compulsory and productive - and explain not only the observed differences in inter-period bargaining outcomes but intra-period differences as well. Why did the FBPC produce inferior outcomes for American bondholders when compared to the CFBH in the 19th century? Moreover, why did the CFBH continue to outperform the FBPC in the interwar and post-war periods? Before moving on to our institutional analysis of the FBPC, it is important that we first explain the political impetus behind the organization.

[405] Eichengreen and Portes (1986), p. 626.
[406] Eichengreen and Portes (1989), p. 27. See also Lindert (1989). This is in part because this sample also captures the 1920 – 1923 period, when nominal rates were higher. It is also interesting to note that these IRR's are very close to the returns that would have been achieved on US and UK government bonds over the same period (1920-1929). UK consuls, for example, would have yielded 4.5% during the same timeframe but would have carried virtually no default risk.
[407] Eichengreen and Portes (1989), p. 40.
[408] Eichengreen (1991), p. 164.

5.3 The American Debate: A Government or Private Institution for Bondholders?

While the British CFBH was founded as a private, not-for-profit institution, U.S. policymakers had a serious internal debate about whether the new U.S. bondholder representative body should be private or public. In the age of the New Deal, as opposed to the laissez-faire 19th century, state involvement was seen as an important corrective to the market failures of the 1920s. As a result, a special provision had already been made under Title II of the Securities Act of 1933 for the creation of a Corporation of Foreign Security Holders under U.S. government auspices. However, this institution did not automatically come into existence with the passage of the Securities Act. Instead, the President was empowered to bring it into existence at any time by a separate proclamation.[409]

If it were not for the persuasive powers of Raymond Stevens, Chairman of the Federal Trade Commission, the FBPC might never have existed. Stevens met privately with President Franklin Roosevelt at Hyde Park on August 3, 1933 and convinced him of the dangers of establishing a governmental organization under Title II of the Securities Act to negotiate on behalf of bondholders. Stevens cautioned him that it might be better for the U.S. government to distance itself from the process of sovereign debt negotiation, lest U.S. bondholders look at their own government as a debt collector and have overly optimistic expectations. In addition, a Title II corporation would create conflicts of interest for the U.S. government. As a creditor in its own right, the government would be negotiating its own claims along side those of private bondholders. And, if the U.S. government were the principal negotiating party for private creditors, sovereign states might look to get political concessions as part of a deal, concessions that would never be on the table if a private creditor body controlled the negotiations.[410] Finally, it was believed that a private organization could relieve the State Department of burdens and responsibilities which could arise at inconvenient times "when other national interests prevent[ed] the exercise of a legitimate influence on behalf of...bondholders."[411] Roosevelt agreed with Stevens that a private, non-governmental organization seemed the better alternative and penned a note to him:

[409] FBPC Archives (1933), File M1287 029.
[410] FBPC Archives (1937). File M1287 030. S.E.C. Report on FBPC dated May 14, 1937.
[411] FBPC Archives (1933). File M1287 029. White House press release dated October 20, 1933.

R.S., It is my thought that if an adequate Bondholders Committee is set up quickly I will hold in abeyance the setting up of the quasi-government board. FDR[412]

A White House press release later confirmed Roosevelt's assessment that the job of negotiating for private bondholders was "primarily for private initiative and interests." The White House was also careful to point out that when the new organization was brought into being, it would be "entirely independent of any special private interests," which, in New Deal parlance, meant that it would have no connections of any kind with the banks and issue houses. In order to put some distance between itself and the new institution, the government announced that it would have no intention of seeking "control of the organization," nor would it "assume responsibility for its actions."[413] However, internal State Department correspondence revealed that the government saw the FBPC as a useful political compromise insofar as it would allow the administration to escape major responsibility for the conduct of negotiations, while at the same time, permit some degree of interference.[414]

5.4 The Creation of the FBPC and Institutional Power

How was the FBPC brought into existence? Cordell Hull, Secretary of State, and Raymond Stevens, Chairman of the Federal Trade Commission, invited a group of distinguished citizens to join them in Washington on October 13, 1933 for the purposes of discussing "the creation of an adequate and disinterested organization for the protection of American holders of foreign securities." Hull and Stevens considered the sovereign defaults to be of such importance and significance to American investors as to "make its proper handling a public service."[415]

---

[412] FBPC Archives (1933), File M1287 029. FDR note attached to letter from Pierre Jay (Fiduciary Trust Company of New York) to Clark (President of FBPC) dated January 23, 1934. Jay thought that this note from FDR was of historical significance and should be retained by the FBPC.

[413] FBPC Archives (1933). File M1287 029. White House press release dated October 20, 1933.

[414] Borchard and Wynne (1951a), p. 193. See also U.S. Department of State (1933), p. 934. "...it was hoped that the existence of the Council would perhaps lessen the necessity under which the Department of State might have to take cognizance of default situations."

[415] FBPC Archives (1933). File M1287 029. Letter from Cordell Hull (Secretary of State) and the Chairman of the Federal Trade Commission to J. C. Traphagen (President of the Bank of New York and Trust Company) dated October 13, 1933. Identical letters were sent to other invitees.

According to a White House press release, only two of the eighteen citizens invited to the initial meeting were from the banking community - Mills B. Lane of The Citizens and Southern National Bank, and J.C. Traphagen of The Bank of New York and Trust Company. The only other financial concern represented was Chubb and Son Marine Insurance. Of the remaining fifteen invitees, three were academics and nine had U.S. government affiliations; rounding out the list was a lawyer, a publisher and a cotton company representative.[416] This was in marked contrast to the original meeting of the CFBH, which was dominated by banking and City of London government interests.[417] In fact, the CFBH boasted of its banking alliances, announcing at its founding that it was "vitally connected" with these interests and enjoyed the support of "the heads of so many eminent banking and financial houses."[418] The proclivity on the part of the Roosevelt administration to exclude bankers reflects the low esteem in which issue houses were held by the administration in the 1930s. In many ways, they blamed the banks' greed and poor underwriting practices for the extensive defaults experienced by U.S. bondholders. They were also deeply suspicious of the banks' motives, as evidenced by the State Department claim that the American banking community was neither "as...closely knit as the British, nor were its members as trustful."[419]

5.4.1 Institutional Form and Operating Rules of the FBPC

The organizing committee of the FBPC firmly believed in the efficacy of such an institution for a number of reasons. From an international relations perspective, they saw the FBPC as a centrally authoritative mechanism that could reduce the friction between the U.S. and other creditor nations when dealing with a sovereign bond default. They also believed that the FBPC could help to surmount the collective action problems among bondholders, since the FBPC's records indicated that U.S. holdings of foreign debt issues were widely scattered throughout the United States, with most issues averaging only three bonds per person.

---

[416] FBPC Archives (1933). File M1287 029. White House press release dated October 20, 1933.
[417] CFBH Archives (1869). File Ms34827. Clipping from the *Times*, February 3, 1869.
[418] The Corporation of Foreign Bondholders (1873-1987), Report of 1876, p. 9. CFBH Archives (1868). File Ms34827. Clipping from the *Morning Post*, November 12, 1868.
[419] Sessions (1974), p. 49.

The FBPC was ultimately organized as a not-for-profit organization under the laws of the State of Maryland and incorporated under the name the Foreign Bondholders Protective Council, Inc. in 1933. Among its main objectives were the protection of bondholder rights, the collection and preservation of reports and data with respect to public securities, and the negotiation of settlement arrangements with foreign government representatives. The FBPC saw its mandate as a fiduciary one insofar as it was to act on behalf of the bondholders who had entrusted the representation of their interests to the Council.[420] In these matters, the FBPC shared many institutional design characteristics with its British counterpart. In fact, the organizers maintained that the "rough model before everyone's eyes was the British Council of Foreign Bondholders."[421]

It is not surprising that the organizing committee of the FBPC looked at the best practices and precedents established by the CFBH and other European bondholder committees when setting up the new U.S. organization. They agreed that, like the CFBH, the FBPC would be a central organization which would coordinate the work of a number of autonomous committees, each of which would be charged with carrying on the day-to-day negotiations with a specific defaulting country. With this in mind, the FBPC agreed that it should form appropriate special negotiating committees, "cooperating wherever practicable with the houses which issued the defaulted bonds."[422] While this seemed to contradict the administration's desire to limit the involvement of the issue houses, in fact, the organizers were not so much giving management control to the bankers as they were recognizing the need to work with them. After all, the banks had a distinct advantage over the FBPC from a negotiating standpoint. First, they acted as fiscal and paying agents for the bonds, which meant they had longstanding contacts with the treasury ministries of the defaulted governments. And, second, as fiscal and paying agents, they maintained a registry of bondholders, making it possible for them to easily identify and communicate with bondholders across the U.S.

A more refined policy regarding the composition of specific negotiating committees was developed by the FBPC in 1937. It indicated a strong desire to have these committees composed as far as possible of "those purchasing bonds at or near the

[420] FBPC Archives (1933). File M 1287 029. Certificate of Incorporation.
[421] U.S. Department of State (1933), p. 934.
[422] FBPC Archives (1933-1934). File M1287 069. Minutes of Executive Committee, 1933-1934.

original issue price;" this would create a bias towards protecting the original investment of the smaller bondholders and not the investments made by speculators in depreciated bonds. It also felt that it was essential to exclude from such committees persons "engaged in the active buying and selling of bonds," either for personal profit or on behalf of customers, since they would be able to trade on insider information.[423]

At inception, the FBPC outlined a negotiating strategy which would ultimately bring it into direct conflict with the U.S. Government. The Council observed that "in view of the depression and the disorganization of world trade...there is little that can be done towards bringing about prompt resumption of interest and sinking fund payments." It maintained that the creation of the FBPC should not been seen by debtor states as "an indication that American bondholders are ready to negotiate permanent settlements on the basis of the present impaired capacity of debtors to pay." The organizers counselled patience on both sides since they saw the recovery of world trade as a necessary precondition for final settlements.[424]

Given the FBPC's posture, all sovereign default situations were approached in the same way. The Council never recommended a settlement which called for any reduction of the principal of the bond; it also required that the defaulting sovereign recognize an acceptable portion of interest arrears. Finally, for even a temporary settlement to be recommended, the FBPC insisted that payments of current interest be resumed at the stated contractual rate.[425] Meetings of the FBPC's board took place anywhere from twice to four times a month in the 1930s and the minutes cover the details of the progress of negotiations as well as the administrative issues related to the running of the organization. The minutes also offer a sense for how slow, tedious, and expensive the actual negotiations were with Latin American states as well as the importance – and necessity – of frequent communication between the State Department and the Council.[426]

Unlike the CFBH, the FBPC could not hold regular meetings for individual bondholders. This was principally for two reasons: their sizable number and their wide

[423] Foreign Bondholders Protective Council (1936-1977), Report of 1937, p. 5.
[424] FBPC Archives (1933), File M1287 029. Report of the Organizing Committee dated December 18, 1933. While it seemed like a reasonable approach at the time, and was in fact the same tactic later adopted by the Bank Advisory Committees in the 1980s, the U.S. government found that it didn't share the patience of the Council in the years leading up to World War II.
[425] Foreign Bondholders Protective Council (1936-1977), Report of 1958-1961, p. vii.
[426] FBPC Archives (1936). File M1287 069. Minute Books of 1936 and 1937.

geographic dispersion throughout the United States. In fact, while the FBPC initially registered over 100,000 U.S. bondholders, by 1961, this had grown to over 300,000, all of whom expected to receive regular communication from the Council.[427] This contrasts sharply with the British CFBH that had the ability to hold meetings at 25 Moorgate in London for small investor groups that numbered anywhere between 70 and 200.[428] Given that U.S. bondholder meetings were impractical, investors who wished to avail themselves of the FBPC's services were asked to register in writing with the Council by proving their contact details and the face amount and description of their bonds. Small bondholders were assured that there would be no fee for registration and no obligation or commitment incurred to the Council by registering.[429]

5.4.2 Staffing of FBPC

Although Raymond Stevens of the Federal Trade Commission was Roosevelt's choice to head the FBPC, by February, 1934, Stevens requested an extended leave of absence due to poor health, and J. Reuben Clark, the institution's chief counsel, was elected acting President.

Clark's personality figures prominently in the accounts of Adamson (2002) and Sessions (1974) as an explanation for the early friction between the Council and the State Department.[430] For this reason, it is worthwhile examining Clark's record. On paper, he certainly seemed like a solid choice to run the fledgling FBPC. Educated at Columbia Law School, he was an international lawyer, State Department solicitor, and former Ambassador to Mexico. He was also a prominent leader of the Mormon Church in Salt Lake City.[431] His resume seemed well-suited to a role in which he would be called upon to negotiate the settlement of debt contracts with foreign governments. However, there was one problem: Clark had a rigid and moralistic view about debt obligations, seeing fiscal probity, at both the individual and national level, as an ethical virtue. While Sessions (1974) attributes this in part to his religious beliefs, it seems that it could be just

[427] Foreign Bondholders Protective Council (1936-1977), Report of 1937, p. 7; See also Foreign Bondholders Protective Council (1936-1977), Report of 1958-1961, p. viii.
[428] CFBH Archives (1880). Files Ms15806; Ms15801; Ms15779.
[429] FBPC Archives (1936). File M1287 069. Minute Books of 1936 and 1937.
[430] Adamson (2002); Sessions (1974).
[431] Sessions (1974), pp. 76-77.

as easily attributable to the fact that Clark was an attorney and an ardent Republican functionary. Even his successor, the Hooverite Francis White, shared Clark's views on the sanctity of debt contracts without sharing his religious fervour. Clark took a decidedly firm, legalistic view about a government's capacity to pay:

> Few, if any, governments have borrowed beyond their capacity to pay if they really had a will to make the necessary levy upon the property of their nationals...Under the theory of international law...the whole wealth of the nation, including the private wealth of all the nationals of that nation, is subject to tax up to extinction for the debts of the sovereign. No nation has any right to invoke its lack of 'capacity to pay'...until it has fully exhausted its taxing powers and no debtor sovereign now in default, insofar as the Council is advised, has even approached a condition of exhausting its taxing powers.[432]

As time progressed, Clark's legalistic and unyielding approach to debt negotiations made him "draw the line between necessity and luxury...far into what [sovereign] debtors would usually regard as the necessity side of the fiscal spectrum."[433] Clark firmly believed that a debt was a sacred obligation and that the only thing that should stand in its way was virtual survival.

What was behind this attitude? First, Clark very much believed that he was working in the best interests of the small investor. He maintained throughout his tenure that there were no important concentrations of foreign bondholdings in the U.S., and he argued that the typical investor had at most one or two thousand dollars of family savings at stake. The many letters which the FBPC received indicated to Clark that the majority of small investors had been impoverished in the wake of the Great Depression and desperately needed the return of their capital. In the 1935 case of Costa Rica, for example, the FBPC cited "instances of hardship among holders of bonds who were in rather indigent circumstances, to whom it was a real hardship to have the service cut down."[434] Since there were hundreds of thousands of these cases across the U.S., Clark

[432] Foreign Bondholders Protective Council (1936-1977), Report of 1936, pp. 6-11.
[433] Sessions (1974), pp. 106-107.
[434] FBPC Archives (1935). File M1287 055. Memorandum to file from White (FBPC) dated June 12, 1935.

felt that the Council could "by its watchfulness and influence, contribute to the security of their savings."[435]

Second, Clark understood the phrase "capacity to pay" to have originated in a discussion "between sovereigns with reference to obligations running between them." In this legalistic rendering, Clark believed that if sovereign states sought to make adjustments to those debts "they were dealing as equals about their own debts, and could, with reference thereto, be generous or otherwise as suited their sovereign interests."[436] This same generosity could not be expected from private bondholders, who were not the equals of sovereigns, and were therefore not in a position to trade political advantages for debt forgiveness.

While the FBPC's board was intended to be as free from the influence of banking interests as possible, the risks of this position were soon becoming apparent. Clark's knowledge of the financial markets was rudimentary at best. He even openly admitted:

> I am not a financier, and I am not a banker...I never bought a bond, I never owned a bond, and I regret to say, I was never a member of one of those preferential lists for underwriting securities.[437]

One FBPC board member went so far as to confide the following to the State Department: "I live in fear...that somebody will presently ask me some questions about the [default] situation and I can think of practically no question that I could answer."[438]

Clark's successor as FBPC President, Francis White, unfortunately shared Clark's views about a debtor's "capacity to pay" as well as his lack of experience in financial matters; however, it was most unfortunate that these qualities were packaged in a much more aggressive personality. White had been Assistant Secretary of State during the Coolidge and Hoover administrations and had apparently offended Europeans and Latin Americans during his tenure by making statements which "smacked of the old American

---

[435] Foreign Bondholders Protective Council (1936-1977), Report of 1946-1949, p. viii. Even by 1942, this picture had not changed. The FBPC has records of Dominican and Chilean holdings in 48 states and some 20 odd foreign countries and dependencies with the majority still held by their original purchasers. See FBPC Archives (1942). Memorandum from White (FBPC) dated February 5, 1942.
[436] Foreign Bondholders Protective Council (1936-1977), Report of 1936, p. 7.
[437] Sessions (1974), p. 76.
[438] Sessions (1974), p. 64.

hegemony doctrines" of Monroe and Theodore Roosevelt.[439] He was described in the New York Press as a "dyed-in-the-wool Tory, hater of Roosevelt policies...[and] on a crusade to squeeze the last penny of interest and amortization from Latin American governments."[440] In fact, it could have been that the Roosevelt Administration gradually began to see the FBPC through partisan eyes. After all, Clark and White may have been characterized as dangerous relics from the failed policies of the Hoover administration.[441] And, since the FBPC's main contact at the State Department, Herbert Feis, was another Hoover appointee, the Council may have been shielded from the opinions of the larger Roosevelt administration by interacting so narrowly with Feis. This made it possible for the FBPC to maintain its rigid policies in the face of mounting frustration and impatience on the part of the U.S. government. In a rather impertinent letter dated October, 1939, Senator Rust Madison recounts his experience to Roosevelt of visiting the Council's offices earlier that summer:

> You can't expect anything else from an organization run by nice old women...and college professors...I really believe something can be done if the problem is approached from a practical standpoint rather than from the standpoint of an economics...professor and an old maid.[442]

The FBPC was certainly a convenient target for Roosevelt loyalists but the question remains: Was the Council pursuing an irrational settlement strategy? Was it advisable to focus so narrowly on temporary settlements and refuse to consider principal forgiveness until such time as the global economy had recovered? We would argue that while the administration saw this as intransigence, it was not an imprudent stance for the FBPC to take. After all, the Council saw itself as having a fiduciary responsibility to hundreds of thousands of small bondholders and wanted to maximize the recovery of their capital. And, with the global economy in such disarray, any attempt to make early, final settlements would have been highly unfavourable to private investors. So, pursuing a

---

[439] Sessions (1974), pp. 115-116.
[440] FBPC Archives (1937). File M1287 030. Clipping from the *New York Post*, July 25, 1937.
[441] CFBH Archives (1942). File Ms34620, Documents 391/2 and 391/5. In a letter from Butler (CFBH) to Bewley (British Embassy, Washington, DC), the CFBH proposes that the FBPC might have fallen afoul of the State Department because of the personality of Francis White. In a letter from Wade (H. M. Treasury) the point is made that the Republican sympathies of White may be responsible for the difficulties between the FBPC and the State Department.
[442] Sessions (1974), pp. 183-184.

strategy that involved temporary settlements and long-term patience was not irrational. Ironically, this was precisely the strategy that the London Club employed in the 1980s when it pushed Latin American debtor states into seven years of debt rescheduling before agreeing to any principal forgiveness. Far from being criticized for its approach, the London Club enjoyed broad support from the G-5 and the IMF. The major difference was that the London Club's actions were helping to preserve the solvency of the global banking system, a goal which was enthusiastically championed by major creditor-country governments. By contrast, the FBPC's bondholders did not present a systemic risk to the global financial system; so, all the FBPC managed to achieve by its strategy was to frustrate the larger political and strategic objectives of its home government. While it may not have been part of the FBPC's mandate to help achieve these objectives, it was nevertheless in the administration's interests to intervene and paint the FBPC as impractical, intransigent, and even incompetent.

5.4.3 CFBH Impression of FBPC Staff

It is very interesting to note how the FBPC's British counterpart, the CFBH, viewed the management team of the new American Council. Archival sources reveal a decidedly negative assessment from the CFBH about the suitability of the men chosen to run the FBPC:

> There has been in our point of view a progressive decline in the combination of character and capacity of three successive Presidents of the American Council. The first, Mr. J. Reuben Clark [Feb. 1934], was Treasurer of the Mormon Society, had some understanding of business, was by no means unfriendly and gave a general impression of honesty and intention. The second, Mr. Frances White [April, 1938], was an ex-Minister to Cuba, was a rather aggressive personality, viewed debt matters from a pronounced legalistic angle, and made one feel that one was dealing with a clever but rather unfriendly solicitor, who might fulfil the strict letter of his bond, but who did not intend to reveal his intentions and would not inevitably be above using truth as a means of deception. The third, Dr. Dana Munro, was a former chief of the Latin American section of the State Department and is now a professor at Princeton University. We have not yet met him, but his actions and our correspondence with him seem to show that he has little beyond an academic understanding of the problems with which we have to deal, and that he...is largely in the pocket of the State Department.[443]

[443] CFBH Archives (1944). Guildhall Library, City of London. File Ms34620, Document 391/26.

In fact, the British were so unsure of the Council's viability in 1937 that they contacted Herbert Feis at the State Department to find out if they should even make the time to meet with the FBPC. The British Council pointedly asked Feis whether "they should talk with the Foreign Bondholders Protective Council, Inc. or somebody else."[444] It appears that the FBPC not only had an image problem with its own government, but with its counterparts in Europe as well. However, the British Treasury ultimately advised the CFBH to continue its dialogue with the FBPC because they believed that the American Council would "emerge more powerfully outside the present administration."[445]

5.4.4 Institutional Funding of the FBPC

One of the first challenges of the organizers of the FBPC was to find a way to fund their operations. There was wide agreement among the original board members that "to get the organization up and running quickly" they would ask the banks and issue houses in New York and other large cities to agree to advance them money. The FBPC's objective was to repay them over time, in a fashion almost identical to the British CFBH. The FBPC anticipated that it needed about $60,000 to cover staff salaries, rent and travel, but aimed to raise $100,000 initially.[446] The Council's inclination was to ask those to contribute who would reap the greatest benefits from the FBPC's existence: the issuing banks, banks engaged in trade finance, manufacturers engaged in import/export businesses, and holders of foreign bonds.[447] In December, 1933, Raymond Stevens arranged for twenty bankers to meet at the New York Federal Reserve to discuss potential funding; Pierre Jay, an FBPC board member, spoke on the same day at the Investment Bankers Associations. Both men were successful in getting funding commitments from the banks.[448]

By April 10, 1934, the FBPC had put together membership forms for banks which would systematize their annual dues payments by tying them to their level of deposits.

---

[444] FBPC Archives (1937). File M1287 030. Memo from Clark (FBPC) to file dated January 18, 1937.
[445] CFBH Archives (1942). File Ms34620, Document 391/5. Memorandum from Wade (Official in H.M. Treasury).
[446] FBPC Archives (1933). File M1287 029. Memorandum titled "Plan for Organization of Foreign Bondholders Corporation."
[447] FBPC Archives (1933). File M1287 029. Report of the Organizing Committee dated December 18, 1933.
[448] Sessions (1974), p. 66.

The level of dues ranged anywhere from $10 to $250 per year; however, the larger banks and issue houses were encouraged to commit up to $5,000 per year. It was an amount that Reuben Clark considered to be meaningful, but not large enough to draw attention or criticism. The minutes of meetings during 1934 show that there were concerted efforts on the part of the FBPC to sign up banks in a pyramid-like way. Larger banks who signed on as members were encouraged to bring in smaller regional banks. The various offices of the Federal Reserve system throughout the U.S. were used as meeting points to put extra pressure on banks, and the FBPC even underwrote the expenses of senior bank officers who took the time to recruit new members to the organization. In its initial phases, the FBPC was funded almost entirely by the banking community with each meeting of the Executive Board presenting new banks to be considered as members.[449]

In fact, early records indicate that the FBPC obtained commitments for funding from the financial community in New York, Chicago and Philadelphia, with $35,800 raised in 1934 from 24 issue houses and $25,030 raised from 18 banks, for a total of $60,830.[450] By the end of 1934, membership had grown to 151 banks and issue houses (or 75% of the total) with annual contributions of $86,253, very close to the original fundraising target.[451] However, this early success provoked the first attack by the U.S. government on the FBPC: an S.E.C. investigation. The newly established regulatory body, charged with looking out for the interests of the small investor, became highly suspect of the involvement of banks in the FBPC's funding and wanted to ensure that the Council was not being unduly influenced in its decisions by members of the financial community.

5.4.5 The S.E.C. Investigation

Before the FBPC had managed to establish itself as a viable institution in the minds of U.S. bondholders, sovereign debtors, and the CFBH, its energies were diverted to an S.E.C. investigation. Reuben Clark was informed about the investigation in 1935, although it formally began on February 25, 1936. He saw the investigators at the S.E.C.

[449] FBPC Archives (1934). File M1287 069. Minutes of Executive Committee, 1933-1934. See also FBPC Archives (1933). File M1287 029. Minutes of the First Meeting of Members dated December 18, 1933.
[450] FBPC Archives (1934). File M1287 029. List of Annual Membership Contributions, 1934. See also Borchard and Wynne (1951a), pp. 196-197.
[451] FBPC Archives (1935). File M1287 069. Minutes of Executive Committee, 1935.

as "very young in their experience of governmental matters" who did not realize "that there is honesty outside government as well as in it."[452] He believed that many of the New Dealers who were in positions of power at the S.E.C. wanted to close down the FBPC and replace it with the Title II governmental organization originally contemplated by Roosevelt.[453] Meanwhile, at the State Department, the FBPC's main contact, Herbert Feis, said that the Department was hoping the final S.E.C. report would fully back up the Council, since the last thing the State Department (or the President) wanted was to "have this whole debt problem back in [our] laps the way it was three years ago." Clark and his board were instructed to redouble their efforts and cooperate fully with the S.E.C.[454]

The S.E.C. report following its investigation was notable in many respects, the most important – and expected - being the sharp criticism levied at the financial support which banks and issuing houses provided the FBPC. The S.E.C. required that banks and bankers be disqualified from any negotiating committees, and even that former officers, directors and partners of banks and issuing houses be disqualified from sitting on a committee, at least until a reasonable amount of time had lapsed. It unequivocally mandated that the FBPC should receive *no financial support* from any person or firm in the banking community. As Sessions (1974) observed, "in their anxiety to gather a group devoid of connections with the investment banking establishment, the organizers had failed to recognize that the Council members would be largely unable to do much besides lend their names and file letters."[455] Finally, the S.E.C. compelled the FBPC to submit to regular oversight by the Commission and the State Department.[456] The hope was that this new level of transparency would enhance the credibility of the FBPC in the eyes of bondholders and sovereigns.

The S.E.C. argued in favour of banning banks and issue houses from FBPC membership on the following grounds:

---

[452] FBPC Archives (1935). File M1287 069. Minutes of Executive Committee, 1935.
[453] The S.E.C. did conclude that it was a prudent decision not to enact the Title II organization, since it would have been funded by the Reconstruction Finance Corporation as an agency of the U.S. government, creating awkward conflicts for the U.S.
[454] FBPC Archives (1937). File M1287 030. Transcript of phone conversation between Clark (FBPC) and Feis (State Department) dated April 16, 1937. There were hundreds of letters that arrived at the State Department each day from aggrieved bondholders, and State wanted to be able to turn those over to the FBPC.
[455] Sessions (1974), p. 64.
[456] FBPC Archives (1937). File M1287 030. S.E.C. Report on FBPC dated May 14, 1937.

1. Issue houses were often called upon to act as fiscal and paying agents for sovereign bond issues. Under these arrangements, the banks' allegiance was to the debtor state. If the banks then also took on the role of bondholder representatives, their loyalties were necessarily divided.
2. Banks and issue houses often had their own claims against debtor states, and these claims generally took the form of short term or trade credits. The S.E.C. believed that this was the most egregious conflict, since the banks generally asserted that their short-term credits had priority over longer-term bonds. In the grab race for limited foreign exchange, the bankers could privilege their own interests at the expense of the bondholders.
3. Where American banks had local offices or business interests in defaulted Latin American states, the banks' interests might have been better served by cultivating and preserving friendly relationships with the sovereign, and not by vigorously advocating the bondholders' cause.
4. In certain cases, bankers had been accused of fraud by the debtor-sovereign based on circumstances surrounding the original bond issuance. The S.E.C. argued that this fraud often arose in no small part due to the "utter recklessness with which the investment banks vied with one another to bring out a constant succession of foreign bond issues." Where such antipathy existed between a debtor state and a banker, that banker would be an ineffective negotiator for the cause of private bondholders.[457]

Although the S.E.C. raised valid concerns, the fact is that the first three objections could have also delivered some benefits to bondholders. For instance, a bank that had developed a longstanding relationship with a sovereign as its fiscal and paying agent could have contributed some measure of trust to the negotiation process, something which the FBPC sorely lacked. In addition, the fact that banks were capable of providing trade financing also endowed them with some bargaining leverage. They could have used that leverage to push recalcitrant debtors in need of short-term credit to the negotiating table. And, finally, banks that had a physical presence in a debtor state also had an

[457] FBPC Archives (1937). File M1287 039. S.E.C. Report dated June 21, 1937.

interest in seeing that debtor states recover. So, while the potential for conflicts of interest were present, the S.E.C. never considered how they might also improve outcomes for small investors.

Clark was unhappy with the S.E.C. Report and told Cordell Hull, Secretary of State, that it was a "trial of the Council." The report attacked the integrity of three of the men who initially served on the board – Chubb, Traphagen and Thacher – given their ties to the financial industry, and then levied criticism against the FBPC for relying heavily on the banks and the issue houses for funding. This was not entirely surprising to Clark, who understood the New Dealers' general hostility toward banking and finance. However, Clark took specific issue with the idea that banks were getting preferential treatment on their short term trade credits to sovereign defaulters, putting small bondholders at a disadvantage. More specifically, he objected to the S.E.C. insinuation that the FBPC was not fighting the banks more forcefully on this issue, since the banks were funding the Council's operations. Clark responded by saying that short term bank credits were the lifeblood of trade and that he did not view it in the best long-term interests of bondholders to "make war" on trade finance. He wondered how else the Latin American countries would obtain the foreign exchange to repay the bondholders.[458]

The S.E.C. report had done great harm to the FBPC, first among bondholders, who were no longer sure what position the FBPC had in the eyes of the U.S. Government, and second, among sovereign debtors, where FBPC negotiators were finding "quite a different [less cooperative] atmosphere" from what they had found before. The report had clearly undermined the Council's authority. In his discussion with Cordell Hull, Clark said:

> the whole S.E.C. report seemed to be dominated by a very bitter complex certainly against Wall Street and everyone in it, and...I was not sure that it did not indicate a hostility against our whole economic system – the Secretary interposed to say 'against capitalism' – and I said: 'Yes, just that – against capitalism;' and the reading of the Report left me wondering whether that was not the real intention of the report, namely to make war upon the whole system.[459]

[458] FBPC Archives (1937). File M1287 030. Memorandum from Clark (FPBC) on meeting with Hull (Secretary of State) dated June 2, 1937.
[459] FBPC Archives (1937). File M1287 030. Memorandum of meeting between Clark (FBPC) and Hull (Secretary of State) dated June 2, 1937.

Herbert Feis of the State Department told Clark that if he thought the report was bad, he "should have seen it before we got at it."[460] Apparently, the original, unedited version was much more damaging to the Council. Feis confided to Clark that despite the criticisms, one thing was abundantly clear: the State Department wanted the Council to continue its work, "and so [did] the S.E.C."[461] Despite Clark's negative reaction to the report, the State Department saw this as a victory. The S.E.C. concluded that "the Council was the more appropriate agency for the protection of the holders of defaulted foreign government bonds" when assessed against the possibility of a U.S. government-funded, Title II organization.[462]

However, from an operating perspective, the S.E.C. had severely damaged the FBPC's ability to finance itself. In order to save the Council, Clark agreed to look for new ways of fund raising that did not include the banks or the issue houses, although he said "the outlook was not too promising."[463] He was forced to immediately cut down on the number of directors to reduce the Council's overhead expenditures. And, while the State Department offered government financing, Clark refused on the grounds that "it would subject us to all sorts of political pressure and endless Congressional investigations," a prospect he was unwilling to face.[464]

In July, 1937, the New York press took the view that the FBPC was nearing its final days, not only because it was now deprived of its main source of funding, but also because the objectives of the FBPC seemed to be at odds with those of the U.S. government. The FBPC was demanding that every cent of defaulted debt be repaid, while

---

[460] FBPC Archives (1937). File M1287 030. Memorandum from Clark (FBPC) responding to S.E.C. report sent to Feis and Livesey (State Department) dated June 2, 1937.
[461] FBPC Archives (1937). File M1287 030. Memorandum from Clark (FBPC) responding to S.E.C. report sent to Feis and Livesey (State Department) dated June 2, 1937.
[462] Foreign Bondholders Protective Council (1936-1977), Report of 1937, pp. 12-13.
[463] FBPC Archives (1937). File M1287 030. Memorandum of meeting between Clark (FBPC) and Hull (Secretary of State) dated June 2, 1937.
[464] FBPC Archives (1937). File M1287 030. Memorandum from Clark (FBPC) responding to S.E.C. report sent to Feis and Livesey (State Department) dated June 2, 1937. Clark believed that the State Department made the offer because they were trying to remove the appearance that they were backing a group that was financed by the "interests which the bondholders feel somehow took advantage of them or defrauded them."

the U.S. government sought to keep Latin American friendship by extending "easy credits which [would] develop Latin America's vast wealth."[465]

In a fight for its own survival, the FBPC advanced several new capital-raising options. White suggested that the FBPC adopt a plan similar to the one endorsed by the CFBH in 1936. Although the CFBH began the funding of its operations in 1868 by collecting money from individual investors and issue houses, by the 1930s, the British institution was "more or less dead on its feet" from a financial perspective. To keep the CFBH viable, the Bank of England took on the responsibility of collecting funds from issue houses and paying them over to the CFBH to cover expenses. The advantage of this arrangement was that the funds were delivered more or less "blind" to the CFBH by the Bank of England; therefore, it was not possible to trace the source of the funds, forestalling any accusations that the CFBH was doing the bidding of a particular issue house. This idea never gained traction in the U.S. and White's other effort – to raise money from foundations - was largely unsuccessful.[466] Ultimately, the FBPC agreed to charge a fee of 1/8 of 1% on the principal amount of each bond, with this fee incorporated into successful debt settlements.[467] This mechanism was instituted in February, 1936 and ultimately sanctioned by the S.E.C. in 1939; however, the fees it generated were not sufficient to keep the CFBH solvent, mainly because the FBPC was not effecting settlements quickly enough.

Signs of severe financial distress begin to show as early as May 1936, when Bankers Trust informed the FBPC that it had reviewed its financial statements and did not think it would be in a position to repay the bank's advances. Clark did not even try to dispute the bank's dire assessment. As a result, we see the FBPC forced to redirect its attention to recover even the smallest expense - like challenging First Boston over a telephone bill and demanding reimbursement.[468] And, from that point on, the FBPC would never again find itself on entirely sound financial footing. In fact, archival sources

---

[465] FBPC Archives (1937). File M1287 030. Clipping from the *New York Post*, July 25, 1937.
[466] FBPC Archives (1939). File M1287 030. Letter from White (FBPC) to Feis (State Department) dated February 11, 1939. Even the Rockefeller Foundation refuses funding to the FBPC. See also Sessions (1974), p. 66.
[467] FBPC Archives (1955). File M1287 037. Letter from Spang (FBPC) to Robinson (State Department) dated December 12, 1955. At this point, the correspondence files with the State Department are much more concerned with financial and administrative matters, as most of the debt settlement work had been finished.
[468] FBPC Archives (1936). File M1287 069. Minutes of Executive Committee, May 26, 1936.

reveal that fiscal uncertainty would follow the Council for decades. In 1943, Dana Munro had to decline a State Department request to send a representative to Peru for negotiations on the grounds that "there was the expense involved which could not be justified at present."[469] By the time it published its Annual Report of 1958-1961, the FBPC announced that it could no longer survive on its current income and needed to dip into its small reserve fund.[470] And, in 1974, George Woods, FBPC President, alerted the S.E.C. that the State Department "should be informed of the precarious financial situation of the Foreign Bondholders Protective Council" where expenses had been "cut to the bone."[471] In the same year, the Wall Street Journal reported that the prime years of the Council were plainly past. At that point, it had only one full-time employee – a secretary – and it was housed in a modest three rooms in lower Manhattan. "We exist on a shoestring," said Alice Popp, the FBPC's secretary.[472]

5.4.6 The Accomplishments of the FBPC

In the face of these numerous challenges, the mere survival of the FBPC is commendable. Moreover, what it was able to achieve with such limited resources deserves to be recounted. There is no question that the work before the FBPC in 1937 was daunting. In the course of the year, this resource-constrained institution dealt with 27 different default situations in 20 countries involving 254 separate bond issues totalling $1.8 billion. In addition, it had to operate in a global environment where virtually all intergovernmental debts owed to the U.S. by European nations were in default, creating a difficult backdrop against which private creditors could press their claims. Great Britain alone was in arrears to the U.S. government on loans in excess of $5 billion.[473]

By 1939, the FBPC announced that of the $2.5 billion of foreign bonds in default ($1.2 billion in Latin America and $1.3 billion in Europe) the Council had negotiated the resumption, continuation or increase in service on over $1.77 billion at the cost to bondholders of a mere .0034% of the amount of interest paid.[474]

---

[469] FBPC Archives (1943). File M1287 070. Minutes of Executive Committee, June 2, 1943.
[470] Foreign Bondholders Protective Council (1936-1977), Report of 1958-1961, p. ix.
[471] FBPC Archives (1974). File M1287 087. Letters between Woods (FBPC) and Garrett (SEC) dated May 17, 1974 and October 11, 1974.
[472] FBPC Archives (1974). File M1287 037. Clipping from *The Wall Street Journal* dated July 24, 1974.
[473] Foreign Bondholders Protective Council (1936-1977), Report of 1937, pp. 17-18.
[474] Foreign Bondholders Protective Council (1936-1977), Report of 1939, pp. 6-7.

By 1951, a more positive public perception of the FBPC's work began to emerge. The *New York Herald Tribune* article credited the Council with doing "an admirable job"[475] The institution's success continued in 1952, when agreements were reached on Germany, Japan, Austria and a number of previously intransigent Latin American cases. At this point, Bolivia was the sole dollar-bonded indebtedness in all of Latin America on which no action had been taken, meaning that much of the work of the FBPC was now behind it.[476]

By July 1958, Kenneth Spang, acting President of the FBPC, notified the State Department of the elimination of the Bolivian default. The Department congratulated Spang saying that "this is indeed a significant development and the Council is to be complimented for the contribution it has made over the past 25 years in dealing with these default situations."[477] In a press release, the FBPC announced that in the course of its operations, it had "concluded negotiations and made favourable recommendations to bondholders on 32 debt adjustment plans of 20 foreign countries, involving obligations having a principal of over $3.5 billion."[478]

In fact, by 1966, Elliot Butler of the CFBH joked with his U.S. FBPC counterpart: "I hope you feel as we do that we have almost worked ourselves out of our jobs by settling so many of the outstanding debt problems."[479]

Although the British CFBH was dissolved in 1988, the FBPC's operations continued, and in 1988, it named a new President - John Petty, Former Assistant Secretary of the Treasury for International Affairs. In a June 2006 interview, Mr. Petty confirmed that while the FBPC was still in existence, it was, for all intents and purposes, dormant. There were only three default cases which remained on its books: one for the former East Germany where no settlement is believed possible; a $30 million Cuban bond where a settlement remains a possibility; and a 1913 sterling/gold loan to China

---

[475] CFBH Archives (1951). File Ms34603, Vol. 2, Document 327/1149.
[476] Foreign Bondholders Protective Council (1936-1977), Report of 1951-1953, p. v. The major accomplishment was the "Agreement on German External Debts" reached in August 8, 1952 which was seen as the foundation stone for the restoration of German public credit.
[477] FBPC Archives (1958). File M1287 037. Letter from Beale (State Department) to Spang (FBPC) dated July 13, 1958.
[478] FBPC Archives (1954). File M1287 037. Press release from FBPC dated November 30, 1954.
[479] CFBH Archives (1966). File Ms34603, Vol. 7, Document 327/1584R. Letter from Butler (CFBH) to Munro (FBPC).

which persists principally because it is a political "hot potato." Mr. Petty said that since the State Department viewed the FBPC's requests on these matters to be an "annoyance," his advances to the Department have largely been rebuffed. Therefore, he has chosen to get involved with a private group called the American Bondholders Foundation, LLC, through which he is working on the 1913 Chinese bond defaults. Frustrated by the lack of State Department cooperation, the American Bondholders Foundation turned to Elliot Spitzer, acting New York Attorney General, for help.[480] Historically, Petty said that the only way to get a debtor country's attention on a bond default matter was for the FBPC to successfully enlist the help of the U.S. ambassador to that country. This, in turn, required the blessing of the State Department. According to Petty: "We have no clout unless we get some support from the State Department. The State Department looks at us as an annoyance, and without them, it is like we are pushing on a string."[481]

5.4.7 Assessing Institutional Power Against Structural and Compulsory Power

It appears that the FBPC was "pushing on a string" for most of its existence. However, we would maintain that its weakness was not institution-specific, but rather the result of powerful structural and compulsory regime elements that were external to the Council and undermined its effectiveness. As we saw in the preceding section, the S.E.C.'s insistence that the FBPC eliminate all banking affiliations had the effect of crippling its funding activities and limiting its staffing options. So, it was government power in the form of regulation that helped, in part, to erode the effectiveness of the FBPC. However, we would argue that even if the FBPC had enjoyed a healthy funding base and no staffing restrictions, it still would have struggled to achieve better bargaining outcomes for private bondholders. Why? Because neither money nor staff would have been able to overcome the collapse of the 1930s capital markets and the larger aspirations of the U.S. government. In other words, the institutional capacity of the FBPC was eclipsed by structure and condition of the 1930s capital markets, the capital export monopoly of the U.S. government, and the political priorities of American officials in the pre- and post-war periods. These structural and compulsory forces trumped the FBPC and

[480] Spitzer was New York Attorney General at the time of this interview. He was subsequently elected New York State Governor.
[481] Author Interview L.

were principally responsible for producing less favourable bargaining outcomes for U.S. investors. By contrast, Britain's dire post-war financial position motivated it to boost national income by improving bondholder recoveries. Since Britain could not afford to have its bondholders accept sub-standard settlements from foreign debtors, compulsory and structural power were pressed into service to meet the national interest, and by default, the private interests of bondholders. These factors – and not the institutional differences between the CFBH and FBPC – help to explain the relative out-performance of sterling bonds during the interwar and post-war periods. In the following sections, we will examine the various manifestations of structural and compulsory power in the U.S. and Britain and explain how they helped produce different bargaining outcomes, both between and within historical periods.

5.5 Structural Power

While structural power accrued principally to the private capital markets in the 19th century, these markets had largely collapsed in the wake of the Great Depression. As a result, structural power in the interwar period reverted mainly to the U.S. government and its agencies - like the Export-Import Bank and the Reconstruction Finance Corporation - the only parties with the ability to undertake large-scale foreign lending programs. After World War II, structural power was also exercised by the multilateral economic institutions (the World Bank and the IMF). It did not return in any magnitude to the private markets until the 1970s.

How did the elements of structural power affect the position of private bondholders in the interwar and post-war years? We intend to show how the FBPC and U.S. bondholders were chiefly undermined by the following structural forces: i) the lack of cooperation between the FBPC and the NY Stock Exchange, whereby defaulted sovereigns were not prohibited from launching unilateral bond exchanges in opposition to the FBPC's recommendations; and, ii) the lending into arrears policy of the U.S. government and the World Bank, which permitted the extension of fresh credit to debtor states that remained in default to their private bondholders. Finally, we will look at how the continued disciplined cooperation between the CFBH, the British banking

community, and the London Stock Exchange served mainly to strengthen the position of British bondholders during this period.

5.5.1 The Collapse of the Private Capital Markets in the 1930s

In the 19th and early 20th centuries, the ability of the CFBH to successfully restrict market access to defaulting sovereigns offered a key incentive for those states to seek mutually agreeable settlements with their creditors. Why? Because as soon as investors had accepted a settlement, the sovereign would be able to issue new bonds in the marketplace. However, following the defaults of the 1930s, this incentive had largely disappeared, and with it, a powerful bargaining chip on the part of the newly established FBPC. As Jorgenson and Sachs (1989) have observed:

> In the absence of the lure of future capital flows (and the threat of their blockage) the power of the U.S. Bondholders Protective Council was nil.[482]

So, the global macroeconomic crisis of the 1930s had removed one of the principal enticements for debtor states to negotiate settlements and suffer large capital transfers back to foreign creditors.[483] Adamson (2002) agrees, and adds that, at the time, it was the U.S. government that "enjoyed a virtual monopoly in capital export," a position it used not to further the narrow interests of private investors, but to advance a higher, national interest. After all, its main concerns were impeding the spread of fascism, and later, communism.[484]

Wallich (1943) observed the same pattern and advanced similar arguments. At the time, he believed that Latin American countries remained in default on their private bonds principally because the bondholders were not offering new money as a reward for settlement, and the U.S. government began dispensing new credit regardless of the status of defaults.[485] According to Wallich:

> Negotiations between the debtor countries and the bondholders...seem to offer very little promise to the latter, because of the holders' weak bargaining position. This weakness derives from the fact that the bondholders cannot

[482] Jorgenson and Sachs (1989), p. 69. Quote from Albert Fishlow.
[483] Eichengreen and Lindert (1989), p. 6. See also Diaz-Alejandro (1983), p. 39; Wallich (1943), p. 334.
[484] Adamson (2002), p. 495.
[485] Wallich (1943).

> hold out to the debtors any immediate prospects of further loans in return for a satisfactory settlement, and from the further fact that debtors at present are not particularly interested in such prospects, since they can borrow freely from the United States government.[486]

As we discussed earlier, post-hoc analysis reveals that the decision on the part of Latin American debtors to default did not necessarily damage their ability to return to the restored private capital markets in the 1950s and beyond. According to Jorgenson and Sachs (1989), although Argentina, the only faithful repayer during the 1930s, did re-access the capital markets in a limited way in the 1930s for a refunding issue, it received "no special treatment after this episode." And, when the defaulting Latin American states returned to these markets in the 1950s "no apparent systematic differences between the defaulters and the non-defaulters" emerged."[487] Cardoso and Dornbusch (1989) reinforced these findings and showed that from the 1930s to the 1960s, Brazil, the defaulter, had no more trouble borrowing than the faithful repayer, Argentina.[488] Eichengreen (1991) argued in a similar vein that countries that faithfully serviced their debts in the 1930s "did not enjoy superior credit access subsequently." He observed that virtually no country had the ability to borrow material levels of new capital abroad "in the 1930s or in the decades following World War II."[489] Lindert and Morton (1989) agreed, claiming that "almost *no* governments in the less developed countries got fresh loans, whether they were repaying ones or not."[490]

However, the Latin American debtor states of the 1930s could not foresee how the capital markets of the future would judge their decisions. They were relying on the past for instruction, and had to weigh the 19th century admonitions against sovereign default as "uncivilized" and "punishable" against a new and uncharted world, one of macroeconomic collapse and the promise of official U.S. lending, regardless of default status.

---

[486] Wallich (1943), p. 334.
[487] Jorgenson and Sachs (1989), pp. 75-79. Apart from unilateral debt exchanges, only Argentina was able to accomplish a refunding in the capital markets in this period. See also Foreign Bondholders Protective Council (1936-1977), Report of 1937, pp. 17-18.
[488] Cardoso and Dornbusch (1989).
[489] Eichengreen (1991), p. 160.
[490] Lindert and Morton (1989), pp. 231-234. *Italics* mine.

5.5.2 Lack of Disciplined Cooperation between the FBPC and NY Stock Exchange.

As we discussed in Chapter 4, the ability of the CFBH, in concert with the London Stock Exchange, to deny market access to defaulting sovereigns was one of the regime's chief weapons against defaulters. However, while the Committee of the London Stock exchange had the power to deny market access to defaulting governments by refusing a listing under Rule 63 of the Exchange, "neither the Securities and Exchange Act of 1934 nor the New York Stock Exchange Regulation [had] any provision similar to London Rule 63."[491]

It may have been that no rule was ever promulgated because of the near impossibility for defaulters – and for that matter, non-defaulters - to access fresh capital given the state of the markets. However, in a 1937 report, the S.E.C. uncovered what it called a "vicious" and "unconscionable" practice of distressed sovereigns: the making of unilateral offers to bondholders "without having attempted to negotiate the terms of a readjustment with representatives of the creditors."[492]

So, while many believe that the unilateral bond exchange is unique to today's markets, there were in fact several examples of this activity in the 1930s. And, it hinged on the ability of a debtor state to list the newly offered bonds on a U.S. exchange, free from restrictions. Chile was the pioneer of the unilateral exchange offer in the 1930s, making its announcement on January 11, 1938. The FBPC, CFBH, and all the other European bondholder associations immediately recommended against it. However, soon after the offer was publicized, members of the FBPC frantically contacted the New York Stock Exchange to see if they could get more information. Frances White discovered that the only thing the listing committee of the Stock Exchange required from Chile was a discussion to sort out the details of "identifying the assenting and non-assenting bonds." In other words, aside from sorting out some technical matters and in direct opposition to the wishes of the FBPC, the New York Stock exchange was perfectly prepared to support Chile's listing.[493] In a more detailed discussion with the exchange about the treatment of defaulting sovereigns, the FBPC was informed that bonds were not de-listed from the Exchange because they were in default, but because "the foreign government had failed

[491] Borchard and Wynne (1951a), p. 173.
[492] Buchheit (2003), p. 11.
[493] FBPC Archives (1938). File M1287 053. Memorandum from White (FBPC) dated May 10, 1938.

to register with the S.E.C." So, there were no procedures in place in the U.S., as there were in London, to de-list the bonds of a defaulting state. Nor does it appear that there were any effective means to prohibit new listings for a defaulted state that wanted to make a unilateral offer to bondholders outside of the auspices of the FBPC.[494]

Following in the footsteps of Chile, and after a series of unsuccessful FBPC negotiations, Peru also decided that it would launch a unilateral exchange. And, again, despite the FBPC's recommendation to the contrary, Peru was able to find a New York bank – the Central Hanover Bank & Trust, Co. - to act as its agent and obtained a listing on the New York Curb Exchange.[495] Neither the bank nor the exchange made any effort to cooperate with the FBPC.[496] James Rogers of the FBPC confessed to the British CFBH that he was "not quite sure of the precise events connected with the application of Peru to list new bonds on the Curb Exchange," but he was powerless to stop it.[497]

To his dismay, Rogers later learned that unilateral exchange offers by sovereigns were also exempt from S.E.C. reporting requirements, which meant that there would be no transparency of results. In other words, there was no way to know what percentage of holders actually accepted the offer or whether the sovereign was self-dealing. This was important because the sovereign could purchase its own debt in the open market, accept the exchange offer, overstate the results of the exchange offer, and cancel the bonds.[498] Unofficial estimates from the Curb Exchange indicate that Peru's offer was relatively successful: 52% of the existing bondholders had consented to it by 1949.[499]

5.5.3 Disciplined Cooperation between the CFBH and the London Stock Exchange

The relationship between the FBPC, the New York issue houses, and the U.S. exchanges stood in marked contrast to the relationship between the CFBH, the London issue houses, and the London Stock Exchange. The British institutions were coordinated

---

[494] FBPC Archives (1937). File M1287 047. Memorandum from Clark (FBPC) dated May 13, 1937.
[495] Foreign Bondholders Protective Council (1936-1977), Report of 1946-1949, p. vi. The New York Curb Exchange approved the listing for the new Republic of Peru Sinking Fund Dollar Bonds in 1947.
[496] Clipping from the *Journal of Commerce*, December 31, 1947.
[497] FBPC Archives (1948). File M1287 040. Letter from Rogers (FBPC) to Lord Bessborough (CFBH) dated January 8, 1948.
[498] FBPC Archives (1947). File M1287 040. Letter to Williams (Peruvian bondholder) from Rogers (FBPC) dated August 26, 1947.
[499] Clipping from the *Wall Street Journal*, August 23, 1949. $39 million out of $76 million was offered for exchange.

and disciplined while their American counterparts were not. On the matter of the unilateral exchange offer by Peru, the CFBH wrote the following to the FBPC:

> We have seen no signs of any pending offer to the Sterling bondholders and it is even possible that, owing to the Peruvian difficulty in finding a London banker willing to make the offer and to the knowledge that if it is made we will oppose it, none will ever be made.[500]

A few months later, the CFBH told the FBPC confidentially that the Peruvian Ambassador approached the British government requesting permission to make a unilateral exchange offer and that the British authorities refused the application on the ground that such an offer would "from a foreign exchange point of view, be contrary to the national interest."[501] The Peruvians persisted and ultimately made an offer directly to sterling bondholders, but the CFBH informed the FBPC that the British authorities "will not grant permission to any British holders to accept the offer."[502] So, even in this instance, where the Peruvian government tried to circumvent the CFBH and the British financial community, the British government stood firm and prevented any private investors from accepting the direct solicitation. While the FBPC felt strongly that "unilateral debt offers were not workable in international finance and should not be tolerated," only the British sovereign debt restructuring regime was able to prevent them.[503]

5.5.4 The Lending into Arrears Policy of the U.S. Government and World Bank

As the main engine of capital export in the 1930s and 1940s, the U.S. government assumed the structural power that had once accrued to the private capital markets of the late 19th and early 20th centuries. And, the way in which it would choose to use this lending capacity would have profound consequences for the plight of American bondholders. In fact, it was not long before the White House would begin to use its power of capital export to directly undermine the authority of the FBPC. In December 1938,

[500] FBPC Archives (1947). File M1287 040. Letter to Rogers (FBPC) from Butler (CFBH) dated September 18, 1947.
[501] FBPC Archives (1947). File M1287 040. Letter to Rogers (FBPC) from Butler (CFBH) dated November 4, 1947.
[502] FBPC Archives (1948). File M1287 040. Letter to Rogers (FBPC) from Butler (CFBH) dated January 2, 1948.
[503] Foreign Bondholders Protective Council (1936-1977), Report of 1946-1949, p. vi.

Frances White, then President of the FBPC, noticed a Wall Street Journal article claiming that the U.S. government intended to use the Export-Import Bank to encourage trade with Latin America. It went on to say that the White House was developing an "alternate plan" to clear the defaults with private bondholders. Feeling threatened, White confronted his main contact at the State Department, who dutifully claimed ignorance about the source of the article and any alternate plans afoot to deal with Latin American defaults outside of the FBPC.[504]

However, by June of 1939, the U.S. government's position with respect to defaulted Latin American states became clear. President Roosevelt was quoted as saying that he "wanted to go ahead with his program of $500,000,000 of loans to foreign governments and especially to Latin America and that the 'ancient frauds of the 1920s should not interfere with the new sound loans under consideration.'"[505] While the State Department agreed with White that this type of statement from the President would make the job of the FBPC "that much more difficult," it would be more accurate to say that the influence of the FBPC in bondholder negotiations was gradually being eroded. The Journal of Commerce even reported that the U.S. government was considering the purchase of Latin American bonds to help debtor governments clear their defaults while providing some sort of compensation to aggrieved U.S. bondholders. Although this plan never materialized, it nonetheless placed the government at the centre of debtor/creditor negotiations, again undermining the role of the FBPC.[506]

When the FBPC tried to condition an Exim Bank loan for Cuba on the settlement of private debt, Secretary Morgenthau wondered how "wise" it was to use "a quasi-governmental banking-lending agency...as leverage to collect private debts." In the end, Morgenthau believed that the collection of debts to private bondholders should not stand in the government's way.[507]

As a result, what was originally a firm prohibition against official lending into arrears was diluted to the point where Exim Bank could lend money to defaulting

[504] FBPC Archives (1938). File M1287 030. Memorandum from White (FBPC) on call to Livesey (State Department) dated December 12, 1938.
[505] FBPC Archives (1939). M1287 030. Memorandum from White (FBPC) on conversation with Feis (State Department) dated June 23, 1939.
[506] FBPC Archives (1939). M1287 030. Memorandum from White (FBPC) on conversation with Feis (State Department) dated June 23, 1939.
[507] Adamson (2005), p. 616.

governments "as long as the latter had made *efforts* to resolve their debt defaults."[508] The ambiguity about what actually constituted "effort" on the part of a debtor government was intended to give the State Department maximum flexibility. Eventually, the New Dealers in the Roosevelt administration "proposed, and worked to implement, public lending programs without much regard for the settlement of private defaults."[509]

U.S. lending into arrears accelerated in 1939 as World War II approached. The security interests of the U.S. government required that U.S. capital be used to increase political allies as well as secure contracts for a steady supply of war materials, most especially from Latin America.[510] Wallich (1943) argued that if the U.S. government wanted the interests of the bondholders to "take a back seat to national security interests" perhaps the bondholders were entitled to some type of compensation. However, it was instead decided that U.S. bondholders would subsidize official efforts to win allies and secure raw materials by agreeing to debt settlements that were highly unfavourable.[511]

After World War II, the FBPC noted that the loans made through the Exim Bank and the Lend-Lease program were "a major [negative] factor affecting the history of sovereign bonds held by U.S. investors." The FBPC was especially concerned that the establishment of the new World Bank and International Monetary Fund would exert a similar influence on sovereign bonds held by U.S. citizens. As a result, the FBPC contacted the officers of the new multilateral lending institutions and told them that "the whole future of public investments in foreign securities hangs on their policies."[512] They were again hoping that the multilaterals would be sensitive to the issue of lending into arrears to governments in default on their private loans. While it seems that the World Bank and IMF tried to avoid lending into arrears, they ultimately followed the precedent set by the U.S. government and prioritized larger political goals over the position of bondholders. The following examples help to illustrate how the lending into arrears policy of the U.S. government and the World Bank helped to strengthen the position of sovereign debtors vis-à-vis the FBPC.

---

[508] Adamson (2002), p. 490. *Italics* mine.
[509] Adamson (2002), pp. 479-480.
[510] Borchard and Wynne (1951a), p. 229.
[511] Wallich (1943), pp. 327-328.
[512] Foreign Bondholders Protective Council (1936-1977), Report of 1945, p. 8.

5.5.4.1 Bolivia

In 1940, American bondholders contacted the FBPC in large numbers to complain bitterly about the fact that the U.S. Government was lending bi-laterally to Bolivia while the private debts of bondholders had not yet been settled.[513] To make matters worse, the U.S. later announced that it would make a $10 million loan to Bolivia, which would be conditioned upon a "just compensation" arrangement for Standard Oil for the expropriation of Standard Oil's property.[514] U.S. bondholders were indignant over the actions of their own government to loan money to Bolivia and take a hand in ensuring the corporate welfare of Standard Oil but "doing nothing whatsoever for the bondholders." Others noted that while the U.S. was diluting the claims of its own bondholders and taxpayers in Bolivia, the "British would certainly see to it that their bondholders were well looked after as they always had done and even under present circumstances were doing."[515]

When Francis White confronted Herbert Feis at the State Department about the Bolivian situation, Feis claimed that the hands of the U.S. Government were tied on the matter of the U.S. dollar bondholders "since the Nazi influence [in Bolivia] was quite strong and they [were] continually stirring up trouble against the United States."[516] In this instance, it was therefore necessary to subordinate bondholders' interests not only to the national interests of the United States, but also to the private interests of a U.S. corporation.

5.5.4.2 Yugoslavia

In the matter of the Yugoslavian default in 1949, the Department of State first asked the FBPC what its attitude would be if it recommended making an Exim loan "without attempting first to work out a definite plan for the resumption of service on the external dollar debt." While the FBPC strongly opposed the idea, the Council felt that the government would make the loan "whatever [the FBPC's] attitude, as they felt political

[513] FBPC Archives (1940). File M1287 047. Memorandum from White (FBPC) dated June 3, 1940.
[514] Clipping from *New York Times,* March 14, 1941. The expropriation resulted from the charge by the Bolivian government that Standard Oil was colluding with Paraguay during the Chaco War.
[515] FBPC Archives (1941). File M1287 047. Memoranda from Wylie (FBPC) dated March 28, 1941 and April 9, 1941.
[516] FBPC Archives (1941). File M1287 047. Memorandum from White (FBPC) dated May 24, 1941.

policy required the support of Tito."[517] The FBPC was correct in its assessment as the *New York Times* reported a few months later that the U.S. Government had set up $20 million in export credits [for Yugoslavia], all of which were granted with the backdrop of "intensified Soviet pressure;" the IMF also established a $3 million facility for the country.[518]

In April, 1950, the World Bank began assessing a possible loan to Yugoslavia. The FBPC was asked again whether a proposed IBRD loan to Yugoslavia would interfere with the chances of the FBPC arriving at a satisfactory settlement with private bondholders. The Council responded that it almost certainly would. In an attempt to help, the World Bank said that it would draft loan documents for Yugoslavia but tell the country that it would withhold disbursement until after a dollar bond settlement had been reached. The FBPC was delighted at this news, hoping that it would lead to a prompt and favourable settlement for the bondholders.[519] However, in a subsequent letter to the Yugoslavian ambassador in June, 1950, the IBRD softened its position materially, saying that "the Bank does not take the position that definitive debt settlements should be made with all creditors before a loan to Yugoslavia is granted;" all the IBRD required at that point was "a statement" from the Yugoslavian government "of the amounts which they [were] prepared to provide for the service of pre-war external debts."[520] In other words, the IBRD was willing to accept something that amounted to nothing more than a unilateral exchange offer by the defaulting state.

So, despite its initial efforts to spur a private bond settlement, the IBRD finally agreed to make a loan for $25-$30 million to Yugoslavia while the pre-war bonds remained in default. The Council was informed directly by the IBRD that although the Bank was not "disregarding or forgetting" the FBPC, "the plain fact [was] that the Yugoslavian economy [was] busted now," and required the help of the U.S. and the

[517] FBPC Archives (1949). File M1287 070. Minutes of Executive Committee, August 31, 1949.
[518] *New York Times*, October 18, 1949.
[519] FBPC Archives (1950), File M1287 043. Memorandum concerning a meeting between Spang (FBPC) and Cope (Loan Officer for the IBRD) dated April 21, 1950.
[520] FBPC Archives (1950). File M1287 043. Letter from Black (IBRD) to Popovic (Yugoslav Ambassador to the U.S.) dated June 5, 1950.

multilaterals. That being the case, the World Bank pushed the FBPC to accept a token settlement on behalf of bondholders.[521]

5.6 Compulsory Power: U.S.

With super-sanctions no longer permissible under international law during this period, compulsory power was exercised by the U.S. government largely to impair the position of U.S. bondholders. This was accomplished through i) active State Department intervention in bondholder negotiations; ii) government press statements designed to weaken the FBPC's credibility and bargaining leverage; and iii) the consistent, U.S. refusal to link its trade and debt policies. By contrast, the British government used its compulsory power to benefit its bondholders' interests by i) supporting clearing arrangements and allowing British trade deficits with debtor states to be used for the direct benefit of bondholders; ii) actively linking its trade and debt policies; and iii) continuing to provide the CFBH with official, consular support. In the sections which follow, we will examine each of these manifestations of compulsory power and link them back to the bargaining outcomes achieved by American and British bondholders.

5.6.1 The Absence of Super-Sanctions in the 1930s

Although the use of compulsory power in the form of super-sanctions had an important impact on sovereign debt negotiations in the 19th and early 20th centuries, creditor country governments were constrained by law, custom and experience in the exercise of this type of power in periods following World Wars I and II.[522] For example, the use of economic weapons, like discriminatory tariffs, were not part of the arsenal of American foreign policy after 1934, and even if they had been, it is not clear that they would have helped the cause of private bondholders. In addition, armed intervention had been outlawed by the *Convention Respecting the Limitation of the Employment of Force for the Recovery of Debt Contracts* at the Second Hague Peace Conference in 1907, which permitted such intervention only in the restricted circumstances where the debtor

[521] FBPC Archives (1951). File M1287 043. Memorandum of conversation between Spang (FBPC) and Garner (IBRD) concerning Yugoslav settlement dated August 29, 1951.

[522] Super-sanctions in Chapter 4 referred to i) the assumption of economic control by a creditor government over a debtor state; ii) the forceful foreclosure of collateral located in a debtor state; iii) the use of trade embargoes or blockades, or iii) the use of military might to collect defaulted debts on behalf of private bondholders.

ignored, obstructed or failed to submit to arbitration.[523] The use of armed force, "however nostalgically viewed by bondholders," was a thing of the past; the U.S. Securities and Exchange Commission advised bondholders to "eliminate from their consideration the use of force as a means of debt collection."[524] President Roosevelt sought to distance himself from America's past debt-related incursions into Latin America by addressing the Woodrow Wilson Society on December 28, 1933. In his speech, the President said that "the definite policy of the United States from now on is one opposed to armed intervention." These words were then translated into a formal obligation of the United States in the *Convention on Rights and Duties of States* on June 15, 1934. In this convention, the contracting states agreed not to recognize "territorial acquisitions or special advantages which have been obtained by force" insofar as the "the territory of a state is inviolable."[525]

The senior management of the FBPC agreed with Roosevelt's sentiments. For example, Reuben Clark strongly opposed military intervention in Latin America, but his opposition had its roots in bitter experience. As a State Department solicitor and former member of the Hoover administration, he had been privy to almost every act of U.S. intervention in Latin America. And, the track record was abysmal. According to Clark:

> Honduras was still wretched and unstable. Bitterness still rankled in Colombia. Haiti was in shambles and racked by civil strife. Cuba was in a permanent slump and someday would be ripe for Communism. And, in Nicaragua, U.S. interventionism, action and reaction had impinged on one another with mounting strain until the thing had sprung closed like a giant steel trap.[526]

However, Clark did appreciate the value of compulsory power in debt negotiations and wrote to the State Department in April, 1937, complaining about the limited resources at the FBPC's disposal. He argued that the inability of the FBPC to coerce debtor states had constrained its operations by conferring upon it extremely limited bargaining leverage:

---

[523] Sessions (1974), pp. 35-36. See also James Brown Scott (1915), *The Hague Conventions and Declarations of 1899 and 1907* (New York: Carnegie Endowment for International Peace), pp. 89-95.
[524] Eichengreen and Portes (1986), p. 619.
[525] Laves (1934), pp. 1048 & 1050-1051.
[526] Fox (1980), p. 520.

> I wonder if you men in the State Department really appreciate in what a perfectly helpless position the Council is in its negotiations with debtor governments. When you men negotiate there in the Department, you have not only the prestige of our government behind you but you also have the potential power of the government to bring to bear measures of coercion and force...We poor fellows sit here absolutely naked of prestige or potential coercive power and wholly dependent upon the friendliness or willingness of the foreign government...I wonder whether or not you men in the Department...do realize what a helpless, unarmed, impotent organization this Council is.[527]

5.6.2. State Department Intervention in Bondholder Negotiations

While the U.S. government had publicly announced its intention to refrain from intervening in the affairs of debtor states, either through the use of military or economic sanctions, the government did change its mind about the amount of coercive power it would bring to bear on the FBPC, and indirectly, on American bondholders. After all, the Good Neighbour Policy left the U.S. government little scope for pressuring recalcitrant Latin American debtors. As Wallich (1943) pointed out, this policy created the impression that any U.S. intervention in debt negotiations would result in the respective debtor states being "treated very considerately."[528] And, although the State Department initially attempted to follow a policy of non-intervention in private debt negotiations, the looming threat posed by Axis governments promoted a more activist stance, one that was biased towards achieving fast and efficient settlements. According to Adamson (2002), the State Department believed it had only one way to accomplish this: "to insert itself directly in the negotiation and settlement process."[529] During 1937, the State Department became more prepared to directly influence private creditor-sovereign state debt negotiations, and as war broke out in Europe, the State Department "conceded more ground to debtors than [the FBPC] or the bankers had been willing to do [previously]...They were willing to accept a drastic reduction in debt service on emergency grounds."[530]

---

[527] FBPC Archives (1937). File M1287 030. Letter from Clark (FBPC) to Feis (State Department) dated April 15, 1937.
[528] Wallich (1943), p. 335.
[529] Adamson (2002), p. 480.
[530] Adamson (2002), pp. 496 & 507.

It was not long before the administration informed the FBPC that "it was removing from the Council the authority to negotiate with the Latin Americans and placing it directly with the State Department."[531] While the U.S. government could have pushed for the closure of the FBPC and enacted the Title II Corporation in its place, the capacity to covertly supplant the FBPC in the negotiations proved to be the more attractive decision politically; it provided the U.S. government with the desired level of deniability, while enabling it to influence the negotiations such that the outcomes would largely favour U.S. national interests. The State Department admitted in correspondence that it preferred a private form of bondholder organization to a public one since "it could escape major responsibility for the conduct of the negotiations and outcomes."[532] If it concurrently managed to commandeer the operation of the Council, it could both escape responsibility *and* determine outcomes.

The Minutes of the Executive Committee meetings of the FBPC clearly demonstrate the active involvement of the State Department in private debt negotiations. And, once the authority of the FBPC had been broken by the U.S. government, we can also observe a fair amount of tentativeness, subservience and permission-seeking on the part of the Council.[533] The examples which follow serve to illustrate this point.

In the 1944 case of Colombia, the FBPC reported that it had "no part in the negotiations or discussions leading to the offer, which had been carried on through the State Department." And, despite the highly unsatisfactory offer which the State Department delivered to the bondholders, the FBPC felt compelled to recommend it, since "nothing better could be expected."[534]

The Peruvian debt negotiations were rife with State Department interference. In a discussion of the status of the settlements in 1943, the FBPC indicated that "the next move...was up to the Department of State."[535] The FBPC needed to tread lightly on Peru since it was aware of the fact that the U.S. was the main purchaser of its exports. Peru supplied the U.S. with the raw materials – metals, rubber, and flax – necessary to support

---

[531] Sessions (1974), p. 184.
[532] Borchard and Wynne (1951a), p. 193.
[533] This was particularly true during World War II and in the years immediately following the war. FBPC Archives (1943-1951). File M1287 070. Minutes of Executive Committee, 1943-1951.
[534] FBPC Archives (1944). File M1287 070. Minutes of Executive Committee, October 17, 1944.
[535] FBPC Archives (1943). File M1287 070. Minutes of Executive Committee, September 1, 1943.

the wartime economy. And, although the FBPC held out hope that their government would assist them with debt negotiations, on balance, "[U.S.] strategic and political economic concerns outweighed pressure from the bondholders' group."[536] This was so much the case that when the Peruvian government elected to make a unilateral offer to bondholders, the U.S. Ambassador said that he was "anxious to have the Council recommend the...proposal." The FBPC ultimately yielded to the Department's pressure, although it did attempt a small protest by reporting the offer to bondholders with the rather unhelpful caveat that the Council "neither approved nor disapproved of it."[537]

Although Mexico had been in default for much of the 1930s, the U.S. government showed little interest in the status of debt negotiations until the onset of World War II, which, as we discussed earlier, altered American security interests in the region. Just as in the Peruvian case:

> the U.S. needed oil, rubber, metals, and other strategic supplies from Mexico...The war fostered a close and interdependent relationship between the neighboring countries...By contrast, American concerns with helping the bondholders – never a primary objective to begin with – quickly diminished...the U.S. was eager to see the debt problem go away.[538]

It is not surprising that once U.S. interest in Mexico was renewed, American pressure on the FBPC and private bondholders led to a settlement agreement. The agreement, dated November 1942, had terms that were extremely favourable to the debtor state: the Mexican government was only required to pay 23.7 cents on every dollar of secured debt bonds and 14.2 cents on every dollar of unsecured debt.[539] Again, this was a triumph of U.S. government interests over those of private bondholders.

Finally, in the case of Brazil in 1940, the State Department covertly engineered a settlement agreement on behalf of private bondholders. Herbert Feis of the Department informed Francis White of the FBPC that the U.S. was working to have this agreement presented as a "unilateral offer on the part of Brazil with the United States out of it and not appearing to have taken part in the negotiations." Feis went on to suggest that White remain silent on the Brazilian offer. White exploded in anger, arguing that the request

[536] Aggarwal (1996), p. 308.
[537] FBPC Archives (1947). File M1287 070. Minutes of Executive Committee, June 17, 1947.
[538] Aggarwal (1996), p. 274.
[539] Aggarwal and Granville (2003), pp. 20-21.

was tantamount to "a suppression of information" and unwise from the Department's point of view in a time when greater transparency was expected from U.S. institutions.[540] In light of the FBPC's uncooperative behaviour, the State Department simply removed the FBPC from all aspects of the negotiation. In fact, White was only presented with a final copy of the agreement "on the day the two sides were set to sign it. When he protested, the department's legal advisor told him that national security interests in the hemisphere trumped the interests of bondholders."[541]

5.6.3 Undermining the FBPC with Official Public Statements

The U.S. government also used its compulsory power to undermine bondholders by shaping the debate in the public arena. The bully pulpit of the American government gave it an enormous advantage over the FBPC, especially when it chose to make public statements that openly supported defaulting states (or their substandard offers to U.S. bondholders). In other cases, aspersions were openly cast on the FBPC and its management. These politically motivated statements served to undermine the authority of the FBPC, further driving bargaining outcomes in favour of defaulting states.

In a 1939 speech, Franklin D. Roosevelt "urged bondholders to settle in order to cement U.S. economic relations with its neighbours to the South." Of course, the implied threat in this message was that diplomatic goals would take precedence over private ones.[542] In the same year, Roosevelt went on record saying that he had been rather disappointed by the work of the Council "because it had not gotten very far" in resolving the Latin American defaults.[543]

Much to the chagrin of the FBPC, the President did not confine himself to broad public policy statements; he was also willing to get involved in the detailed aspects of debt negotiations. On the matter of Cuba, Dana Munro of the FBPC said that he was informed by U.S. officials that he would "jeopardize the whole negotiation by standing out for...an interest rate higher than 4 ½%." These same officials said that "Mr. Roosevelt himself had told several Cubans that this would be a fair rate, and that they had been informed that neither the State Department nor the Embassy would support [the

[540] FBPC Archives (1940). Memorandum from White (FBPC), February 21, 1940.
[541] Adamson (2002), pp. 511-512.
[542] Eichengreen (1991), p. 164.
[543] *New York Times*, October 28, 1939, p. 1.

FBPC] in insisting on a higher rate."[544] Clearly, no amount of argument or persuasion on the part of the FBPC would have had any real effect if its government were not squarely behind it.[545]

Even Secretary of State George Marshall went on record supporting Peru's unilateral exchange offer, one which the FBPC argued was detrimental to the interests of bondholders. Marshall said that it was "gratifying to have this...effort to resolve a situation which has existed for over fifteen years." He went on to express his sincere hope that the bondholders would accept the offer and that such acceptance would clear the way for new Exim Bank credits from the U.S.[546]

One of the most publicized statements made during this period was by President Roosevelt on the matter of the Bolivian default. Roosevelt offered a public apology to General Enrique Penaranda, the Bolivian President, for the American loans made to Bolivia. Roosevelt said:

> if he had anything to do with it money never would have been lent to a foreign country at the high interest and commission rates which figured in the loan he had in mind...He used the term 'super-salesmanship' to describe the process by which Bolivians were convinced that they even needed a loan.[547]

The President's public position helped him to achieve some political ends, which at the time included securing contracts for Bolivia's raw materials - tin, copper, and rubber - for war purposes; however, it also made it highly unlikely that the U.S. would ever openly press for the claims of its aggrieved bondholders.

The FBPC discussed this comment by President Roosevelt in its Executive Committee meeting on June 2, 1943. One of the board members maintained that in view of the president's public statement, "the Council's efforts on behalf of Bolivian bondholders could scarcely be hoped to bring any satisfactory offer;" the statement also "raised in his mind the question of the Council's usefulness and continuance."[548]

---

[544] FBPC Archives (1936). File M1287 057. Letter from Dana Munro (FBPC) in Cuba to Frances White (FBPC) dated August 23, 1936.
[545] FBPC Archives (1936). File M1287 057. Letter from Dana Munro (FBPC) in Cuba to Frances White (FBPC) dated August 31, 1936.
[546] Clipping from the *Financial Times*, June 28, 1947.
[547] Clipping from the *New York Times*, May 8, 1943.
[548] FBPC Archives (1943). File M1287 070. Minutes of Executive Committee, June 2, 1943.

The financial press seized on Roosevelt's comments, and argued that "the 'never mind' of the late President Roosevelt" on the issue of Bolivian bond debt meant that the "official American attitude" adds up to a subsidization of those foreign countries by the American bondholder.[549] British bondholders, who shared some of the Bolivian sovereign debt, argued that the words of the American president and State Department also had "profound effects on the fortunes of British holders of foreign bonds." They felt that while "Uncle Sam...[could] afford to turn generous to his debtors (often for purely political reasons)" the same luxury was not afforded to "impecunious countries like Britain."[550]

In fact, the British CFBH found it necessary to appeal to its U.S. ambassador after learning of Roosevelt's statement. Elliot Butler of the CFBH said:

> we are constantly finding ourselves handicapped by the U.S. Government's indifference to the claims of bondholders and fear of giving offence to the debtor countries...One can appreciate and be grateful for the wisdom of the Good Neighbour policy and recognize the necessity of backing this policy with substantial credits, but yet see no necessary conflict between the execution of the policy and a firm and tactful insistence on reasonable settlements of prior loans.[551]

The CFBH made a very good point. Since the U.S. government had so much negotiating leverage with Latin American debtors - especially since it was the sole source of credit in the 1930s and 1940s - why did it not firmly but tactfully push for better settlements for bondholders? If it was willing to use its leverage to benefit U.S. exporters, by offering Exim credits, why wasn't it similarly willing to tie the provision of new trade credits to more generous bondholder settlements? It could be that the bondholders paid the price for the New Deal administration's negative view toward the underwriting banks and Wall Street in general. Or, as Tomz (2004) argued, such linkage may not have ultimately served the bondholders' interests, since a sovereign debtor needs foreign currency in order to pay its external debts. In addition, trade sanctions would have had major

---

[549] CFBH Archives (1950-1952). File Ms34603, Vol. 2, Document 327/1120. Article by Harold Wincott of *The Investors Chronicle.*

[550] CFBH Archives (1950-1952). File Ms34603, Vol. 2, Document 327/1120. Article by Harold Wincott of *The Investors Chronicle.*

[551] CFBH Archives (1942). File Ms34629, Document 391/2. Letter from Butler (CFBH) to Bewley (British Embassy, Washington, DC)

distributional consequences, insofar as they would have damaged exporters and selected importers in the creditor country. According to Tomz:

> the linkage hypothesis requires the central government to side *consistently* with bondholders and banks at the expense of trading interests. This seems unlikely, given that exporters and importers have been relatively concentrated throughout history, whereas bondholders - the principal lenders to foreign governments - have been more atomized.[552]

5.7 Compulsory Power: U.K.

Even though the U.S. government sidestepped the use of compulsory power in the form of trade and credit sanctions to assist its own bondholders, the British government regularly employed these tactics. We would argue that this difference in strategy was in large measure responsible for the slightly better returns delivered to sterling bondholders during this period. In addition, the British government continued to allow the CFBH to leverage government assets - in the form of official consular offices – to strengthen the bargaining position of the British private investors. In the discussion which follows, we will examine how i) the establishment of clearing operations, ii) the linkage of trade and debt policies, and iii) the close relationship between the CFBH and the British consular offices positively impacted outcomes for sterling investors. It is important to point out that in these cases, Britain may have been less motivated by sympathy for the plight of her bondholders and more by the fact that the British economy had been severely damaged by the experience of two world wars. As we discussed earlier, recovering payments on sterling bonds would help to boost national income. Therefore, the British national interest was more closely aligned with the interests of private bondholders in the interwar and post-war periods, making it more likely that she would use direct, coercive measures for their benefit.

5.7.1 Clearing Arrangements

One of the most effective negotiating tactics on the part of bondholders during this period was to threaten the imposition of a clearing arrangement with a defaulted state. The mechanics were rather straightforward, but implementation required the satisfaction of two important conditions: the cooperation of the bondholders' home

[552] Tomz (2004), pp. 43-44. See also Tomz (2001).

government and the existence of a trade deficit with the debtor state. Once a clearing arrangement was established, an office would be set up in the creditor state to recover out of the proceeds of its trade with the debtor state a sum sufficient to service the private debt of the creditor state's bondholders. In other words, the proceeds that would have normally gone to extinguish the trade deficit with the debtor state are instead sequestered by the creditor country government and used to satisfy the claims of its own private bondholders. [553]

The U.S. was largely precluded from initiating clearing arrangements on behalf of the FBPC since the U.S. was running trade surpluses with defaulted states. Britain, on the other hand, had trade deficits with several important Latin American states – including Argentina and Uruguay – as well as with Europe's largest defaulter, Germany.

In the case of Uruguay, Britain insisted that the country allocate the greater part of her sterling exchange in the exclusive settlement of British debts. While this put American bondholders at a great disadvantage, there was very little that the FBPC could do about it. The New York press reported that "Great Britain holds the whip hand...being practically the only customer for Uruguay's exports of meat and animal products, the market in the United States having been closed by import restrictions."[554]

When the FBPC launched its obligatory complaint, the Uruguayan finance minister said that the country was unable to continue to service its U.S. dollar bonds because "Great Britain was insisting that Uruguay furnish funds first...to service all British long-term obligations, second...to meet British-Uruguayan trade necessities, and third, to pay the dividends due on the very large British investments in Uruguay." He went on to say that he felt the need to comply with British demands since they were "backed up by the threat that they will either curtail trade or establish compulsory clearings."[555] The FBPC's plea for State Department intervention in this case went unheeded.

The most important clearing arrangements established during this period were with Germany. In fact, as soon as Germany declared a moratorium on overseas interest

[553] Eichengreen and Portes (1989), p. 21.
[554] Clipping from *New York Herald Tribune*, June 20, 1934.
[555] FBPC Archives (1934). File M1287 041. Letter from Clark (FBPC) to Hull (Secretary of State) dated July 3, 1934.

payments in the summer of 1933, the Dutch and Swiss rejected the pact and threatened sanctions. The credibility of these threats was, once again, enhanced by the fact that both countries ran trade deficits with Germany. The strategy on the part of the Dutch and Swiss were successful, resulting in an immediate resumption of debt service.[556]

The FBPC understandably felt that American bondholders were being discriminated against as debtor States were "paying full interest on the Dawes and Young loans to Europeans and a reduction of interest to Americans." The Germans argued that they had no choice and blamed the threats of creditor country governments for this state of affairs.[557] The FBPC knew from the outset that American bondholders were at a negotiating disadvantage given the configuration of world trade, but the Council expressed deep concern over the growing prevalence of inter-creditor inequity in German settlements. In fact, the FBPC noted how certain creditor country governments were determined to forge separate settlement agreements with Germany, for the express purpose of ensuring that their nationals would receive "highly preferential treatment in the service of their bonds."[558]

Britain would soon join the list of nations considering clearing arrangements with Germany. The *New York Herald Tribune* reported in 1938 that:

> Whitehall, its patience exhausted, showed that it was not unwilling to put on a little economic pressure itself. The result: a payments agreement whereby 45 per cent of Britain's current trade debts to Germany are being balanced against old German bonded debt to the British.[559]

As it turned out, merely the suggestion of a debate in the British Parliament was sufficient to force Germany's hand. Before the clearing arrangement could even be put to a vote in Britain, a German delegation was dispatched to London, and "within a month an agreement was reached providing for full interest payments to British nationals on Dawes and Young plan bonds."[560]

---

[556] Sweden, France and Belgium used the same tactic with similar success.
[557] FBPC Archives (1938). Memorandum from Clark (FBPC) dated July 1, 1938.
[558] FBPC Archives (1934). File M1287 069. Memorandum from the Berlin Conference Relating to Long-term and Medium-Term External German Debts dated May 29, 1934.
[559] CFBH Archives (1938). Clippings File, Germany, Vol. 1i. *New York Herald Tribune*, July 6, 1938.
[560] Eichengreen and Portes (1986), p. 620.

Whereas the British and other European governments took an aggressive stance with Germany on behalf of their respective bondholders, the American government was much more tentative. Roosevelt was reported as saying to his ambassador in Berlin: "lend what personal, unofficial aid you can, but no more."[561] This was partially because the direction of American-German trade precluded a credible threat for a clearing arrangement, but it did not mean that the American government was necessarily helpless in bringing any pressure to bear on Germany. There were other opportunities to link trade and debt agreements, and, as the next section illustrates, the British were once again more assertive in linking their broader, national policies with the preferences of their private bondholders.

5.7.2 Linkage of Trade and Debt Policies

In 1942, the British Treasury acknowledged that the relationship between the United States and the governments of Central and South America would likely be shaped by major political considerations, with the interests of bondholders playing "a minor part." But, the Treasury also recognized that the U.S. could "afford to be generous at the expense of their bondholders," while Britain, expecting to face serious balance of payments problems after the war, enjoyed no such luxury.[562]

So, in addition to its willingness to create clearing arrangements on behalf of its bondholders, the British government endeavoured to link new, bi-lateral trade agreements with the final settlement of defaulted, sterling debt. In the case of Colombia, U.S. bondholders objected to the preferential treatment enjoyed by sterling investors which came as a by-product of the British-Colombian trade treaty. The Americans saw the British strategy of linking trade and debt as being "very prejudicial to American interests." However, when presented with the same opportunity, Cordell Hull, the U.S. Secretary of State, refused to link new U.S. trade agreements to the settlements of old debts, preferring instead to keep the two matters entirely segregated.[563] The FBPC also charged Argentina with discrimination, for "the diversion of revenues...pledged to

[561] Eichengreen (1991), p. 164.
[562] CFBH Archives (1942). File Ms34620, Document 391/3R. Letter from Waley (British Treasury) to Bewley (British Embassy, Washington, DC).
[563] FBPC Archives (1935). File M1287 047. Memorandum to file from Clark (FBPC) dated December 12, 1935.

American dollar bonds to the benefit of sterling bonds."[564] Even Bolivia was asked by the FBPC to explain to its American bondholders "why service should be made on sterling loans when no interest is being made on dollar bonds."[565]

The British were also able to enforce stricter lending into arrears policies on the part of the new multilateral lending institutions. When the World Bank announced that it was planning a loan to Peru, the British took "violent exception to the loan," warning that "the City [of London] will have nothing to do with the Bank if the Bank pursues such a course." In the end, it was the unrelenting pressure on the part of the British government that forced the Peruvians into making a settlement on their defaulted debt on terms that were much more favourable to sterling bondholders than originally intended.[566]

5.7.3 Linkage Between British Consular Offices and the CFBH

Finally, we can explain the variation in outcomes between American and British bondholders by the way in which the CFBH could continue to successfully leverage the power of the British consular network. The British were well aware that the interests of U.S. bondholders were "not regarded by the State Department as needing or deserving the protection which H.M. Government endeavours to give British bondholders."[567] The CFBH suggested that the New Deal administration displayed a decidedly negative attitude toward the vested interests of Wall Street, and, therefore, the FBPC and American bondholders suffered by association.

In stark contrast to U.S. policy, the British allowed the CFBH to "delegate a British minister to a foreign country, or his consul-general, as their local agent."[568] Reuben Clark of the FBPC testified that "the British Government goes further in the diplomatic support" of the CFBH by allowing its "foreign service to act as agents of the Corporation." By comparison, he argued that the State Department had done very little in assisting the FBPC.[569] There was no question that the British Foreign Office was more

[564] FBPC Archives (1935). File M1287 069. Minutes of Executive Committee, July 30, 1935.
[565] FBPC Archives (1937). File M1287 047. Letter from Clark (FBPC) to Norweb (Finance Minister of Bolivia) dated April 21, 1937.
[566] Aggarwal and Granville (2003), pp. 20-21.
[567] CFBH Archives (1942). File Ms34620, Document 391/5. Memorandum from Wade (Junior Official in H.M. Treasury).
[568] Eichengreen and Portes (1986), p. 619.
[569] Borchard and Wynne (1951a), p. 251.

intimately involved in bondholder negotiations, and that this involvement often served to improve the position of its bondholders. The Foreign Office dispensed advice to the CFBH and would regularly permit Embassy officials to conduct negotiations. The British Treasury would also inform debtor states that the status of bondholder debts would influence its decision of "whether to extend official credits to foreign countries."[570] By consistently lending official support to the CFBH, the British government ensured that the demands of bondholders carried greater weight with sovereign debtors.

Since the CFBH enjoyed such broad support within its own government, the FBPC found it unfair when the State Department tried to compare the performance of the two bodies. For instance, when Herbert Feis of the State Department pointed out how the FBPC was doing an inadequate job in Brazil since it did not have a representative in Rio, Francis White of the FBPC replied angrily that:

> the responsibility for this rested squarely with our Government who prevented us from getting funds from the one source where funds could be had...The British not only had a banker representative but he had been incorporated into the Embassy...[And, if the CFBH is doing a better job] it is largely their *Government* that is doing it and the inadequacy, if any, of our organization is due to the fact that we did not get the same support from our Government.[571]

The FBPC was right to point out that the CFBH achieved better results for its constituents largely because the British managed to maintain market discipline and boasted an official sector that played an active, investor-friendly role in sovereign settlement negotiations. How were these negotiations influenced, if at all, by the changing characterization of the act of sovereign default?

5.8 Productive Power

In the 19th and early 20th centuries, we saw the act of sovereign default characterized as a betrayal of trust and a moral failing, undertaken only by states that were willing to breech the rules of civilized international society. The sanctity of the debt contract was inviolable, and for this reason, extraordinary pressures were often placed on debtor states to settle. Extreme measures, including the assumption of economic control

[570] Eichengreen (1991), p. 164.
[571] FBPC Archives (1940). Memorandum from White (FBPC), February 21, 1940.

by a creditor state and outright military intervention, were not uncommon. However, the years of the interwar and post-war periods challenged these traditional assumptions about sovereign default in a number of ways.[572]

Beginning in the 1930s, the default calculus was driven less by considerations of honour and more by pragmatism. Latin American states needed to conserve resources for domestic purposes and did not see that onerous settlements would be rewarded with new capital, especially in light of the collapse of private markets. Matters of honour and integrity took a back seat to the imperatives of maintaining economic stability. And, once the ethical aspects of the debtor-creditor relationship receded into the background by the crushing impact of the Great Depression, debt service took on the appearance of a luxury which could no longer be afforded. According to Wallich (1943):

> The question 'to pay or not to pay' thus tended to be reduced to a simple utility calculus: Did the advantages of maintaining a good credit record constitute an adequate reward for the sacrifice of continued payments...Faced with this question, nearly all our South American debtors decided in favour of default, regardless of the relative size of their debt.[573]

However, Latin American belief in the sanctity of loan contracts was perhaps most damaged by "British default on the war debt, Germany's failure to make payments on the greater part of her international obligations, and the derogation of the gold-clause in the United States."[574] Even the CFBH recognized that "the question of odium attaching to a government as a result of its default on its legal obligations has disappeared more and more into the background." Unfortunately, what disturbed the CFBH was the fact that most nations now considered sovereign default to be an accepted practice, keeping with the precedent set by Great Britain, who, "as a leader amongst the nations of the world has itself set an example as a notable defaulter."[575] Although Britain had defaulted on inter-

---

[572] Lipson (1985b), p. 67.
[573] Wallich (1943), p. 322.
[574] Wallich (1943), p. 322.
[575] CFBH Archives (1948-1950). File Ms34603, Vol. 1, Document 327/216. The letter expresses concern that even the Annual Report of the Corporation of Foreign Bondholders in 1936 puts the defaulted debt of Britain to the U.S. at over $5 billion, but does not make it clear that this is intergovernmental debt. Apparently, this author believes that while it is unethical to default on private debt it is acceptable to default on intergovernmental debt.

allied war debt and not private debt, that distinction was lost on Latin American and smaller European states.

With the war debt issue garnering a good deal of media attention, there was no question that the average person regarded it to be "a matter beyond argument that Great Britain [was] a defaulter,"[576] and that the British attitude was influencing the decisions of other important states.[577] In 1938, the FBPC argued that:

> one of the principal reasons the small debtors were not paying their debt was because the large debtors were not paying theirs, and among the large debtors they were thinking constantly of Great Britain, France and Germany. They made no distinction between the inter-allied debt and the ordinary debts. They regarded them all as defaulters. The consistent position of these small debtors was, if the big fellows do not pay, why should we?[578]

According to Diaz-Alejandro (1983), if we put aside the ethics and legalities of default, the economic situation of the 1930s also induced greater tolerance for the actions of debtor states. He argued that the statement justifying the suspension of German reparations applied equally to other European and Latin American defaults:

> When productive resources were allowed to go to waste in idleness and countries everywhere were restricting imports to protect jobs, it made no economic sense whatsoever to insist on the transfer of real resources as reparations.[579]

Britain made a similar argument in a formal declaration of her unilateral suspension of war debts to the U.S. on June 4, 1934. Convinced that the existing system of inter-governmental war debt had broken down, H.M. Government maintained that there was a difference between war debt obligations and normal credit operations for development purposes - the most obvious being that war debts were neither productive nor self-liquidating. The British government also argued that it was economically impossible to make debt transfers to America and that any further attempt to do so would have disastrous consequences for trade. The declaration went on to mention the significant

[576] CFBH Archives (1948-1950). File Ms34603, Vol. 1, Document 327/216.
[577] CFBH Archives (1948-1950). File Ms34603, Vol. 1, Document 327/216. Clipping from the New York *Financial Chronicle*, June 18, 1938.
[578] FBPC Archives (1938). File M1287 047. Memorandum from Clark (FBPC) dated July 1, 1938.
[579] Diaz-Alejandro (1983), p. 31.

sacrifices of the British people, suffering tax rates more that twice as high as their U.S. counterparts, and the increased burdens of debt service associated with the depreciation of the sterling. The declaration finished by saying how any attempt to resume payments would "intensify the world crisis and...provoke financial and economic chaos."[580]

In many ways, the pleas of the British government echoed those that were delivered by many of the defaulting states of the 19th and early 20th centuries. Yet, while they were developing countries, Britain was not. It was one of the major European powers and had been the world's principal capital exporter and rule-enforcer until 1914. The effect of this proclamation, as well as those of the other major European powers, would materially change the characterization of the act of sovereign default.

The FBPC and U.S. bondholders were also hurt by the anti-banking discourse that gained momentum during the Great Depression. In this discourse, money was represented as "a force for greed, corruption and exploitation."[581] According to Rosenberg (1999), hostility toward banks appealed to large and disparate voting groups in the U.S, from "Bible-belt social conservatives to socialist radicals," and it helped to carry Roosevelt and the New Deal Democrats to power.[582] This in part explains the President's belligerence towards the FBPC. The Roosevelt administration, reflecting public opinion, routinely acted as if the FBPC were trying to collect on loans that had been intended to defraud and exploit unsuspecting Latin American republics.

As we argued in Chapter 4, the great powers who were the capital exporters of the 19th century were largely able to define what was meant by the act of sovereign default, and their material resources allowed them to both prescribe and enforce remedies. Eventually, these remedies were enshrined in an evolving framework of international law, one that successfully regularized international trade and lending.[583] In other words, productive power was tied very closely to structural power. In the 1930s, we observe a sea change in the characterization of the act of default principally because the same powers that enforced the sanctity of debt contracts in the 19th century, found themselves

[580] FBPC Archives (1934). File M1287 077. Proclamation of H.M. Government delivered by Lindsay (British Ambassador) to Hull (Secretary of State) dated June 4, 1934. For the U.S. response, see FBPC Archives (1934). File M1287 077. Letter from Hull (Secretary of State) to Lindsay (British Ambassador) dated June 12, 1934.
[581] Rosenberg (1999), p. 7.
[582] Rosenberg (1999), p. 8.
[583] Lipson (1985b), p. 38.

in default in the interwar period. Suddenly, the arguments that had been used by developing countries since the 1820s to suspend debt service – the crushing domestic economic burdens, the devalued currency, the unproductive nature of war debt – were all given legitimacy by the experiences of the Britain, Germany, France and Italy. Unproductive spending, the ravages of war and political ambitions had all "invest[ed] default with the halo of patriotism."[584]

5.9 Power and the Production of Bargaining Outcomes in the Interwar and Post-War Periods

We set out in this chapter to explain the observed bargaining outcomes between sovereign states and private creditors during the interwar and post-war periods, and also to assess the institutional relevance of the FBPC to those results. Measurements of negotiating outcomes showed a marked decline in settlement terms for bondholders when compared to pre-1914 levels: principal reduction was 23% vs. 12%; capitalization of interest arrears was only 35% compared to 71%; and the reduction in interest rates was 34% vs. 16%. By every measure, bondholders of the 1930s and 1940s achieved sub-standard results relative to their 19th century counterparts. And, when we look at intra-period results, we find that British investors enjoyed superior returns when compared to their U.S. counterparts, both across a wide sample of bonds and in the specific case of the German default. Why? The traditional explanation has been that the CFBH was an effective, respected, and well-funded organization run by men of great character and capacity, while the FBPC was a disappointment. However, using our power-based analytical framework, we have challenged the traditional notions about the CFBH and FBPC and have argued that structural and compulsory regime elements, not institutional ones, were much more relevant in producing bargaining outcomes in the 19th century as well as in the interwar and post-war periods.

Whatever weaknesses the FBPC might have exhibited, it could never have surmounted the pressures placed on it by its own government. Changes in its structure, staffing, funding or rules of operation would have made little difference in the pattern of bargaining outcomes. This is because the national interest of the United States between

[584] CFBH Archives (1938). File Ms34828. Clipping from *The Economist*, April 2, 1938, pp. 16-17.

the wars and immediately after World War II forced bondholders' interests into the background. Private investors were asked to subsidize their own government's political and strategic ambitions by entering into lenient settlements with debtor states. In addition, the collapse of the private capital markets and the virtual capital export monopoly of the U.S. government completely eroded the FBPC's bargaining leverage. In short, structural and compulsory regime elements overwhelmed the FBPC and were principally responsible for producing less favourable bargaining outcomes for U.S. investors. By contrast, Britain's dire post-war financial position incentivized it to increase national income by improving bondholder recoveries, thereby aligning the larger national interest with the narrower interests of investors. The country's willingness to use sanctions in the form of clearing arrangements and to link its trade and debt policies materially enhanced both the bargaining position and the observed outcomes for sterling bondholders.

The findings in our first two case study chapters have important implications for today's debate surrounding the reform of the international financial architecture, especially on the question of whether we erect new bondholder representative bodies. Our conclusions in Chapters 4 and 5 have been that history has either mistakenly credited or blamed an institutional body for results that were produced by powers that were external to it. The CFBH of the 19th century benefited from the size and importance of the British capital market as well as the actions taken by an investor-friendly British government. By comparison, the FBPC was penalized by the general collapse of private capital markets and the debtor-friendly foreign policy of the U.S. government.

So, do private creditor representative bodies matter? While we would hesitate to say that they have no effect, our analysis implies that they certainly do not figure as materially in the overall production of negotiating outcomes to the extent previously thought. Therefore, financial architecture reformers need to be mindful that any calls for the establishment of a new bondholder council might lead to the creation of an institution whose impact would be largely circumscribed by those structural and compulsory elements unique to the current political and financial landscape.

Chapter 6

When Creditors Were King: The "London Club" Bank Advisory Process, the Creditors' Cartel and Sovereign Debt Restructuring in the 1980s

If greed often drives people apart, fear often drives them together.

William Rhodes
Citibank, Bank Advisory Committee Chairman

There is a thin line between "advisory" and "adversary."[585]

Unnamed Latin American Finance Minister

6.1 The London Club and the Four Faces of Power

In Chapter 4, we challenged the received wisdom about the British Corporation of Foreign Bondholders ("CFBH"), arguing that its achievements were less a product of its institutional capabilities and more the result of external structural and compulsory regime elements that tended to favour the interests of private creditors. More specifically, we concluded that bargaining outcomes between private bondholders and defaulting states in the late 19th century were chiefly driven by two things: the structural power of a centralized, hegemonic, British capital market, and the willingness of the British government to use a wide array of coercive actions – ranging from diplomatic moral suasion to outright military force – to benefit bondholders.

In Chapter 5, we similarly attempted to assess the institutional impact of the U.S. Foreign Bondholders Protective Council ("FBPC") during the interwar and post-war periods. Here we argued that the sub-standard results achieved for bondholders during this era were not so much the inevitable consequence of a failed institutional experiment – which is the prevailing view - but rather the legacy of a collapsed market and a series of actions taken by the U.S. government and its agencies to subvert investor interests. In stark contrast to the close and cooperative working relationship between the British government and the CFBH in the 19th century, the FBPC suffered repeated setbacks at the hands of the American government, and eventually, the multilateral financial institutions.

[585] Mudge (1984), p. 65.

To illustrate this argument, we showed how the Securities and Exchange Commission eliminated the FBPC's main source of funding in the early days of the Council's operations, and how, by the end of the 1930s, the State Department had largely supplanted the FBPC as chief negotiator with a number of Latin American countries.[586] In this capacity, the State Department coerced bondholders to accept much more lenient settlement terms with debtor states than the FBPC had initially recommended. In addition, the U.S. government, along with the IMF and World Bank, made decisions to offer bi-lateral and multi-lateral funding to troubled sovereigns that remained in default to U.S. bondholders. This more aggressive "lending into arrears" policy on the part of official creditors seriously compromised the negotiating leverage of the FBPC.[587] In short, the political expediencies of the interwar and post-war periods pitted the broader national interests of the U.S. government against the narrower interests of its bondholders. The ultimate effect was to force the latter to subsidize the former without compensation. So, while structural and compulsory elements worked to benefit 19th century British bondholders and the CFBH, they worked against the interests of U.S. investors and the FBPC in the 1930s and 1940s.

In this chapter, we will assess the relative impact of the London Club on bargaining outcomes between commercial banks and sovereign debtors beginning in the 1980s. The London Club was the first body to emerge with a mandate to manage commercial bank debt restructurings on a global basis. So, the London Club can be contrasted with the CFBH and FBPC on two counts: the nature of the debt being restructured (bond vs. commercial bank debt) and the nationality of the lender (domestic vs. global). That is to say, each of the bondholder councils was restricted to negotiating on behalf of their home country investors: the CFBH helped to restructure sterling bonds held by UK investors and the FBPC did the same for dollar bonds held by US investors. However, the London Club negotiated on behalf of commercial banks globally.

The effect of the London Club, as a private creditor representative body, will be measured against the influence of other regime elements – official intervention and the credit market dynamic – that have been included in our analytical framework. We will

[586] Adamson (2002). See also Adamson (2005) and Eichengreen and Lindert (1989).
[587] U.S. government loans were generally extended through the Export-Import Bank or the Reconstruction Finance Corporation.

also examine the changes in public discourse regarding the act of sovereign default and attempt to gauge how those changes influenced results for private creditors.

Although the London Club process is often idealized as a mechanism of coordination when compared to today's institution-less, market-based regime for sovereign debt management, we intend to argue that the "success" of the 1980s regime for creditors did not emanate from organized and disciplined negotiations by bank steering committees, but rather from the heavy-handed exercise of coercion and control by the official sector. Once again, we will demonstrate that compulsory and structural power, not institutional power, drove bargaining outcomes in this era. Creditor governments threatened debtor states with severe sanctions to prevent them from declaring unilateral defaults, and non-cooperative regional banks were routinely intimidated by increased regulatory scrutiny. The IMF, bringing its much-needed incremental lending capacity to the table, was able to coerce banks of every size and nationality into lending new money to troubled debtors by making private involvement a pre-condition for the extension of official, structural adjustment loans.[588] Additionally, large money-centre banks pressured smaller, regional and European banks into making new loans and staying within the multi-year rescheduling process. Non-compliance was punishable by exclusion from the global payments system or industry blacklisting. And, if private incentives were not sufficient to induce consent, recalcitrant banks would ultimately hear from the official sector.

The power of the banks, the IMF and creditor governments was further enhanced by a key structural element: they were the source of all credit to developing countries. Their control of the market made it possible for them to act in a cartelized fashion and extract large concessions from debtor states – states that had no other place to turn for short-term trade credit and longer term development lending. However, that being said, we would maintain that the structural power that accrued to individual members of the London Club would not have been sufficient to drive bargaining outcomes in the banks' favour. These outcomes were instead heavily dependent upon the IMF's strict prohibition

[588] In this example, compulsory and structural power were exercised concurrently.

against lending into arrears and its insistence on concerted private lending.[589] Commercial bankers connected with the process admitted that once the crisis began, the natural inclination of every bank was to reduce – not increase – its exposure to Latin America.[590] Therefore, if left to their own devices, the banks would have been unable to surmount their collective action problems and would have presided over a complete collapse of the syndicated loan market. And, since a collapsed market eliminates a key incentive for debtors to repay, unilateral default would have been invited rather than avoided.[591] In short, whatever control the commercial banks may have enjoyed over private capital export, they would not have continued lending to Latin America unless the IMF compelled it.

The question remains: Why did official creditors throw their weight behind private banks? After all, in the 1930s, the U.S. government preferred to decouple its actions from those of private creditors, ultimately making the decision to lend into arrears. The IMF chose a similar course in the period immediately following World War II. This changed in the 1980s because official and private financial interests were once again aligned. If creditor country governments and the IMF had abandoned the commercial banks, they would have done so at their own peril. This is because at the outset of the crisis, the largest money-centre banks had amassed a reckless level of balance sheet exposure to Latin America. Unilateral defaults by the debtor states would have led to major bank failures, and systemic collapse would have in turn triggered payouts under national deposit insurance schemes. This meant that creditor governments were *as interested* in the satisfactory resolution of the crisis as the banks themselves. Finally, since IMF quotas were heavily weighted toward G-5 countries, the multi-lateral institution acted in concert with creditor country governments to protect the solvency of the global banking system. In summary, any success which the 1980s debt regime might have achieved on behalf of private creditors went far beyond the London Club process.

---

[589] When the IMF refused to "lend into arrears," the Fund declined to make loans to sovereigns that were in default to - or engaged in a rescheduling with - private banks until such time as the debtor state had settled satisfactorily with the private banks. In the reschedulings, the Fund essentially forced private banks to lend new money as a pre-condition for IMF loans.

[590] Author Interviews A, C & D.

[591] See Chapter 5 for a discussion of how market collapse alters a debtor's default calculus.

Compulsory and structural power - exercised most effectively by governments and multilaterals – were key contributors to bargaining outcomes.

6.1.1 Parallels Between The London Club and the CFBH

The London Club was not a formal organization like the CFBH or FBPC,[592] but it nevertheless bore a much closer resemblance to its 19th century counterpart when evaluated through the lens of our power-based analytical framework. Although commercial bank negotiations are rarely compared to those of bondholders, and the debt regime of the 19th century is seldom compared to that of the 1980s, there are a number of parallels worth noting.

6.1.1.1 Institutional Power

Members of the CFBH and the London Club appeared to exhibit strong cohesion and discipline. In the case of 19th century bondholders, the groups were small, relatively homogenous and drawn together by the administrative burdens of managing complex collateral pools. In the 1980s, large commercial banks enjoyed an alliance that came from operating out of the "clubby and oligopolistic confines of New York or London,"[593] their shared regulatory and accounting conventions, and the legal traditions embodied in their syndicated loan documents. In addition, for both sets of creditors, the institutional element served as a clearinghouse for information and a venue for consensual decision-making.

6.1.1.2 Compulsory Power

The degree and orientation of creditor country government intervention was also comparable in the 19th century and the 1980s. While the CFBH had close ties to the British Foreign Office and Treasury, and was often the beneficiary of coercive government action, the London Club linked itself with creditor county governments, global bank regulators and the IMF. This meant that a united and powerful creditors' cartel pitted itself against weak, individual debtor countries in the 1980s, just as the

[592] For purposes of this analysis, the London Club will be treated as having the same institutional standing as its predecessor organizations, the CFBH and FBPC.

[593] Devlin (1989), p. 218. Cohesion was strong among large U.S. lenders. As we will demonstrate later, this was not the case for smaller, regional and non-U.S. lenders.

British government apparatus was often used to intimidate debtor states in the 19th century. The IMF structural adjustment programs of the 1980s could also be viewed as the modern day equivalents of 19th century debt administrations.[594] Both diluted the economic sovereignty of debtor nations with the goal of restoring creditworthiness and market access.[595] And, in both periods, the interests of private investors appeared to be more closely linked with broader, national interests, a circumstance that served to improve the lot of bondholders.

6.1.1.3 Structural Power

The structure and condition of the credit markets were also similar in the 19th century and the 1980s, principally by virtue of their centralization and control. Prior to World War I, Britain enjoyed the largest and most liquid capital market in the world, and through disciplined arrangements with the London Stock Exchange, was able to systematically deny market access to defaulting sovereigns. In the 1980s, the commercial banks were the sole source of private credit to troubled sovereigns, and this monopoly enabled them to successfully withhold access to new credit until mutually agreeable settlement terms had been reached. In contrast to the 1930s and 1940s, the creditor country governments and the IMF stood firmly on the side of the private commercial banks in the 1980s, refusing to disburse official loans to countries that had not reached acceptable agreements with their private creditors. This gave the banks enormous bargaining leverage, since virtually all new credit for debtor states – official and private - was conditioned upon the banks' approval of settlement terms.[596]

6.1.1.4 Productive Power

Finally, from an ideological perspective, we can observe some similarities between the 19th century and 1980s. Sovereign default in the 19th century was deemed to be an "immoral and uncivilized" act worthy of intervention by "civilized" states, a

[594] Ferguson and Schularick (2006).

[595] Suter (1992), p. 105. Suter argues that in the 1930s: "there were virtually no cases of open political and economic control of debtor countries by creditors. By contrast, there has been substantial but indirect economic pressure by creditors in multilateral reschedulings due to IMF adjustment programs imposed on debtor countries."

[596] The IMF policy changed in 1989, after the announcement of the Brady Plan, in part to spur banks to reach a final settlement with sovereign debtors.

rendering which revived itself in the 1980s after a brief respite in the inter-war period.[597] As we discussed in Chapter 5, the global nature of the Great Depression, the ravages of two world wars, and the defaults of nations like Britain, France and Germany in the 1930s, had all induced far greater tolerance for debt suspension. With fiscal distress engulfing the great powers of Europe along with developing countries, default was seen as an acceptable policy choice - one which prioritized the needs of citizens over the demands of creditors. However, since the 1980s debt crisis confined itself to the periphery, the old stigma attached to default had conveniently re-emerged. This was in part because the act of default had become unthinkable in the 1980s. Commercial banks had concentrated a perilous amount of risk on their balance sheets, and outright default in the early days of the crisis would have rendered them insolvent. Banks were therefore better served by labelling the event as a "temporary, liquidity crisis" so that they could maintain the book value of their loans and use the time to salvage their badly compromised balance sheets. They were also careful to dissuade any country from considering a unilateral default by resuscitating the 19th century characterization and raising the spectre of its consequences.

6.2 The Performance of the London Club: Default Cases and Bargaining Outcomes

Given these observations, we would expect to see the London Club deliver better outcomes for banks in the 1980s than the FBPC delivered to bondholders in the 1930s and 1940s. The empirical evidence below suggests that while the banks did improve on the bargaining results achieved by their interwar and post-war counterparts, they were not able to replicate the strong results achieved by the CFBH in the late 19th and early 20th centuries. However, we do see a clear shift of bargaining power back to creditors in the 1980s, and the purpose of this chapter will be to explain why the shift occurred and which aspects of the regime of the 1980s were most responsible for it.

[597] Winkler (1933), p. 9. See also Rippy (1934), p. 195.

Table 6A: Bargaining Outcomes (1871 - 1975)[598]

Time Period	*Dominant Creditor Representative Body*	*Duration of Defaults*	*Capitalization of Interest Arrears*	*Reduction in Interest Rates*	*Reduction in Principal*
1871 – 1925	CFBH	6.3 years	71.6%	16.3%	12.0%
1926 – 1975	FBPC	10.1years	35.2%	34.5%	23.2%

Source: Suter (1992)

Table 6B: Bargaining Outcomes (1926 – 1997)[599]

Time Period	*Dominant Creditor Representative Body*	*Duration of Defaults*	*Debt Forgiveness (incl. forgiveness of interest arrears)*
1926 – 1975	FBPC	10.1 years	55.9%
1980 – 1997	The London Club	8.5 years	35%

Sources: Cline (1995); Bowe and Dean (1997); Rieffel (2003); The World Bank (1996).

The first table above compares the results of the CFBH and the FBPC which were presented in Chapter 5. However, due to methodological differences in calculating pre-1980s and post-1980s data, it was necessary to put the measurements on a comparable basis. So, the second table more accurately compares the total debt forgiveness (including the forgiveness of interest arrears and reductions in contractual interest rates) received by debtors in the 1926-1975 period with amounts received by debtors in the Brady Plan deals of the 1980s and 1990s. Also, due to small differences in calculations of Brady Plan outcomes among several sources, the results of these sources have been averaged.

The empirical results suggest that London Club era saw a reduction in default duration, from 10.1 years to 8.5 years and a marked reduction in debt forgiveness, from 55.9% to 35%, both of which were an improvement on the results delivered by the FBPC. While default durations were shorter in the 19th century – just 6.3 years – we would argue that expedient resolution was *not* the objective of the commercial bank creditors in the

[598] Suter (1992), p. 94. Reduction in principal in the 1871-1925 period excludes those settlements in which the creditors assumed either political or economic control over the debtor or foreclosed on collateral. See discussions in Chapter 4.

[599] The data in this table has been compiled from the following four sources: The World Bank (1996), pp. 78-86; Cline (1995), p. 234; Bowe and Dean (1997), p. 13; Rieffel (2003), p. 171. Methodological differences between the sources serve to create small discrepancies in the results. Therefore, for the purposes of this study, the results have been averaged. Also, in order to compare the measurements of debt forgiveness for the periods 1926 – 1975 and 1980 – 1997, the figure for 1926 – 1975 had to be re-calculated to include the forgiveness of interest arrears. See Suter (1992), p. 105 for this re-calculation as well as the author interview with Christian Suter, October 19-20, 2006.

1980s. In fact, this put them somewhat at odds with their bondholder counterparts. The table below helps to illustrate why it was the case that the London Club banks opposed more efficient settlement times.

Table 6C: Bank Exposure to Sovereign Debtors as a Percentage of Bank Capital (1982-1992)[600]

Country	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
US Banks											
Troubled	130.1	119.8	104.3	86.6	74.8	63.6	52.7	40.4	32.0	28.9	26.7
Total	166.2	153.9	130.9	107.0	88.5	73.0	60.4	47.2	39.2	35.7	33.1
Top 9 US Banks											
Troubled	194.2	185.1	169.3	140.1	121.6	106.6	92.5	79.6	66.7	63.5	50.6
Total	255.1	242.3	211.5	174.0	144.5	122.9	104.2	90.6	78.9	76.5	61.4
UK Banks											
Troubled	85.0	82.5	78.2	68.6	52.4	42.4	30.3	21.0	13.6	12.2	-
Total	119.3	111.4	104.7	88.8	67.4	53.7	38.4	27.9	20.0	17.1	-
German Banks											
Troubled	31.4	32.6	45.1	50.7	38.5	33.5	29.0	28.0	21.8	19.9	18.5
Total	49.5	51.9	68.8	76.0	59.9	52.9	47.2	48.6	40.8	47.0	45.4
French Banks											
Troubled	-	-	135.0	126.6	78.9	62.8	52.8	51.7	37.1	33.5	22.7
Total	-	-	170.6	183.4	125.0	93.8	81.4	85.8	63.9	55.1	37.7

Source: Cline (1995)

This is not just a numbers game. We are concerned with the maintenance of the international monetary system.[601]

William Rhodes
Citibank, 1983

In 1982, the top nine U.S. money centre banks had exposures to troubled debtor states, including Latin America, that were close to two times their capital base.[602] The

[600] Cline (1995), Tables 2.10 to 2.14. See also Federal Financial Institutions Examination Council, Country Exposure Lending Survey.
[601] Rhodes (1983), p. 28.
[602] Cline (1995), Tables 2.10 to 2.14. In Cline (1983), the figures are different but still dangerous from the point of view of the American banking system, with the top 9 U.S. money centre banks having exposures to Latin America of between 107% and 262% of their capital, or close to 160% on average.

situation was not much better for U.S. banks taken as a whole, with their aggregate exposure of 130% still sufficient to eradicate the equity of the entire system. In fact, loans to the three biggest Latin American debtor states – Mexico, Brazil and Argentina – represented close to 80% of the capital in the U.S. banking system.[603] And, the crisis was hardly confined to American lenders. Among U.K. banks, exposures to troubled debtors were in the range of 85% of capital, while they were 135% in France. Although German banks were better positioned and sources put the level of distressed debt at Japanese banks at 50% of equity, these were still exceedingly high percentages when compared to normal levels of non-performing loans.[604] Even the less exposed banks could have faced a loss of confidence and a run by depositors as a result of their troubled loan portfolio.

While the threat to national banking systems might have varied by degree, the linkages among the world's banks were such that no major country could feel immune. Paul Volcker, Federal Reserve Chairman at the time, recounted that although many people now think of the Latin American debt crisis as a problem for the third world, when it began, "it was just as much a problem for the first world, which found its banking system suddenly threatened with collapse."[605] Even Bill Rhodes, current Vice Chairman of Citigroup and one of the principal architects of the 1982 bank advisory committee process, admitted that among his goals, the one that was "first and foremost was to prevent the collapse of the international financial and banking system."[606]

The clearest way to self-preservation for the banks was to ensure that no major debtor country declared a default and that each was instead incentivized to stay within the confines of the multi-year rescheduling program. The banks could then use the time to safely reduce their exposures to a manageable level, something which they successfully achieved. By 1989, when the Brady Plan was announced, U.S. banks had reduced their troubled loan exposure from 130% to 40% of capital.[607]

---

[603] Devlin (1989), p. 217.

[604] Cline (1995), Tables 2.10 to 2.14. See also Oatley and Nabors (1998), p. 46, for Japanese exposure level. Normal levels of non-performing loans as a percentage of capital would have been in the 1% - 2% range.

[605] Volcker and Gyohten (1992), p. 189.

[606] Volcker and Gyohten (1992), p. 311. See also Eichengreen and Lindert (1989), p. 7.

[607] Corden and Dooley (1989), p. 34. "Even when banks write down the value of a loan in their books on the basis of their expectations of a possible loss, it is not necessarily in their interests to give up the possibility of full repayment. For an individual bank the argument against writing down the contractual debt is even stronger. If it does so while others do not, its share of eventual payments will be reduced."

Observers have also remarked on the strong contrast "between the lenders' robust profitability up through 1986 and the borrowers' depressed economies."[608] It was ironic that during the 1982 – 1985 timeframe, the debt crisis did not adversely affect the reported earnings of the U.S. banks, despite the fact that it "threatened their very solvency."[609] In some cases, the banks' income was actually enhanced by the crisis because early rescheduling agreements required the payment of large front-end fees and higher interest rates.[610] In fact, bank earnings as a percentage of assets from 1982 to1986 actually exceeded the levels earned in pre-crisis periods,[611] and major banks managed to maintain their dividend payouts to shareholders through 1986 "as if the debt crisis hadn't even occurred."[612]

Therefore, the debt regime of the 1980s appeared to meet one of its primary objectives: to maintain the solvency of the world's major banks and avoid the destabilization of the international financial system. Achieving this objective meant that efficient settlements were *not* on the agenda. By prolonging the negotiations, the banks were able to record profits and postpone losses for five years; and, when losses were finally taken, it was with the implicit understanding that they could be managed and absorbed. The experience of the banks contrasts rather sharply with the predicament of debtor sovereigns, who had experienced "losses in output and employment that would have been difficult to imagine possible in 1982."[613]

Given the above considerations, we would argue that the sovereign debt restructuring regime of the 1980s favoured creditor interests, both in design and outcomes.[614] However, the question remains: Why? What aspects of the regime – institutional (London Club), compulsory (government/IFI), structural (market) or productive (discursive) – drove regime design and the corresponding results? We will

---

[608] Devlin (1989), pp. 234-235.
[609] Sachs and Huizinga (1987), p. 567. "Reported net income rose between 1980 and 1986 for all of the nine major banks [Citicorp, BankAmerica, Chase Manhattan, Manufacturer's Hanover, J.P. Morgan, Chemical, Security Pacific, First Interstate, Bankers Trust, First Chicago] with the conspicuous exception of BankAmerica, which suffered major losses on its domestic loan portfolio."
[610] Sachs and Huizinga (1987), p. 567.
[611] Devlin (1989), pp. 234-235. This helped the banks double the level of their capital: 1982: $66.2 billion in primary capital, (Top 9 – $27.1 billion); 1987: $129.1 billion, (Top 9 - $51.5 billion).
[612] Sachs and Huizinga (1987), p. 574.
[613] Devlin (1989), pp. 234-235.
[614] Corden and Dooley (1989), p. 11.

begin by examining each aspect of the regime, using the same framework developed in previous chapters.

6.3 The Creation of the London Club and Institutional Power

The process has been informal. There is no procedures book, no "cook book," and no international bankruptcy court with jurisdiction over these issues. The forum has been the conference room, not the courtroom.[615]

Alfred Mudge
Bank Advisory Committee Attorney, 1992

6.3.1 The Onset of the 1980s Debt Crisis

Most accounts of the Latin American debt crisis begin with the phone call that Jesus Silva Herzog placed to Donald Regan, U.S. Treasury Secretary, on August 13, 1982 announcing Mexico's inability to continue to service its external debt. What is not as commonly reported is that upon Herzog's arrival in Washington, D.C. he was immediately ushered into a meeting room where representatives were assembled from the State Department, National Security Council, Central Intelligence Agency, Office of Management and Budget, and lastly, the Federal Reserve.[616] One can surmise from this line-up that the U.S. considered an imminent Mexican default to represent a formidable threat, not only to the U.S. economy, but to U.S. security as well. Difficulties in Mexico of any type are ordinarily of great concern to the United States. The two countries share a 1,760-mile border, meaning that internal crises in Mexico can have a material impact on its North American neighbour. The degree of economic interdependence is also significant. In 1982, Mexico "was the third largest trading partner of the United States after Japan and Canada, sold more oil to the United States than Saudi Arabia, and purchased U.S. grain quantities second only to Japan."[617] When the crisis broke, a former State Department official aptly described it as a "tremendous violation of expectations."[618]

---

[615] Mudge (1992), p. 143.
[616] Silva-Herzog (1991), p. 56. See also Dornbusch and Marcus (1991).
[617] Biersteker (1993), p. 84.
[618] Hurlock (1984), p. 45. This characterization of the 1980s debt crisis came from Richard Cooper, U.S. Undersecretary of State for Economic Affairs in the Carter administration.

Given the seriousness of the crisis and the potential repercussions, banks were able to accomplish rather quickly what their bondholder counterparts in the 1930s could not: "they coordinated effectively to confront the problem debtor countries in order to avoid defaults and an immediate devaluation of their assets."[619] The debt crisis of the 1980s centred largely around the debt owed to commercial banks by approximately twenty highly-indebted, middle-income developing countries, and it was on this task that the London Club focused its efforts.

6.3.2 The London Club as a Negotiating Body

As we discussed earlier, the London Club is not a formal institution like the CFBH and FBPC, but a framework for rescheduling loans between commercial banks and sovereign debtors.[620] According to Eichengreen and Portes (1995), "it is a set of conventions rather than an institution...there is no fixed venue or continuing secretariat, but rather a body of agreed procedures and case law."[621] In the absence of a secretariat, written charter, or published minutes, the origins and early operations of the London Club are opaque.[622] Even the lack of membership continuity has caused some to describe the London Club as "artificially contrived by...players who find it convenient or advantageous to camouflage their activities from others."[623] Suspicion naturally arises from this lack of transparency, leaving the London Club's agenda open to speculation by outsiders. This section will therefore focus on the institutional activities of the London Club. How did it operate? Who were its members? What insight are we able to gain from those who participated in its negotiations with debtor states? What did it achieve?

The first London Club meeting was actually held six years before the onset of the Latin American debt crisis, when commercial banks met in 1976 to discuss a rescheduling for Zaire.[624] In fact, between 1976 and 1982, the London Club apparatus was used to deal with the debt problems of Zaire, Turkey, Sudan and Poland. The origins

[619] Devlin (1989), p. 217.
[620] Unlike the CFBH and the FBPC, which dealt with restructurings of bond debt held by UK and US investors respectively, the London Club was the first body to emerge to handle restructurings of commercial bank debt globally.
[621] Eichengreen and Portes (1995), p. 26.
[622] Rieffel (2003), p. 103.
[623] Brown and Bulman (2006), pp. 12-14.
[624] Brown and Bulman (2006), pp. 12-14.

of the "London Club" moniker had more to do with these first rescheduling meetings, which took place in London, than they did with the meetings for the 1980s debt crisis, which took place mainly in New York City. Rieffel (2003) also credits the "London" tag with the fact that most Eurocurrency loans were governed by English law and their benchmark base rate was the London Inter-bank Offer Rate ("LIBOR").[625]

While post-hoc analyses of the creation of the London Club often present it as a seemless and natural effort, in fact, "the birth of the London Club was a messy affair."[626] According to Rieffel (2003):

> A close examination of the origins of the Bank Advisory Committee (BAC) process reveals the same pattern of muddling through that was seen after 1994 in the search for an orderly process for restructuring bonds. Indeed, no machinery of any kind existed in 1975 for multi-bank reorganization of commercial banks debt. It had to be invented. Five years and more than five workout cases were required for the commercial bank process to metamorphose from a series of experiments to a recognizable process.[627]

The idea behind the London Club was simple. In order to streamline discussions between hundreds of lending banks and a troubled debtor state, a small committee of between ten to fifteen lead banks would take responsibility for bargaining with the sovereign.[628] It was generally the case that the bank that had the largest exposure to a debtor state would be asked to organize and chair a Bank Advisory Committee ("BAC").[629] The lead banks would then communicate the outline of a proposed deal to the remaining lenders and work with them until a consensus could be reached on final terms.[630] During the negotiations, each member of the BAC was charged with securing the cooperation of a group of smaller banks that were not directly represented on the committee.[631] The challenge for the lead banks was that absent a formal, legal mandate from the debtor

---

[625] Rieffel (2003), p. 103.
[626] Rieffel (2003), p. 103.
[627] Rieffel (2003), p. 95.
[628] Aggarwal and Granville (2003), p. 67. In 1982, the 15 lead banks held 85% of the total distressed debt. The largest committees had fifteen members and the smallest had three to five.
[629] Rieffel (2003), p. 108. BACs are also referred to as Steering Committees. "London Club" is an umbrella term for the Bank Advisory Committee Process.
[630] Kearney (1993), p. 66.
[631] Rieffel (2003), pp. 116-117.

country or their banking syndicate, they had to develop proposals that would attract unanimous approval.[632]

Citibank's Bill Rhodes[633] was careful to point out that membership on these committees was not decided unilaterally by the banks, but in conjunction with the debtor countries. In fact, according to Rhodes, the entire process could not begin unless the debtor sovereign formally requested the establishment of the committee:

> These committees were organized in coordination with each of the debtor countries, and that is important to remember: They were not put together by the banks alone; they were requested by the debtor countries...The committees have served as an informal pipeline for the borrower governments, who otherwise would find it difficult – if not impossible – to negotiate with the thousand or so interested banks an any one time around the world.[634]

Rhodes went on to stress that when deciding the make-up of an advisory committee, the debtor state needed to take into consideration more than simply the size of a bank's exposure - geography and regional influence were important as well:

> We have learned much about organization. In the past, for example, when choosing a committee chairman, the government usually went to its leading bank lender and asked it to help put together the rest of the committee. Most often...it would tend to be an American bank. Now, however, we are broadening the geographical representation to include other regions of the world.[635]

Rhodes believed that the effectiveness of the steering committee was increased to the extent that it could mirror the interests of the institutions around the world that it represented. And, as we will discuss later, the need to harmonize a final deal around different regulatory and accounting conventions across the U.S., Europe and Asia certainly increased the importance of non-U.S. representation in the London Club process.

---

[632] Mudge (1992), p. 143.

[633] Rhodes, currently Citigroup Senior Vice Chairman, headed a number of high-profile steering committees during the 1980s debt crisis and was widely considered to be the architect of the 1980s bank advisory process. Today, he focuses his efforts on the debate about how to improve the international financial architecture and is a contributor to the IIF's *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets.*

[634] Volcker and Gyohten (1992), pp. 312-314. Comment by William Rhodes of Citibank.

[635] Rhodes (1983), p. 26.

6.3.3 The London Club Economic Sub-Committees

Often overlooked in accounts of the London Club is the key role played by economists. Until 1982, most banks in the United States conducted their foreign lending business without the benefit of thorough and disciplined in-house economic analysis. This meant that bank credit officers in the 1970s could not turn to a staff of experienced economic practitioners to help them spot potential lending pitfalls. In 1983, Jack Guenther, Citibank Economist observed: "I think this is one reason why the IMF – with its experienced staff – has seen its own role grow."[636]

However, once the crisis began, the banks set about to remedy this shortcoming. There were immediate efforts to establish a series of economic subcommittees, especially for the larger restructurings in Mexico and Brazil. And, these subcommittees were not necessarily dominated by U.S. economists. The banks sought input from around the world and invited practitioners from Japan, Europe, Canada and South America. The role of the economic subcommittee was to independently evaluate economic data that was given to the banks by the debtor countries and the IMF. Nothing was taken for granted or accepted at face value. In addition, they worked directly with the finance ministers of debtor governments to prepare data for distribution to the banks, and they frequently had a say in how debtor sovereigns presented their economic information. For instance, in 1983, the Bank of Mexico produced a quarterly financial report in a format which had been prescribed by the banks' economic subcommittee. Similarly, in Brazil, the data packages produced by the Central Bank were strongly influenced by the advisory committee economists. Not only did the economic subcommittees work closely with the debtor states, they also had regular dialogue with the IMF and central banks globally. Their mission was a difficult one. They were expected to provide reliable economic data around which debtors and creditors could frame their negotiations, and they often had to deliver a verdict on what they considered to be the debt servicing capacity of a given state.[637] In the case of Mexico, the London Club was dealing with over five hundred

[636] Guenther (1983), p. 33.
[637] Rhodes (1983), pp. 26-27.

banks and in the case of Brazil, over six hundred. It was therefore imperative that they had the best available information on which to base their restructuring decisions.[638]

6.3.4 London Club Guiding Principles and Negotiations

According to Rieffel (2003) the London Club had three guiding principles: i) negotiations were to take place on a *case-by-case* basis with debtor states so that agreements could be specifically tailored to the particular circumstances of each country; ii) agreements were *voluntary,* meaning that they were not imposed by official bodies like the IMF; and, iii) agreements were *market-based,* implying that they had to be flexible, pragmatic and, above all, "apolitical." Since the London Club banks were ultimately responsible to their shareholders, they also endeavoured to conclude their earliest deals with the countries needing the fewest concessions. This way, they would establish the most favourable precedents for dealing with the harder cases.[639] O'Brien (1993) argued that the "case-by-case" principle was not so much meant to bring tailored solutions to debtors, but to give the banks additional bargaining leverage. With their insistence on bargaining individually with debtor states, the banks "ensured that the powerful cartel of creditors faced a weak debtor."[640]

Each negotiation would generally begin with a debtor presenting to the BAC the terms of its preferred restructuring deal. Almost immediately, the BAC would commence its deliberations to prepare a counter-offer from the banks. The economic subcommittees played a key role in this process. They had to independently determine the debt capacity of the troubled sovereign and construct detailed balance-of-payments projections. The economists also had to ensure that they accounted for all of the debt outstanding, since a sovereign's records were not always reliable.[641] London Club negotiators confided that reports on sovereign debt positions were not only unreliable, but that delays in

[638] Rhodes (1983), p. 27.
[639] Rieffel (2003), pp. 109-110. In order for deals to be considered "market-based," they had to be agreed at rates that were above LIBOR, the banks' marginal cost of funds. In addition, the payment terms had to be set in accordance with a country's capacity to pay, something that was more easily determined in theory than in practice.
[640] O'Brien (1993), p. 94.
[641] Rieffel (2003), pp. 117-120.

publication made them analytically useless.[642] Rick Bloom, a London Club negotiator for Bank of America, pointed out that Argentina had under-reported its bank debt by $10 billion in 1982, and that one major bank had to concede that its own exposure to Argentina was twice the level reported to its board, because bank affiliates, offshore subsidiaries and consortia banks were slow to identify their defaulted loans.[643]

Despite these information gaps, the steering committee banks and the debtor state eventually managed to converge and produce a final terms sheet. This tentative agreement was considered "accepted" only when near unanimous approval was obtained from all the participating banks; the level of unanimity was considered to fall somewhere north of 95%.[644]

6.3.5 London Club Legal Conventions

In seeking broad consensus from participating banks, the London Club process was certainly helped by the standard legal provisions in syndicated loan agreements. These provisions had the effect of increasing the cohesion among the banks by making unilateral action much less attractive. The most important clause from this perspective was the *sharing clause*. It required the agent or lead bank in a syndicated loan to distribute any proceeds received from the debtor state to all participating banks on a pro-rata basis. It also compelled a participating bank to share any payments received from the borrower - even if they came as the result of independent legal action - with the rest of the syndicate members. This discouraged member banks from "going it alone" or invoking legal options, since their upside was limited. As a result, creditors developed informal, behavioural rules that included a commitment to negotiate rather than seek legal action.[645]

Once again, post-hoc analyses of London Club restructuring agreements tended to give the banks and their lawyers too much credit for "considered and rational judgement"

---

[642] Author Interviews A & C. The interviewees also admitted that the banks' own records concerning their sovereign exposure were less than accurate and accounting systems had to be materially upgraded to ensure that all exposure was captured.

[643] Rieffel (2003), p. 123.

[644] Rieffel (2003), p. 123.

[645] Rieffel (2003), p. 108. Other important legal conventions included the *pari passu* clause, which required the debtor state to treat banks in a syndicated loan no less favourably than banks in similar loans. *Cross-default* clauses permitted syndicate banks to declare a default if the sovereign borrower defaulted on another loan.

when they observed a trend towards increasing standardization of loan documentation. Attorneys representing the banks tended to dispute this characterization, preferring a more "human explanation." According to Walker and Buchheit (1984), of the New York law firm Cleary, Gottlieb:

> The community of lawyers around the world actively engaged in sovereign debt workouts is surprisingly small. It is not uncommon to find a single law firm representing either the lenders or the borrowers in a number of different negotiations all taking place simultaneously. Given the natural human instinct to follow precedent when confronted with new and complicated assignments, an increasing standardization of documentation...is probably inevitable. Thus legal documentation...prepared in the context of one negotiation not only can be, but often [is], marked up as the basis for another borrower's restructuring. Provisions which may play a useful role in one agreement are sometimes uncritically incorporated into its progeny.[646]

Cleary Gottlieb believed that the standardization of restructuring agreements - often a response to time pressure and overlapping bank representation - did not necessarily produce optimal results for banks or their borrowers. While it might have appeared to be the outcome of careful deliberation, it was not. Other attorneys were quick to point out that with the passage of time, the focus on precedent forced the banks and borrowers into a "lowest common denominator" approach to negotiation. According to Davis (1992):

> When it is in their interest, the banks say, 'We can't give you X even though we gave it to another country, because you have not done the following,' or 'You have to agree to Y because another country agreed to it.' And, in other circumstances, when it is in their interest, the government negotiators will say, 'Well, you gave it to country X, so you have to give it to us,' while resisting other points agreed to by other countries by stressing how different their country's position is from that of those countries that acquiesced in these demands.[647]

Therefore, the negotiation tended to devolve into a process where each side argued from points of precedent, but only when it served their interest to do so. As time progressed, it became even more difficult to achieve consensus, either among the creditors or between the creditors and debtors. In fact, the inability to surmount fractured interests without coercion was just one of the many weaknesses of the London Club process.

---

[646] Walker and Buchheit (1984), p. 140.
[647] Davis (1992), pp. 149-150.

6.3.6 The Weaknesses of the London Club Bank Advisory Committee Process

6.3.6.1 The Principle of Consensus

The simple fact that the process operated on the principle of consensus meant that each committee bank held a powerful veto and could, in theory, stall negotiations for long periods of time. And, even after the bank committee reached agreement on a set of terms with the debtor state, close to 100 percent acceptance was then required from hundreds of participating banks. Whereas you could often get agreement from the first 90 to 98 percent "in a relatively short time," it often took "months to obtain commitments from the last 2 to 3 percent."[648] Some likened the BACs to a "miniature United Nations, making consensus laborious and time consuming."[649] Practitioners engaged in London Club negotiations agreed that any attempt to idealize the 1980s framework would be "profoundly a-historical," since it was far from being "smooth and organized."[650] As we will discuss later, the only available tools for securing such acceptance were compulsory in nature: moral suasion by lead banks, regulators, and central banks and the threatened loss of access to the global payments system.[651]

6.3.6.2 Debtor Confusion: The Lack of Coordination Among Classes of Creditors[652]

In addition to the principle of consensus, the lenders – both private and official – offered the debtor little help in trying to coordinate complex negotiations among various classes of creditors. Jeffrey Garten (1982), a partner at Lehman Brothers, argued that the almost comical "Alphonse-Gaston" routines that developed led to costly delays and terrible confusion as a debtor state continued to suffer economic decline:

> The separate negotiations with the IMF and each category of creditor are uncoordinated. The creditors demand an IMF programme as a pre-condition for rescheduling debt. The IMF, on the other hand, needs to know the outcome of the rescheduling before it can develop a viable stabilization programme based on an accurate projection of the country's foreign exchange

---

[648] Davis (1992), p. 150.
[649] Rhodes (1989), p. 26.
[650] Author Interviews, A, C, D, and I.
[651] Buchheit (2003), p. 12.
[652] Classes of creditors included the London Club, Paris Club and IMF. The Paris Club was established in 1956 as a forum to negotiate official, bi-lateral debt restructurings on a government-to-government basis.

position. In addition, the governments prefer to act after the banks reschedule their loans. Of course, the banks want to wait for the governments.[653]

So, while the creditors were struggling to secure for themselves the largest share of the debtor's foreign exchange pie, the financial cost of uncoordinated negotiation was being borne by the debtor state. In addition, the whole process was an immense drain on the talent and energy of the sovereign's finance ministry, who could have put their time to much better use by tackling the domestic economic problems that gave rise to the crisis in the first place.

6.3.6.3 London Club Fatigue: Negotiation Without End

The cast of characters, drawn from the principal commercial banks around the world...is getting physically, and perhaps mentally, tired of this process.[654]

Francis Logan
BAC Attorney, 1992

Given the above considerations, it was not surprising to see London Club negotiators begin to complain of fatigue. According to Francis Logan (1992) a Cleary, Gottlieb attorney, creditors not only grew weary with the demands of debtors, but also found it increasingly difficult to get along with each other.[655] Richard Davis, a lawyer representing the BACs, argued that the fatigue ostensibly developed from the "never-ending" nature of the process.[656] It was also a function of the fact that the general perception of the crisis had changed. After all, the term "crisis" connotes something that comes to a head, but the 1980s debt problems appeared to be more of an unsolved, prolonged dilemma.[657] This meant that early on, when the risks to the banks were perceived as being very high, senior decision-makers attended meetings and had the power to commit their institutions; however, once the immediate risks receded, senior management delegated the task to more junior personnel.[658] Eventually, meetings were

[653] Garten (1982), pp. 281-283.
[654] Logan (1992), p. 155.
[655] Logan (1992), p. 157.
[656] Davis (1992), p. 147.
[657] Davis (1992), p. 148.
[658] Mendelsohn (1983), p. 10.

attended by people who primarily recorded information, voiced complaints, and made phone calls for guidance on every important issue.[659]

While Citibank's William Rhodes was careful to point out how much progress had been made from 1982 to 1989, the lawyers were much more circumspect.[660] They argued that hard work, good luck and collective effort on the part of the banks helped to avoid systemic financial collapse, but that no solution had been found for the plight of the debtor countries, despite the rhetoric from Rhodes and U.S. Treasury Secretary James Baker.[661] In fact, in 1983, Rhodes proved to be overly optimistic about the potential economic recovery of debtor states. He predicted that by 1984, Mexico would have its private sector restructured and that in the following year, 1985, Mexico would be "back in the marketplace."[662] His assessment was off by approximately five years.

6.3.7 Why Did it Take So Long? Was the London Club the Right Process?

As we suggested at the beginning of this chapter, the commercial bank lenders would have been rendered insolvent if debt forgiveness were offered in 1982, at the outset of the Latin American debt crisis. Therefore, a process which was both consensus-building and time-consuming helped the banks meet one of their principal objectives: to bolster their loan-loss reserves and build their equity bases through nearly seven years of healthy profits. The stakes were so high that the banks "had to assume that the crisis could be managed."[663] The outcome could not be determined solely by market forces, since systemic risk had to be eliminated first.[664]

With a vested stake in the London Club process, the bankers were naturally more careful to defend it. Bill Rhodes argued that the "flexibility and innovativeness of the case-by-case, market-based, cooperative approach" was often underestimated by outside observers,[665] and that "imposed" debt solutions would have severely curtailed

[659] Davis (1992), p. 149.
[660] Logan (1992), p. 154.
[661] Logan (1992), p. 156.
[662] Rhodes (1983), p. 31.
[663] Rhodes (1989), p. 19.
[664] Volcker and Gyohten (1992), p. 319. Comment by Manuel Guitian, Assciate Director, Central Banking Deparmemt, IMF.
[665] Rhodes (1989), pp. 23-24.

commercial bank lending to developing countries.[666] Others have also offered a defence of the banks' position. Rieffel (2003) argued that it was "necessary to 'bump down the stairs' before beginning broad-based debt reduction. Leaping from the top to the bottom would have risked systemic consequences that could be avoided by taking more time."[667] Some bankers simply admitted that "no one ever imagined a different way to do it."[668] Cline (1995) maintained that the London Club approach "bought time" for the triage process that would eventually separate those countries that needed debt forgiveness from those that did not.[669] Rodney Wagner of J.P. Morgan declared with the benefit of hindsight that "we at Morgan have never thought that the LDC debt problem would be short-term in nature, a so-called liquidity problem."[670] He admitted that the main goal of the lengthy process was to save the banks so that the "fear of collapse of the financial system" would pass.[671]

However, some economists, including Jeffrey Sachs (1986), argued that it was a "myth" to assume that U.S. banks could not have afforded debt relief prior to 1989. Sachs suggested that debt relief in the form of five years of forgiven interest payments to all but the three largest debtors – Brazil, Mexico, and Venezuela - would have represented only 15 percent of bank capital for the major U.S. banks and 5 percent for all U.S. banks. In other words, it was affordable.[672]

It was not until 1989, seven years after the crisis started, that Latin American debtor states were finally offered debt forgiveness of close to 35% in the form of the Brady Plan. The plan was menu-driven, allowing the banks to choose from among four, equivalently valued alternatives.[673] The design of the Brady Plan also served an important American political agenda – it required U.S. banks to suffer some pain for their perceived

---

[666] Rhodes (1989), p. 27.
[667] Rieffel (2003), p. 152.
[668] Author Interview I.
[669] Cline (1995), p. 224; Rieffel (2003), p. 153.
[670] Wagner (1989), p. 35.
[671] Wagner (1989), p. 36.
[672] Sachs (1986), p. 408. If the relief were also extended to include Brazil, Mexico and Venezuela, the cost would rise to 41 percent of money centre bank capital and 14 percent of total bank capital.
[673] Option 1: A par bond, exchanged for the same principal amount of old loans but bearing a fixed, below-market interest rate; Option 2: A discount bond, exchanged at a substantial discount from the principal amount of old loans but paying interest based on the current market rate; Option 3: A debt-equity swap yielding a local-currency claim that could be exchanged for shares in an enterprise being privatized; and, Option 4: A cash buyback at a discount. See Cline (1995) and Rieffel (2003), p. 172.

folly. There was a strong feeling, especially among American voters and politicians, that the commercial banks should not be bailed out for their imprudent lending to Latin America. At the time, N.Y. Congressman Chuck Schumer argued that "no taxpayer bailout" was an "article of faith in the debate on Third World debtors."[674]

Yet, the protracted sovereign debt negotiations of the 1980s allowed banks to reduce their troubled loan exposure from an average of 130% to 40% of primary capital and avert financial collapse.[675] The strategy of rolling over debt and waiting seven years for a debt restructuring worked very well for the banks, both in containing losses and even making profits in some cases. Those banks that had written their debt down below the level of the haircut, were able to recognize profits when they exchanged their loans for Brady Bonds. In addition, the banks were often more than compensated for their losses as the prices of the restructured instruments rose in the market. The *ex-post* sovereign spreads on private credit in the 1989-1994 period were 23.3% for Latin America, well above the 16.7% for all emerging market debt as a class.[676] However, it would not have been possible for the banks to achieve such results without the strong backing of their governments and the IMF. The 1980s sovereign debt restructuring regime was highly coercive in almost every respect, and in the next section, we will establish the important role that coercion played in the negotiation process.

6.4 Compulsory Power

During the 1980s and early 1990s, the official sector ran the sovereign debt restructuring business much like Wyatt Earp ran Tombstone, Arizona on a Saturday night: there could be as much shouting and blaspheming as you wanted, but everybody had to check their guns before they came into town.[677]

Lee Buchheit
Cleary, Gottlieb, 2005/2006

Creditors had all the sticks on their side in the 1980s.

Author Interview D
February 4, 2005

---

[674] Schumer (1989), p. 233.
[675] McGovern (2003), p. 74. See also Cline (1995), Tables 2.10 to 2.14 and Federal Financial Institutions Examination Council, Country Exposure Lending Survey.
[676] Klingen, Weder et al. (2004), pp. 27-29.
[677] Buchheit (2005-2006), pp. 339-340.

While the London Club process may have seemed cohesive and cooperative to outside observers, in truth, its success was largely dependent upon the use of coercion and compulsion at many levels. Within bank syndicates there were divergent interests. Large money-centre banks could not afford to walk away from the restructurings, and smaller, regional banks were loathe to lend new money. Different accounting and regulatory policies were often a source of friction between U.S. and European banks, forcing solutions that were American-centric and cumbersome for the non-U.S. banks. In many instances, the IMF was seen as using its own lending capacity as a "stick" for the banks. And, finally, creditor country governments and regulators had a vested interest in safeguarding their own domestic financial systems, making them less reluctant to threaten potential defaulting states with meaningful sanctions.[678]

In this section, we will examine the use of coercive power in the London Club process and argue that it was critical in skewing bargaining outcomes in favour of the banks. We will look at how this power was exercised over U.S. regional bank holdouts, non-U.S. banks, and sovereign debtors. In the majority of cases, the most effective form of persuasive power was official, in the sense that it was exercised by creditor country governments, their agencies, and the IMF; however, in some instances, large, money-centre banks were also able to directly influence the actions of regional banks.[679]

6.4.1 The Coercion of Regional Banks

Regional banks were the holdout creditors of the 1980s debt crisis. They were more numerous than their money-centre banking counterparts and, in theory, posed a

---

[678] Rhodes (1989), p. 20. In many ways, the creditors' cartel that formed between the commercial banks, creditor country governments, financial regulators and the IMF was somewhat unusual in that it developed among parties that often had adversarial or competitive relationships. After all, the banks that made up a steering committee were usually competing for the same clients and business outside of the London Club. Bank regulators often found themselves in contentious relationships with the commercial banks they monitored, and the international financial institutions - like the IMF and World Bank - "traditionally kept their distance from commercial lenders." In the face of these obstacles, Rhodes credited the success of the London Club working arrangement with the leadership provided by certain key individuals: Jacques de Larosière at the International Monetary Fund; Paul Volcker and Tony Solomon at the Federal Reserve; Gordon Richardson at the Bank of England; Tim McNamar and Marc Leland at the U.S. Treasury; and a group of senior international bankers led by Walter Wriston, Chairman of Citibank, and Sir Jeremy Morse, Chairman of Lloyds Bank.

[679] Although our analytical framework attributes compulsory power capabilities mainly to creditor country governments and multilaterals, this chapter also examines how lead banks had the capacity to coerce regional banks in the London Club process.

threat to the consensus-driven, decision-making process of the London Cub. In the Mexican bank syndicate alone, there were 180 U.S. regional banks with exposures ranging anywhere from $625 million to less than $10,000.[680]

From the perspective of the regional banks, the London Club process was two-tiered. The inner core was comprised of dominant international banks like Citibank, J.P Morgan, Chase Manhattan, Bank of America, Lloyds and Dresdner. Smaller, regional banks were in the periphery, often treated with contempt and referred to as "stuffees."[681] In the core, the large banks bargained among one another to set the terms. In the periphery, the regional banks were expected to ratify them without question. According to Nancy Gibbs (1984), an attorney representing regional banks in Mexico, the term "cram down" was not "an unduly harsh description of what in fact occurred."[682] Banks were given less than a week to commit to a complex new deal that was outlined in a twenty-foot long telex. And, Mendelsohn (1983) offered this observation from an executive of a smaller bank: "We simply get a telex from the steering group banks that they are meeting in Zurich or wherever, that they have agreed on such and such terms, and would we kindly telex our agreement no later than 2 p.m."[683] When asked how the larger banks secured agreement from regional banks, one London Club negotiator replied: "Regulatory pressure, moral force and yelling."[684]

The bargaining leverage of the core came from three principal sources. First, the lead banks were heavily engaged in cross-depositing through the inter-bank market, meaning that they were an important source of funds for regional banks. Money centre banks also offered a critical range of products and services to regional banks, including correspondent banking and loan syndication. According to Lipson (1985a), these interdependencies permitted "both reciprocity and retaliation," thereby facilitating policy coordination.[685]

---

[680] Gibbs (1984), p. 11.
[681] Author Interview I. The term "stuffee" was a derogatory reference to regional banks by their money centre counterparts, since the latter would routinely offload unwanted loans to the former via the syndications process.
[682] Gibbs (1984), pp. 23-24.
[683] Mendelsohn (1983), p. 15.
[684] Author Interview C.
[685] Lipson (1985a), p. 205.

Second, from a documentary perspective, the regional banks did not have the same degree of control over the voting process. They could not, for instance, call a default since voting was weighted by loan values and generally required a two-thirds majority.[686] Therefore, the larger banks were better able to block any regional bank efforts to trigger a default. This gave the money centre banks an effective veto over the wishes of the smaller syndicate banks.[687]

Third, the money centre banks controlled the flow of information. The simple act of forming a BAC meant that a debtor government would limit its contact to the banks that were members of the steering committee. So, even those regional banks that had local offices in Latin America were unable to obtain better information from troubled sovereigns than their BAC counterparts. This afforded the lead banks a power base almost as influential as the size of their loan commitments and meant that they could shape the terms of the restructuring.[688] And, those regional banks without an international staff were left to feel as if they were at the bottom of the banking food-chain. In fact, lead banks were not terribly moved by grievances of smaller banks which, in their estimation, "were happy enough to enter the markets in a subsidiary role when the going was good," and should therefore not complain in times of adversity.[689] According to one steering committee member: "There are obviously some 'Johnny come lately's' who went in late without adequate staff and did not understand and are now having a difficult time."[690]

Next to an outright default by a debtor state, the main threat to the London Club process was an effective hold-out strategy by regional banks. It may have been a "perilous and lonely course" for any small bank to choose, but it remained a distinct possibility. Therefore, a considerable amount of effort was invested in preventing it.[691] There were a number of pragmatic options devised by the lead banks to deal with potential holdouts. Sometimes, there would be "arm-twisting at the chairman or CEO level."[692] If that was unsuccessful, state and federal regulators or central bank authorities

---

[686] Aggarwal (1987), pp. 23-24.
[687] Lipson (1985a), pp. 216-217.
[688] Gibbs (1984), pp. 23-24.
[689] Mendelsohn (1983), p. 16.
[690] Aggarwal (1987), p. 19. Cited in *Financial Times*, December 21, 1982, p. 8.
[691] Lipson (1985a), p. 219.
[692] Rieffel (2003), p. 114.

were brought into the process.[693] Central banks such as the Federal Reserve Board and the Bank of England were particularly adept at putting pressure on holdouts when the stakes warranted it.[694] There were even cases where the central banks of debtor governments got involved in the monitoring process. In one instance, the Central Bank of Brazil gave Banker's Trust the information it needed to send out 'name and shame' telexes to those regional lenders that had failed to restore their credit lines to Brazil.[695]

However, before enlisting official help, the lead banks simply isolated the potential holdouts and used their banking relationships "to point out the error of their ways." The goal was to make it clear that non-cooperation was transparent, that defectors would be punished in the future, and that "asymmetry of bank size" permitted "effective, low-cost sanctions."[696] According to one lead banker: "A small bank, especially, has to have access to the world money market and big customers; a reputation for being a solo artist is not considered desirable."[697]

Yet, it was still the case that many smaller, regional banks harboured resentment against steering committee banks for what they felt was "unjustified pressure to go on lending."[698] Frederick Heldring, Chairman and CEO of the Philadelphia National Bank, spoke openly in 1989 about the errors of the London Club process. He argued that it had been wrong to lend new money to Latin American states simply to keep interest payments current, and he maintained that the banks should have accepted the need for debt forgiveness earlier in the process.[699] Heldring also implied that since many of the regional banks were not threatened with collapse by the crisis, they were able to more honestly assess it for what it was: a solvency, not a liquidity, problem.[700] And, his main concern was that by inducing stagnation and lower living standards in Latin America, the banks had sown the seeds of a "potential social revolution" in these countries."[701]

---

[693] Rieffel (2003), p. 123. Author Inteviews A & C.
[694] Lipson (1985a), p. 221.
[695] Aggarwal (1987), pp. 25-27. Cited in *Fortune,* July 11, 1983.
[696] Lipson (1985a), p. 220. See also Devlin (1989), p. 219.
[697] Aggarwal (1987), p. 24. Cited in *Wall Street Journal,* April 13, 1984.
[698] Mendelsohn (1983), p. 13.
[699] Heldring (1989), pp. 30-31.
[700] Heldring (1989), p. 33.
[701] Heldring (1989), p. 32.

The positions of the money centre and regional banks could not have been more divergent. It was therefore interesting to see how the steering committee banks actually used the recalcitrance of the regional banks to their advantage when negotiating with debtor sovereigns. For example, the BACs would often threaten troubled debtors with the negative reaction of "maverick" regional lenders, when the goal was principally to secure better terms for all the banks. According to Walker and Buchheit (1984):

> During the course of the negotiations, the sovereign borrower can expect to hear much about risks posed by such maverick [regional] lenders who may refuse to participate in the restructuring process. The sovereign may be told again and again that its approach to particular points in the negotiations...will increase the chance that maverick lenders may reject the restructuring...The sovereign will rarely be in a position to verify whether potential maverick lenders are in fact possessed of the sensitivities claimed for them by the bank advisory group during negotiations. Nevertheless, the sovereign will be asked to concede a great deal to forestall possible adverse reactions by some lenders when both the imminence and relative importance of such reactions remains largely speculative.[702]

6.4.2 The Coercion of Non-U.S. Banks

It was not just the regional banks that were at the receiving end of coercive power. Non-U.S. banks were also subject to coercion from U.S. steering committee banks and official institutions, including their own central banks and treasury departments. Because exposures were skewed within national boundaries - North American banks accounted for 35.7% of total international lending to Argentina, Brazil and Mexico - U.S. commercial banks often found it difficult to get their European or Asian counterparts to go along with what the Europeans criticized as the "American show."[703] This often resulted in a fair amount of "posturing" by non-U.S. banks which wasted valuable time and energy.[704]

In addition to smaller exposures, the lack of regulatory harmonization was the most frequent obstacle to cooperation. The Deputy Chairman of AG Becker Paribas voiced concerns over the fact that there were "vast differences in the supervisory systems around the world." Each country had its "own specialized supervisory system...based

[702] Walker and Buchheit (1984), p. 156.
[703] Aggarwal (1987), pp. 16-17.
[704] Author Interview C.

upon its history, its traditions, [and] the size of [its] banking system."[705] Nationalized French banks did not have to be concerned with showing a quarterly profit, and therefore could afford a longer-term view on the 1980s debt crisis. Swiss banks, which declared profits only on an annual basis, were also willing to take a longer view than the Americans. Moreover, European banks were encouraged by favourable tax laws to make larger provisions for loan losses on their foreign debt. In West Germany, for example, provisioning against potentially uncollectible loans significantly reduced tax liabilities, and in Switzerland, the central bank strongly promoted the building of extra loan loss reserves against exposure to Mexico and Brazil.

National regulatory differences were also evident on the issue of interest capitalization. For most continental European banks capitalizing interest did not require the approval of the board of directors.[706] The European banks strongly suggested that the London Club capitalize interest payments instead of mandating new loans, especially since the loans were being used principally to fund the interest payments. As they saw it, the administrative burden of advancing new loans across a 600-member banking syndicate was much greater than making a simple accounting entry for capitalized interest. But, North American banks were vehemently opposed to the suggestion since they were obliged to classify loans as non-performing as soon as interest payments were past due by more than 90 days. For them, the illusion that interest was being paid – even though the payments were coming from new loans – was necessary for them to keep the loans "performing;" and, only performing loans could be maintained at full book value.[707] So, they successfully pushed back against their European counterparts to avoid the potentially disastrous costs to them of interest capitalization.[708]

Despite the questionable accounting treatment of U.S. troubled loans, the European banks has little power to change the London Club process. One French banker, who complained bitterly about Citibank's "imperialism," said that it would be "nonsense to try to increase French influence [for four reasons:] the bigger commitment by U.S. banks; [the fact that they] had lead managed the loans, they are respected the world over

[705] Heinman (1983), p. 32.
[706] Lipson (1985a), pp. 212-213.
[707] Aggarwal (1987), pp. 20-21.
[708] Rieffel (2003), p. 164.

and they got organized quickly."[709] Even a major international lender like Lloyd's bank, when telexing its acceptance of rescheduling terms to the London Club stated: "We are only doing this because the Bank of England asked us to."[710]

6.4.3 The Coercion of Debtor States

As tar babies go, few have proven stickier for the official sector than the plight of private sector lenders trying to recover their bad loans to foreign governments. Inevitably, these lenders have looked to their own governments for succour and protection against defaulting sovereign debtors. At several points and in several ways over the last two centuries, the official sector has tried to detach itself from this problem, only to discover how relentlessly adhesive it can be.[711]

Lee Buchheit
Cleary, Gottlieb, 2005/2006

At no time did international banking occupy a market free of such exogenous factors as governments.[712]

Philip Wellons, 1985

Although the commercial banks tried to perpetuate the "myth" that the 1980s debt crisis was a purely private affair between debtor states and their creditors, the process that developed was anything but apolitical.[713] As we have discussed earlier, there were a number of places in the London Club process where politics and finance intersected, most notably with the activism of creditor country governments, regulators and the IMF.[714] And, from the moment that Mexican treasury officials communicated their payment difficulties to the U.S, "U.S. officials assumed that America's own security, not just Mexico's, was at stake."[715] From a foreign policy perspective, Latin America had long been regarded as a region that was vitally connected to U.S. interests, and there was no Latin American nation more strategically important to the United States than Mexico. While the foreign policy objectives of the U.S. may have had little salience for American bankers, the alignment of official and private interests in the 1980s debt crisis was a boon

---

[709] Aggarwal (1987), p. 22. Cited interview with French commercial banker.
[710] Aggarwal (1987), p. 28.
[711] Buchheit (2005-2006), p. 333.
[712] Wellons (1985), p. 441.
[713] O'Brien (1993), p. 94.
[714] Kahler (1986c), pp. 7-8. According to one Chase banker: "I do remember in April 1982 when Argentina went to war with [Britain], Chase had a loan drawdown request [from Argentina]...I was...trying to get them to *retract* their request and [got] the Fed, Treasury, State Department, and the Argentinian ambassador to the U.S. on the phone with the President of the Argentine Central Bank. They finally retracted their request..." See Author Interview C.
[715] Cohen (1986a), p. 212.

for private creditors.[716] U.S. lenders had dangerous levels of loan exposure to a strategically important neighbour, thereby combining the threat of regional instability with domestic financial collapse.[717] The dual domestic and international threat led the U.S. government and its agencies to support the London Club restructuring process and its main proponents, the money-centre banks. From a realist perspective, "national economic and political objectives took precedence," and debtor states were strongly encouraged to cooperate with the banks.[718]

If the main internal threat to the London Club process was the defection of regional and non-U.S. banks, the main external threat was unilateral default by a major borrower. For this reason, official, coercive power was used to keep debtor states in line. Kahler (1986b) describes the first two years of negotiation, from 1982 to 1984, as a "game of chicken" with the penalties for non-cooperation large and largely unknown."[719] Since most commercial banks benefited from government-sponsored deposit insurance programs, a series of sovereign defaults would have seriously undermined the domestic financial systems of creditor governments and socialized the costs of bank failure.[720] So, to avert default, political pressure from creditor country governments, especially the United States, carried "the implicit message that sanctions of a non-financial kind" be imposed on any countries that failed to service their debt.[721] The Deputy Treasury Secretary of the United States painted an alarming picture of what might happen to countries that default:

> The foreign assets of a country would be attacked by creditors throughout the world; its exports would be seized by creditors at each dock where they landed; its national airlines unable to operate, and its sources of desperately needed capital goods and spare parts virtually eliminated. In many countries, even food imports would be curtailed.[722]

---

[716] Aggarwal (1987), p. 38. Said one Citibanker: "Who knows which political system works? The only test we care about is: Can they pay their bills?" Cited in *Wall Street Journal*, December 21, 1981.
[717] Wellons (1985), p. 471.
[718] Wellons (1985), p. 442. See also Wellons (1986).
[719] Kahler (1986b), p. 249.
[720] Buchheit (2005-2006), pp. 338-339.
[721] Krugman (1989b), p. 292.
[722] O'Brien (1993), p. 100.

In 1983, most bankers and bank supervisors dismissed the possibility that any indebted country would choose the path of outright default. A senior spokesman of a large and advanced developing country agreed, saying that "if his country ever defaulted, its ships and aircraft everywhere would instantly be seized by creditors, as would any goods that his country tried to export."[723] Loss of access to trade credit and the international payments mechanism would have been untenable for troubled sovereigns, forcing them into a barter arrangement for their goods on an international basis.[724] Sachs (1986) argued that creditor country governments had, in effect, endorsed the London Club reschedulings,[725] thereby prioritizing the protection of commercial banks, "at least on a short-run accounting basis."[726] Jose Angel Gurria Trevino, Undersecretary for International Affairs in the Mexican Finance Ministry, observed the one-sided nature of official support in the London Club negotiations: "The initial goal was to keep the banks going. They lent us a little bit and we had to produce the rest by putting a big squeeze on our balance of payments...Such enormous sacrifice by the debtors – to keep the banks going!"[727]

Diaz-Alejandro (1986) argued that the ability of the commercial banks to enforce their desired terms rested not only on their own bargaining power but on the "willingness of the U.S. government to back them up at critical junctures." Any decision by a debtor state to unilaterally default would have been "as much a foreign policy decision as a financial one." And, whereas countries might be willing to break their ties with commercial banks and resort to autarkic financial policies, most would be hesitant to break with the rest of the international system. According to Diaz-Alejandro:

> Breaking official ties with creditor governments would involve such crucial financial and non-financial areas as aid, trade policy, technology licensing, and arms deals. Moreover...defaults could let loose political passions that would threaten the debtor government itself. For a while, the leader may bask in nationalist glory, but the forces unleashed by default, especially an active

[723] Mendelsohn (1983), p. 9.
[724] Corden and Dooley (1989), pp. 34-35.
[725] Sachs (1986), p. 398. Sachs maintained that reschedulings were prioritized over debt relief, where "relief" is defined as any arrangement - such as below-market interest rates, forgiveness of principal, or repurchases of debts by the debtor country at below par - that reduces the present value of contractual obligations of the creditor country.
[726] Sachs and Huizinga (1987), p. 557.
[727] Volcker and Gyohten (1992), p. 319.

> one, may threaten constitutional order and could reopen the gates to populist-nationalistic authoritarian generals – after all, the nation would be surrounded by enemies.[728]

Creditor country governments and the IMF could have altered the balance of power that gave the banks a stranglehold over sovereign debtors. The most effective way would have been to declare that official bi-lateral and IMF loans would no longer be conditioned upon the successful renegotiation of private debts. Unfortunately for the debtor countries, a change in the "lending into arrears" policy was not to be forthcoming, at least not until the banks had sufficiently recovered in 1989. This has led some to observe that, prior to 1989, the "public good of IMF lending" had been "captured by private interests."[729]

While the banks were busy congratulating themselves on the results achieved by the London Club process, debtor country finance officials were decidedly more critical. Speaking about the onset of the crisis, Jose Angel Gurria Trevino, Undersecretary for International Affairs in Mexico, said:

> Banks typically reacted by folding and withdrawing the umbrellas that they offer their clients on sunny days...banks started calling in their short-term debts as they matured, sucking up what little was left in liquid reserves in LDCs' vaults...Here was a dramatic exercise in lack of communication and, even more serious, complete lack of social sensitivity and total absence of political foresight. OECD central bankers took over and, in addressing their own fiscal and monetary imbalances, condemned hundreds of millions to prolonged poverty and declining standards of living. In so doing, they also created the most serious political problem facing the world in the nineties.[730]

Far from seeing the London Club process as orderly, Trevino called it "unprecedented, daring, and scandalous." With the tenor of restructured debt and new money so short, the banks simply created "an unmanageable accumulation of maturities" for the debtor states.[731] Latin American finance ministries were so consumed with the rescheduling process that they had little time to address the underlying economic problems of their respective countries. Luiz Carlos Bresser Pereira, Former Brazilian Finance Minister was

[728] Sachs (1986), p. 411. Citation from Carlos Diaz-Alejandro.
[729] Devlin (1989), p. 219.
[730] Trevino (1989), p. 72.
[731] Trevino (1989), p. 75.

less diplomatic in his assessment of the 1980s debt regime. In his view, it merited a different name:

> Perhaps it should be called something like the "slavery-collection approach" as it is reminiscent of the old-fashioned forms of collecting credits. When a debtor was unable to pay, he or she was reduced to slavery.[732]

Why did elites comply with the demands of the London Club? One of the principal reasons was fear of retaliation. According to Pereira: "The creditors are always threatening to cut the short-term trade credits, or to take even stronger steps against debtors who take unilateral measures."[733] Even after U.S. banks had made available $300 million in new trade credit to Peru, one New York banker said: "If they get too confrontational, we'll cut off all that. Then they won't be able to import food or spare parts and there'll be an immediate political cost."[734]

From the banks' perspective, the principal agitator in the group was Argentina. Widely believed to be the only country in Latin America that had the potential to pursue autarkic policies - given its self-sufficiency in food and energy, as well as its considerable industrial base - Argentina would often adopt a confrontational approach with the London Club. It openly supported the formation of a debtors' cartel and even threatened to turn to the Soviet Union for help.[735] According to Kaletsky (1985), one needs to examine a debtor's incentives to default in the context of theoretical disincentives: sanctions (i.e., retaliation) and the lack of ongoing access to capital markets.[736] In the case of the 1980s debt regime, the ability to impose sanctions and make new credit available were both within the grasp of the London Club banks and their governments. With the economic consequences of default to creditors so grave, it was not unreasonable for debtors to assume that lenders would follow through on any retaliatory threats.

---

[732] Pereira (1989), p. 95.
[733] Pereira (1989), pp.103-104.
[734] Aggarwal (1987), p. 6.
[735] Aggarwal (1987), pp. 7- 9. Cited in *Wall Street Journal*, June 26, 1984 and *Financial Times*, November 4, 1983.
[736] Kaletsky (1985). Other formal models developed to explain patterns of negotiation and make policy recommendations include: Corden (1989); Bulow and Rogoff (1989b); Krugman (1989a). See also Frenkel, Dooley et al. (1989).

6.4.4 Why Debtor States Didn't Organize into a Negotiating Cartel

Even with the unwelcome picture painted by creditors of the aftermath of default, the threat of sanctions was not solely responsible for preventing the formation of a debtors' coalition.[737] There were domestic factors that weighed heavily on the decision of the larger countries, especially Mexico and Brazil, to continue to play by the rules of the game. The weakness of Latin American collaboration could be said to reflect a divergence in their domestic capabilities for adjustment.[738] By 1984/1985, Mexico had achieved modest growth and Brazil more rapid growth, so they were "unwilling to press their case with the bankers and set in motion unknown risks."[739] Even Argentina, who had agitated at the debtors' meeting in Cartegena in 1984 to form a cartel, was happy to use the rhetoric of the Castro campaign to obtain better terms from creditors, but in the end, never used its bargaining power to secure any meaningful concessions.[740] That being said, the creditors were sufficiently worried about the Cartegena conference to roll out new and more favourable terms to those states that remained in the London Club process. The message was clear: "those countries that cooperated with creditors would be rewarded."[741] Paul Volcker pointed out that "by good fortune or otherwise, there always seemed to be one important country that was doing well and sensed it had a lot to lose from joining others in a strong confrontation with creditors."[742] What Volcker neglected to say was that the "good fortune" in this instance accrued mostly to the banks, since they stood to gain the most by averting cartelized behaviour on the part of the debtors.

There were also issues of distrust and rivalry among Latin American countries, which played to the advantage of creditors. Many debtors felt that they would be "pulled down to the lowest common denominator if they joined together."[743] And, according to one banker, since "most countries were ruled by military dictators, there was a certain

---

[737] Mendelsohn (1983), pp. 14-15. "Debtor countries themselves showed that they were opposed to the concept of any generalized debt renegotiations with creditor countries on common terms at a meeting in early 1983 of UNCTAD."
[738] Kahler (1986a), p. 34.
[739] Krugman (1989b), p. 292.
[740] The United States also timed the announcement of the Baker Plan to ensure that the Consensus of Cartegena never moved from rhetoric to action. Of all the debtor countries, Argentina seemed to understand its relative power in the debt negotiations. The country was largely self-sufficient, making it the most likely to successfully withstand potential creditor sanctions. See Ferrer (1983).
[741] Devlin (1989), p. 223.
[742] Volcker and Gyohten (1992), p. 210.
[743] Author Interviews A and C.

amount of machismo in each country's attitude toward the other; I think that they each felt they were different and could work a better deal on their own."[744] Another banker pointed out that coordination was limited by "national pride and feelings of superiority."[745]

Unfortunately for debtors, these mutual suspicions limited their ability to coordinate bargaining positions. So, the strategy in which the banks required borrowers to "continue to pay a modest proportion of their interest in cash" and accept their legal responsibility for the rest "gave the U.S. authorities and major banks much more room to manoeuvre."[746] In fact, it seems that no government in Latin America "seriously attempted to work out the potential costs and benefits of some form of collective and/or unilateral action on the debt."[747] There were no earnest talks of a moratorium, and during the early rounds of rescheduling, the debtors "competed vigorously with each other to appear as the most creditworthy client of the banks."[748] The creditors and their governments encouraged this behaviour by promising more rapid and favourable treatment to those debtors that acted alone.[749] From a theoretical perspective, the creditors and their governments were behaving in the same way as a monopolist. And, any monopolist confronted by competitive economic agents can engineer outcomes that are likely to result in the exploitation of the latter.[750]

Another factor that hindered cooperation among the debtors was the large variation in their size, geo-strategic significance, and total debt burden. For example, Mexico and Brazil benefited from their large markets and were able to obtain better terms in their rescheduling agreements than smaller countries like Uruguay and Bolivia. Even more important, Mexican officials were aware that their long border with the U.S. gave them enhanced bargaining leverage. After all, the U.S. would not want the debt restructuring efforts to impinge on domestic or political stability in Mexico. Therefore, Mexico felt that it would have little to gain from joining other countries, since that would

---

[744] Author Interview C.
[745] Author Interview A.
[746] Kaletsky (1985), p. 47.
[747] O'Brien (1993), p. 101.
[748] Devlin (1989), p. 220.
[749] Aggarwal (1987), p. 34. Cited in *Institutional Investor,* July, 1984, p. 233.
[750] Devlin (1989), p. 222.

only dilute its own bargaining position in the process.[751] The fact that some countries "were more equal than others" was also evident by the IMF's behaviour. According to one banker, the commercial bank "arm-twisting" that was so crucial in the cases of Mexico and Brazil was hardly noticeable in the cases of smaller debtor states, making it much more difficult for smaller countries to mobilize incremental external financing.[752]

Further support for debtor acquiescence came from the Latin American business classes, who were opposed in principle to any action which might hinder their access to foreign credit, increase the cost of trade credit, or make selling abroad more difficult. Businessmen wanted the debt to be reduced through non-confrontational dialogue with creditors, and were happy to throw their weight behind IMF programs that promoted privatization and integration into the world economy. The investing class was also opposed in principle to debt repudiation, since it would throw open the question of the legality of contracts and the sanctity of private property. Finally, the debt negotiators within Latin America were a small group of technocrats from the Central Banks and Ministries of Finance whose personal accounts have revealed how closely aligned their values and attitudes were to those of their creditor counterparts.[753] Sharing the bankers' paradigm, the Latin American ministers "initially had a relatively passive bargaining strategy."[754] Even as late as 1985, a study of the debt problem by a Latin American commission dismissed as "radical" alternatives such as a moratorium or the unilateral conversion of bank debts into bonds.[755] In any case, it would have been difficult to construct a debtors' cartel without some major country assuming hegemonic leadership. Once Mexico and Brazil locked themselves into the London Club process, there were no remaining countries with the credibility to act as a regional hegemon.[756] Unfortunately for the Latin American states, it was not until much later in the rescheduling process that the exaggerated nature of the creditors' threats became apparent. By that time, the banks

[751] Aggarwal (1987), p. 32.
[752] Aggarwal (1987), p. 33. Cited from statement of Christine Bindert in Joint Economic Committee of the U.S. Senate and House, Subcommittee on Economic Goals and Intergovernmental Policy, 98th Congress, 2nd session, November 13, 1984.
[753] Silva-Herzog (1991); Volcker and Gyohten (1992).
[754] Devlin (1989), p. 220.
[755] Kahler (1986b), p. 259.
[756] Aggarwal (1987), p. 33.

had already successfully rebuilt their balance sheets; however, the debtor states were still dealing with economic decline.[757]

6.4.5 Coercive Role of the IMF

The Managing Director of the IMF, Jacques de Larosière, was described by Paul Volcker as a "bankruptcy judge on a grand international scale," mediating between the debtor countries and the banks. Under de Larosière, the IMF agreed to disburse incremental funds to Mexico only on the condition that the country's 1400 creditors simultaneously extended $5 billion in new loans. Said one prominent U.S. banker: "It was clear that somebody had to step in to play a leadership role...The IMF sensed a vacuum and properly stepped into it."[758] The importance of the IMF's role cannot be overemphasized. It acted where the U.S. government could not. At the time, over half of the total loan exposure to Latin America was held by non-U.S. banks, i.e., banks that would prefer IMF to U.S. influence. There is also evidence that the money centre banks welcomed the IMF's role; while there was "some grumbling over the banks' loss of autonomy...large banks generally appreciated the IMF's stance because it facilitated collective action among lenders."[759] In other words, without the involvement of the IMF, the London Club process might have failed. Walker and Buchheit (1984) pointed out that the IMF adopted "an unabashedly paternalistic approach" by calling together the borrower and major commercial bank creditors to discuss how much each party would be expected to contribute to the workout.[760] Once again, however, the reaction of troubled sovereigns to the IMF's role was somewhat different. The IMF was seen as exerting its greatest pressure on debtor countries, "urging full repayment and macroeconomic adjustment."[761] So, while creditor optimism was growing during the course of negotiations, policymakers in debtor countries were presiding over a fairly continuous economic decline. With the exception of one mediocre year – 1984 – they had "little to

[757] Devlin (1989), p. 233.
[758] Cohen (1986b), p. 152.
[759] Lipson (1986), p. 229.
[760] Walker and Buchheit (1984), p. 149.
[761] Eichengreen and Lindert (1989), p. 7.

cheer about."[762] In fact, the average decline in real per capita GDP from 1981 to 1985 for Latin American debtor states was 11.72%.[763]

Diwan and Rodrik (1992) have argued that the IMF did have an "efficiency enhancing" role to play in the Latin American debt crisis, based on two functions which the Fund could perform better than the commercial banks. The first was the enforcement of conditionality: the IMF could condition loan disbursements on specific policy reforms to be undertaken by the debtor government, and had a superior capacity to monitor those reforms. Second, the IMF had a comparative advantage in alleviating the asymmetric information that exists in the creditor-debtor relationship. They had closer relationships with the debtor country and were better at fact-finding than commercial banks.[764] In fact, Brown and Bulman (2006) argued that the inability of private banks to monitor the policy conduct of debtor governments "allowed the IMF significant leverage."[765]

If official institutions like the IMF helped to coordinate the behaviour of lenders so that "non-destructive" outcomes prevailed,[766] they were also able to join the chorus of other official institutions and exert pressure at key points in the negotiating process. According to Rieffel (2003):

> The IMF managing director would contact a BAC chairman on occasion to stress the implications of specific terms for the debtor country's recovery prospects. G-7 finance ministers and their deputies would more often engage in arm-twisting with BAC chairman or members. The views of certain governors and senior staff members of the Federal Reserve Board were conveyed occasionally and were given great weight by banks generally.[767]

6.5 Structural Power

The debt regimes of the 19th century and the 1980s were similar to the extent that both were characterized by a high degree of centralization and control over the supply of credit. In the last quarter of the 19th century, Britain was the world's dominant capital exporter, and through close cooperation with the London Stock Exchange, the CFBH was able to deny market access to defaulting sovereigns. During the 1980s, we observed

[762] Sachs (1986), p. 402.
[763] Sachs (1986), p. 410.
[764] Diwan and Rodrik (1992), pp. 6-7.
[765] Brown and Bulman (2006), pp. 12-14.
[766] Cuddington and Smith (1985), p. 15.
[767] Rieffel (2003), pp. 121-122.

similar aspects of centralization and control. The commercial banks, creditor governments and the IMF were the sole sources of all credit to developing countries. During the Latin American debt crisis, they coordinated their behaviour to ensure that no new funds were disbursed to any troubled debtor until such time as acceptable rescheduling agreements had been reached with private creditors. As a former Mexican finance minister pointed out: "There were big incentives to pay the banks, because, unlike bondholders, they had all the money."[768]

Although the commercial banks and the more heavily-indebted non-oil exporting countries each had the ability to undermine the other's stability, they were not exactly "mutual hostages." The banks derived greater leverage from the fact that the Latin American debtors needed to continue to tap the international capital markets.[769] This was most especially the case with short-term trade credits. Since official finance was tied to bank finance in the 1980s, the borrowing countries could not afford to alienate the system's largest commercial lenders. To do so would have meant to disrupt the credit lifeline that supported the daily import and export trade, bringing food, energy and other essentials to developing economies.[770]

As we have already discussed, the power of private creditors was materially enhanced by the position of official creditors, most especially the IMF. By conditioning IMF adjustment lending on the satisfactory settlement of arrears with commercial banks, the IMF implicitly supported, "or at least never questioned, the onerous commercial terms that the banks demanded to effect reschedulings."[771] In addition, the IMF's insertion into the London Club restructuring process gave the banks "one more lever" which they could use to control the debtors' conduct. According to Devlin (1989):

> In effect, when the Fund permitted a direct link to be established between the commercially based rescheduling demands of the private banks and its macroeconomic standby programs, it unwittingly allowed a major contradiction to emerge: an international public good (the Fund and its adjustment programs) became a partial hostage of the short-term private logic

[768] Author Interview H.
[769] Aronson (1979), p. 305.
[770] Devlin (1989), p. 218
[771] Devlin (1989), p. 219.

> of profit-driven banks...The pretence of being an honest broker in the adjustment process therefore became increasingly difficult to sustain.[772]

It should be noted that the banks were not initially pleased with the IMF's assessment that large scale default could only be prevented if substantial new money were provided *jointly* by the Fund and the banks. The IMF was not bailing-out the banks, but bailing them in. According to James (1996), "the procedure of providing new funds was known by a variety of names, most politely 'concerted lending,' more clearly as 'involuntary lending,' and mostly (by the bankers) as 'forced lending.'"[773] However, since the banks had every interest in avoiding a potential default, they "could...be coerced into being compliant over additional lending."[774] Although the bankers may have initially complained about their loss of autonomy, the fact is that from the perspective of the debtor states, the IMF and the commercial banks represented a powerful, credit-exporting negotiating bloc.

Some have argued that the IMF was "gamed" by the banks, a charge that is not without empirical support. Despite the "new money" packages offered by commercial lenders, U.S. bank exposures to problem debtor countries *fell* in absolute dollar terms from 1982 to1986. In effect, there was no "new money." Loans were round-tripped from debtor countries back to the banks to make interest payments, and in most cases, the loans were considerably less than the interest bills owed to the banks. Therefore, the net resource transfer from the banks to the debtor states during these important early years of the crisis was *negative*. Who filled the gap? The IMF, with its structural adjustment loans.[775] Official lending made it possible for the banks to withdraw, albeit at a slow pace, from the business of development lending to Latin America.[776] Representatives of the IMF would later refer to this process as moral hazard in slow motion.[777]

To address this criticism, the Fund decided to decouple its lending programs from the business of commercial banks. In October, 1987, the IMF announced a $65 million standby agreement for Costa Rica which was *not* conditioned upon the Costa Rican

---

[772] Devlin (1989), pp. 228-230.
[773] James (1996), p. 369. See also Bordo and James (2000).
[774] James (1996), p. 366.
[775] Sachs and Huizinga (1987), p. 565.
[776] Krugman (1989b), p. 291.
[777] Jeanne and Zettelmeyer (2001).

government reaching a satisfactory settlement with its private creditors.[778] Two years later, in 1989, the IMF decided to implement a more formal change in its "lending into arrears policy." It was timed to coincide with the announcement of the Brady Plan, which moved the 1980s debt crisis from a series of temporary settlements to a permanent one.[779] Under the new IMF policy, the Fund was permitted to lend into situations where the "debtor country was implementing a credible adjustment program and was negotiating in good faith with its commercial bank creditors but had not yet concluded these negotiations."[780]

6.6 Productive Power

6.6.1 Avoiding the "D" Word: The Usefulness of the Illiquidy Diagnosis

The U.S. government believes that current problems basically involve questions of liquidity, not solvency.[781]

Marc E Leland
Assistant Treasury Secretary for International Affairs, 1983

Rolling loans gather no loss.

John C. Henman
Deputy Chairman of A.G. Becker Pariabas, Inc.

Discursive practices surrounding the 1980s Latin American debt crisis not only helped to frame the nature of the problem, they also helped frame the solution. It was clear from the outset of the crisis that any diagnosis that centred around insolvency or default was unthinkable, especially from the perspective of the banks. So, the "d" word was avoided at all costs. Instead, the more acceptable, initial diagnosis of the problem afflicting Latin American countries was one of illiquidity. And, the negotiating process that was established flowed directly from this diagnosis, ruling out any need for debt forgiveness, at least in the early stages when the banks were the most vulnerable.[782] This is not to imply that there was no basis for the illiquidity diagnosis. There were, in fact,

[778] Devlin (1989), pp. 228-230.
[779] Although the Brady Plan would not put an end to financial crises in Latin America, it did offer some measure of debt forgiveness and helped spur the flow of private capital back into the recovering states.
[780] Rieffel (2003), p. 173.
[781] Leland (1983), p. 109.
[782] Silva-Herzog (1991), p. 59.

several economic factors which suggested that the problems of Latin American countries might be temporary. Nominal and real interest rates were high by historical standards and were expected to fall. There was scepticism that worldwide inflation had been broken as late as 1984 and that any resumption of inflation would help Latin American export earnings while eroding the real value of their debt. And, even if inflation did not pick up, it was widely believed that commodity prices would rise in line with the worldwide recovery from recession.[783] Bankers recalled that ""in the beginning...[we] really did believe [the illiquidity diagnosis] to be true. But, as more information came out – and it didn't always come out easily – things looked worse."[784]

Debt-management practitioners are more sceptical when it comes to making accurate distinctions between "illiquidity" and "insolvency" in a sovereign financial crisis. Robert Rubin, former U.S. Treasury Secretary, has argued that the terms "illiquidity" and "insolvency" are "approximately useless." According to Rubin: "I don't mean they're useless if you want to have interesting discussions; I just mean they're useless when you actually have to do something."[785] Paul Volcker agreed and has said that the distinction between illiquidity and insolvency is easier to make in a textbook than in the real world. He added that he was not certain that he had ever seen a "pure liquidity problem."[786] Bankers involved in the Latin American debt negotiations maintained that a diagnosis other than illiquidity was "unthinkable." And, they were helped by the fact that it was virtually impossible to determine the question of solvency at the outset of the crisis. This was because timely, complete, and reliable information was scarce. In some cases, there was a two-year lag in getting consolidated debt figures from sovereign borrowers.[787] One observer noted that "frugal middle-class Americans would have to give more information to their friendly neighbourhood bank to get a car loan than Poland gave to develop a country."[788] Finally, a European bank reported a shift in the value of its claims on Brazilian banks "from $2 million to $30 million in a single day."[789] In short, the inability to determine the question of solvency with any precision gave creditors a

[783] Krueger (1991), p. 41.
[784] Author Interview C.
[785] Rubin (2003b), p. 283.
[786] Volcker and Gyohten (1992), p. 210.
[787] Author Interview C.
[788] Aggarwal (1987), p. 9. Cited in *Wall Street Journal*, August 8, 1981.
[789] Mendelsohn (1983), p. 10.

valuable option: they could *choose* to support the illiquidity diagnosis in order to buy themselves the time they needed to build their loan loss reserves and repair their badly compromised balance sheets.

Luiz Carlos Bresser Pereira, Former Brazilian Finance Minister, attacked the initial "illiquidity" diagnosis of the London Club banks as self-serving:

> It is clear that the creditors' first tendency will be not to recognize that it is unfeasible to pay the debt fully. First, they will define the problem as transitory, a problem of liquidity, asserting that a combination of financing and adjustment, with emphasis on adjustment, would solve the problem.[790]

Pereira accused the banks of dishonesty, arguing that while they had understood for some time that they would not be able to collect the debt in full, they still refused to recognize this officially. He argued that it was in their interest to simply ignore the underlying problem while they strengthened their own capital ratios. In Pereira's view, the main culprits were the big U.S. banks - like Manufacturers' Hanover, Chase Manhattan, and Bank of America. They were all opposed to a "global solution" that would involve some measure of debt forgiveness since they would not have been able to absorb the losses. Apart from the large money-centre banks, Pereira believed that the European and smaller regional banks would have been more receptive to offering forgiveness earlier.[791]

The choices that existed between a diagnosis of "illiquidity" and "insolvency" mirrored those that existed between the loan classifications of "performing" and "nonperforming." According to one regional bank head:

> What are obviously non-performing loans are called performing; dividends are paid on interest that has been loaned; and countries that should be classified as substandard or doubtful receive more lenient classifications.[792]

He added that the problem was not what *was* non-performing, but what was *called* non-performing. The regional bank CEO went on to argue that he was among those who had correctly diagnosed the Latin American debt crisis as a solvency crisis from the outset and called upon the banking syndicate to immediately convert their short-term loans to

---

[790] Pereira (1989), p. 94.
[791] Pereira (1989), p. 101.
[792] Heldring (1989), pp. 30-31.

long-term, fixed-rate bonds.[793] Of course, regional banks were not fighting for their very survival when the crisis began. And, unfortunately for them, the discursive power "trump card" was held by the largest banks that were running the London Club advisory committees.

Cline (1995) pointed out that even though a credible insolvency diagnosis began to appear in 1986, with the collapse of oil prices, it would have been too risky for the banking system to accept that premise until it had set aside sufficient loan loss provisions. Otherwise, "the debt strategy's objective of international financial stability would have been compromised."[794] And so, in May 1987, when Citibank announced its $3 billion reserve against its Latin American debt exposure, it signalled to the market that it was both ready and able to absorb losses on these loans. Other banks followed suit, announcing new loan loss provisions of between 25% and 50% of their Latin American debt portfolio. Paul Krugman attempted to give debt forgiveness its economic justification in his 1988 essay on debt overhang, and shortly thereafter, the IMF and World Bank agreed that the dominant paradigm was changing to insolvency.[795] From a discursive perspective, the major commercial lenders were able to privilege the "illiquidity" diagnosis, until such time as they no longer needed it.

6.6.2 The Changing Characterization of Sovereign Default in International Law

The principal change in international law between the 1930s and the 1980s that affected sovereign debt management was the dilution of the absolute theory of sovereign immunity. As sovereigns became more involved in commercial activities outside their own borders, the question arose: "Why should they not be answerable in foreign courts for their commercial conduct?" As a result, a more "restrictive" theory of sovereign immunity emerged, first in the United States with the 1976 passage of the Foreign Sovereign Immunities Act ("FSIA"), and two years later, when the United Kingdom enacted the State Immunities Act ("SIA") of 1978.

Most syndicated loan agreements contained standard "waivers of sovereign immunity." This meant that a sovereign acknowledged in advance that the loan could be

[793] Heldring (1989), p. 33.
[794] Cline (1995), p. 20.
[795] Krugman (1988); Cline (1995), p. 16.

treated as a commercial transaction, permitting any dispute to be referred to the judicial body specified by the governing law provision. In theory, this meant that creditors could pursue legal remedies for debt collection in London or New York.[796] In practice, however, they were strongly encouraged not to. Official sector propaganda routinely warned against litigation, arguing that the only effective means to resolution was negotiated settlement in the London Club process. Also, even if some banks had launched unilateral lawsuits, any judgments would have been subject to inter-creditor sharing clauses, forcing them to distribute the proceeds among the remaining syndicate banks. In short, it would have been a lonely and expensive road for a solo lender to take.[797] As a result, despite the new rights granted to creditors under international law, there was widespread forbearance from litigation by commercial banks during the Latin American debt crisis.

6.6.3 The Persistence of the Idea of Honour

In the late 19th century and 1930s, bondholder councils routinely equated the act of honouring debt contracts with "morality" and "civility."[798] The goal was to inspire political leaders to choose the path of repayment over default. Of course, bondholder councils were much less successful with this tactic in the 1930s, when defaults engulfed both developed and developing countries, and the collapse of the bond markets offered little reward for faithful repayers. However, in the 1980s, we saw a resurgence of the old notion of honour among both the citizens and officials of debtor states.[799]

A former Brazilian finance minister noticed how measures to unilaterally reduce the debt had been referred to in his country as "*calote,*" a "deprecatory Portuguese word for the immoral non-payment of a personal debt." Although he likened the action more to a judicial statute, like Chapter 11 of U.S. bankruptcy law, he found it difficult to convince his constituency. He went on to say that this was partially due to "their cultural subordination" to industrialized countries who are somehow idealized as "keepers of the

[796] Buchheit (2005-2006), pp. 338-339. In the United States, this restrictive theory of sovereign immunity was first formally acknowledged as State Department policy in 1952. However, it was not codified in U.S. law until 1976, with the passage of the Foreign Sovereign Immunities Act ("FSIA").
[797] Buchheit (2005-2006), pp. 339-340.
[798] See the discussions of productive power in Chapters 4 and 5.
[799] Creditor country governments largely confined themselves to threats of sanctions against potential defaulters, rather than appealing to national honour or pride.

truth."[800] Even financially astute Brazilian businessmen supported the London Club and IMF processes because they assumed that a more confrontational stance with creditors would threaten Brazil's integration with the North. While one could argue that the interests of the first world were not entirely bound up with the interests of the banking community, it was difficult for debtor states in the 1980s to separate the two. It was also difficult to de-link default and dishonour, although some leaders tried. They argued that integration with advanced capitalist democracies would not be accomplished by "good manners but rather through economic growth and price stability - precisely the two goals that are made unfeasible by the debt."[801] Despite these appeals, debtor states found themselves locked into the London Club process for much of the 1980s.

6.7 Power and the Production of Bargaining Outcomes in the 1980s

Assessments of the 1980s sovereign debt restructuring regime are wide-ranging. Some scholars, like Cline (1995) believed that the experience proved that "contingent, evolutionary, and informed international policymaking succeeds." After all, in Cline's view, international financial collapse was avoided and sovereign debtors were able to re-access the capital markets within a decade.[802] Biersteker (1993) and Haggard and Kaufman (1989) were more circumspect. They argued that the regime differentiated between large and small borrowers, treating the former more favourably, since they posed a real threat to the global financial system. Large debtors were accorded more attention and fared a bit better than their smaller neighbours, especially since they could credibly sustain "relatively autarkic policy measures."[803] Others took a dim view of the regime, seeing it as one that evolved with a "clear distributive bias, one directed principally against the developing countries."[804] According to Riley (1993), the crisis seemed to bypass the commercial banks, who reported healthy profits through 1986, and in 1987, took losses which were largely managed and easily absorbed. He argued that political leaders in borrowing states simply "pass[ed] along the costs of the debt in the form of

[800] Pereira (1989), pp.103-104.
[801] Pereira (1989), pp.103-104.
[802] Cline (1995), p. 4.
[803] Biersteker (1993), p. 7. For a similar argument, see also Haggard and Kaufman (1989), pp. 210-220.
[804] Biersteker (1993), p. 2.

structural adjustment to their poorer citizens."[805] Biersteker (1993) concurred with this view, and observed:

> The distribution of global burden sharing has fallen disproportionately on the debtor countries, not on their creditors. At the same time, the distribution of domestic burden sharing within the debtor countries has fallen principally on the poorest and most marginal.[806]

We have argued that the 1980s sovereign debt restructuring regime produced bargaining outcomes that were highly favourable to creditors and were largely impacted by regime elements external to the private creditor representative body.[807] During the 1970s and early 1980s, commercial bank creditors accumulated dangerous levels of exposure to Latin American sovereigns on their balance sheets. When the debt crisis began in 1982, this risk concentration threatened the very solvency of the global financial system. However, it also translated into bargaining power. To stem the potential crisis, creditor governments, regulators, and the IMF spoke with a powerful, unified voice, bailing-in the large, money-centre banks at the helm of the London Club, and facing troubled debtors as a formidable negotiating bloc. While the London Club insisted on negotiating with debtor countries on a case-by-case basis to exploit the weakness in Latin American collaboration, creditor governments threatened troubled sovereigns with severe sanctions in the event of debt repudiation. And, creditor governments, along with their financial regulators, pressed smaller regional and international banks into compliance with the regime to ensure limited defection. The exercise of compulsory power was pervasive in the 1980s sovereign debt restructuring process, aimed not only at sovereign borrowers but at non-cooperative banks as well.

Adding even more leverage to the creditor side of the balance sheet, the IMF agreed to provide structural adjustment loans only to those debtor states that remained in the London Club process and settled satisfactorily with private banks. Debtors had little choice but to accede to the demand of the creditors' cartel, especially since they could not tap any alternative channels of finance. The concentration of structural power with the banks and the IMF made debtors fear the consequences of disruption to their short-term

[805] Riley (1993).
[806] Biersteker (1993), p. 11.
[807] Strange (1979). Strange also focuses on the design of the 1980s debt regime.

trade credit. After all, short-term credits supported essential imports like food and energy, and the repercussions of being excluded from the international financial system would have had high political costs in debtor states.

In retrospect, it would be difficult to describe the 1980s regime as optimally efficient or equitable. U.S. bank accounting rules forced cumbersome new loan disbursements when interest capitalization would have been a more effective alternative. The process was certainly slow and laborious, taking an average of eight years to reach a final conclusion. However, it was precisely this inefficiency which worked to the banks' advantage. Creditor groups were able to cling to the illusion that they were dealing with an illiquidity problem for years after the insolvency diagnosis began to gain currency, giving them more time to restore their weakened balance sheets.

Formally, the banks presented their London Club committee structure to the world as a public good, that is, "an innocent mechanism of coordination among the hundreds of lenders, which facilitate[d] the rescue of the borrower." But, as Devlin (1989) observed, there was a "potential dark side to the committee structure" in that it "facilitate[d] collusion and the formation of an effective cartel geared to skew the distribution of the costs of [the] problem."[808] Most of the adjustment burden was forced on debtor countries in the early years through IMF programs, and while creditors ultimately suffered loan losses, it was only after they had safely provisioned for them out of many years of earnings.[809]

[808] Devlin (1989), p. 218.

[809] O'Brien (1993), pp. 7 & 94. Cline (1995) and James (1996) both argue that the 1980s regime served an important purpose insofar as it prevented systemic collapse in the global financial system and eventually permitted private capital to flow back into Latin America. However, Sachs (1986) argues that debt relief could have been offered as early as 1986 to all but the largest three debtors, and O'Brien (1993) points to the "lost decade" of growth in Latin America as evidence that the regime's distributive bias worked largely against debtor states.

Chapter 7

Better a Debtor? The Institutionless Regime of the "Market-Based Exchange" and the Evolution of Sovereign Debt Restructuring Since 1998

The outcome of debt negotiations has become more favourable to debtors over the years.

Thomas Callaghy

7.1 Sovereign Lending in the 1990s and Beyond

The Brady Plan helped to close the final chapter of the 1980s debt crisis. It also had the effect of moving developing countries back to the bond market for the first time since the Great Depression. In fact, by the second half of the 1990s, private creditors accounted for over two-thirds of outstanding Latin American debt, with bondholders taking a leading share.[810] And, on the eve of the Asian crisis in 1997, close to 86% of the net external borrowings of emerging markets countries were in the form of bonds.[811] Why had the issuance of emerging market bonds grown so rapidly in the period after the Brady Plan? One reason is that commercial banks had largely decided to exit the business of sovereign lending after the 1980s debt crisis. They had learned from bitter experience that short-term, floating-rate loans were hardly the most appropriate funding vehicles for third world infrastructure projects. By contrast, bonds, with their fixed rates and longer durations, were much better suited to the task of development financing. Another reason is that bonds, lacking the laundry list of covenants required by banks, carried terms that were much less onerous than syndicated loans. This increased their attractiveness to emerging markets finance officials since they imposed lower sovereignty costs. Lastly, bonds were thought to carry a smaller risk of default than bank loans. This assessment was a legacy of the 1980s steering committee process which excluded them from

[810] Krueger (2003), p. 71.
[811] IMF, *World Economic Outlook*, April 2005, pp. 252 - 253.

settlement negotiations because they were regarded as too difficult to restructure.[812] As a result, a small group of 1980s bondholders enjoyed *de facto* seniority over their commercial bank counterparts, despite the fact that their claims were *pari passu*.[813] Even at the apex of the Asian crisis in 1997-1998, Korean eurobonds were treated as senior to bank claims. However, sentiments began to change in the late 1990s, principally because bonds had become a much more meaningful component of external sovereign financing. It was widely believed that improvements to the international financial architecture would have to address bond debt and find some new mechanism to "bail-in" bondholders. The IMF, heavily criticized for its large-scale financial bailouts from 1994 through the Asian debt crisis, responded to this challenge by "encouraging a number of highly indebted, emerging-market borrowers to default on their bond service payments."[814] This tactic forced bondholders to the negotiating table along with banks and official creditors. By the close of the 1990s, both Pakistan and the Ukraine had been encouraged by the official sector to "renegotiate [their] bonds as a precondition for the extension of official assistance."[815]

Although bondholders were now "bailed-into" the restructuring effort, the international financial system still had no mechanism – either formal or informal – which would negotiate for bondholders in the same way that the London Club negotiated for the banks. Unfortunately, the framework for resolving the 1980s debt crisis could not be easily adapted to the new era of bond finance. The steering committees at the heart of the London Club worked well for commercial banks since they were driven by shared accounting and regulatory standards. However, they also operated by consensus, which meant that they were slow and laborious. This was not a major issue for banks since they held their sovereign loans at book value, giving them the flexibility to control and manage the write-off process. By contrast, bonds are marked-to-market on a daily basis, meaning that their prices immediately adjust to new information. As a result, bond investors are not prepared to engage in a decade-long negotiation process like the one run

[812] It was also less onerous to exclude sovereign bond debt from the 1980s rescheduling process since the level of bond debt was negligible, especially when compared to the volume of commercial bank loans.
[813] Although bond claims and bank claims had the same legal standing, the exclusion of bond claims from the restructuring process accorded them senior status.
[814] Brown and Bulman (2006), pp. 23-24.
[815] Brown and Bulman (2006), pp. 23-24.

by the London Club in Latin America. Bondholders want to "return value to the paper as quickly as possible," because any delays only result in bonds "languishing on the creditors' books at default or near-default levels."[816] Since the London Club process could not be easily reconciled with the new world of atomistic investors that included hedge funds, institutional money managers, pension funds and small retail investors, some new machinery had to be developed.

7.1.1 The Institutionless Regime and Bargaining Outcomes: 1998-2005

As in previous chapters, we will employ our power-based analytical framework to explain the development of the today's sovereign debt restructuring regime and the bargaining outcomes it has produced. However, we need to be mindful of the fact that the current period differs from past eras in a few ways. First, when we examine sovereign debt restructurings since 1998, we are witnessing settlements that have emerged from the earliest evolutionary stages of a new regime – the market-based debt exchange – as opposed to those produced by the fully-developed and functioning debt regimes of the 19th century, interwar period and 1980s. This also means that we have the smallest case sample for this period - only six - compared to between twenty to fifty cases in each of the previous periods, making our argument more tentative here than in previous chapters. While we recognize the weakness inherent in the small number of cases, we also believe that an analysis of this time period offers us a unique vantage point. It allows us to understand in much greater detail how the structure of the new machinery is being created and contested, and how the elements of the emerging regime impact bargaining outcomes.

The process that has evolved thus far - the market-based debt exchange - is straightforward. A country in financial distress and in need of restructuring its bonds hires sovereign debt advisors that are generally drawn from the investment banking and legal communities. The advisors then "sound out" a representative sample of bondholders with the objective of identifying the haircut that the majority of investors

[816] Buchheit (2003), p. 17. Bondholders want sovereigns to make an offer that is NPV positive; in other words, bondholders expect an offer which, when discounted at prevailing market rates, will produce a valuation that is higher than the holder is showing on its books.

would be willing to accept.[817] The offer is made on a unilateral basis to the market, and individual bondholders have the opportunity during the tender period to accept or reject it. The process is very different from the ones we have observed in previous eras chiefly because it lacks any formal debtor-creditor negotiations. The institution-less nature of the regime appears to confer a distinct advantage on debtor states evidenced by the results that have been produced since 1998:

Table 7A: Debt Restructuring Outcomes: 1998 - 2005[818]

Country	*Settlement Period (Years)*	*Haircut (%)*	*Participation Rate (%)*
Russia	1.67	69	98
Pakistan	.83	30	95
Ecuador	1.00	60	97
Ukraine	.25	40	95
Argentina	3.33	67	76
Uruguay	.083	26	93
Average	*1.19*	*48.67*	*92.3*

Sources: Sturzenegger and Zettelmeyer (2005a); Roubini and Setser (2004a); Dhillon, Garcia-Fronti et al. (2006); Miller and Thomas (2006b).

Contemporary cases have produced some of the largest haircuts for bond investors - between 26% to 69%, with an average of 48%.[819] However, the more remarkable observation is how quickly these outcomes were produced: 1.19 years on average compared to 6 years for bondholders in the 19th century and 10 years for the interwar period. And, if we exclude Argentina from the sample, the time from default to settlement would be an even more impressive 7 months. Not only has the level of debt forgiveness been significant, the results have been achieved in record time by all historical measures. This means that sovereigns have been able to restructure their debt on favourable terms and re-access the capital markets promptly. How were these outcomes produced?

[817] "Sounding out" investors generally involves a series of informal discussions with large institutional investors. In a few cases, retail investors may be canvassed as well.
[818] Sources: Sturzenegger and Zettelmeyer (2005a); Roubini and Setser (2004a), Table A3; Dhillon, Garcia-Fronti et al. (2006); Miller and Thomas (2006b).
[819] Sturzenegger and Zettelmeyer (2005b), p. 43. Dhillon, Garcia-Fronti et al. (2006).

7.1.2 The Three Faces of Power: Explaining Regime Formation and Outcomes Since 1998

This chapter will argue that the emerging regime delivers better results to debtors since structural and compulsory regime elements have worked to enhance debtor negotiating leverage, both in the process of regime formation and the resulting settlement negotiations. Since the current regime does not feature a private creditor representative body, the format of this chapter will need to deviate slightly from earlier chapters. First, we will examine only three aspects of regime power – structural, compulsory and productive. Second, we will illustrate the impact of structural and compulsory power by looking at two specific cases. The first concerns regime evolution and centres on the contractual changes made to sovereign bonds by Mexico in 2003. These changes had the intended effect of burying the IMF's proposal for a new Sovereign Debt Restructuring Mechanism ("SDRM"), supplanting it instead with a debtor-driven menu of collective action clauses ("CACs"). We will show how Mexico, in a pre-emptive and largely symbolic endeavour, was able to ensure that the new CACs preserved the advantages that debtor states already enjoyed in the market-based exchange process. Our second case focuses on the outcomes produced in the aftermath of the Argentine default in 2005. Here, the degree and orientation of official sector intervention served to strengthen the hand of history's largest sovereign defaulter. While structural and compulsory power figure in both cases, we will emphasize the role of structural power in the first case and compulsory power in the second. What we hope to demonstrate is that both forms of power, which materially enhanced creditor bargaining leverage in the 1980s, are currently working to benefit debtor states. This leaves sovereigns in a stronger position to influence the blueprint of the debt management regime and extract concessions from private creditors in settlement negotiations.

With respect to structural power, the growing importance of bond financing relative to bank lending has led to a decisive weakening in creditor unity. Additionally, the supply of credit is much more dispersed today than in previous periods - when Britain, the U.S. and the G-7 commercial banks dominated emerging market lending. This lack of cohesion and control has made it more difficult for creditors to coordinate

their actions and speak with a common voice in cases of sovereign default. Furthermore, the global savings glut has made capital ever more promiscuous as it traverses the globe in search of yield. As a result, lenders have allowed distressed sovereigns to enjoy prompt renewal of their capital market access following a restructuring. As former U.S. Treasury Secretary, Robert Rubin, observed: "After the 1982 crisis, Mexico took seven years to regain access to the capital markets. In 1995, it took seven months."[820] Finally, changes in IMF policies have been more accommodating to debtor states. More specifically, the availability of official loans is no longer conditioned upon a satisfactory settlement agreement with private bondholders.[821] This change has reduced the bargaining leverage that had previously accrued to private investors - leverage which they enjoyed during most of the 1980s through the mid-1990s. Taking all of these factors into consideration, it seems that the various structural power elements embedded in our analytical framework have aligned more closely with debtor interests during this period.

What about compulsory power? On this front, we see officials from G-7 governments taking a more sympathetic approach to the plight of sovereign debtors. While their public position has been one of detachment and de-politicization, their less public actions have often served to advance the cause of emerging markets debtors. The case of Argentina will help to illustrate this dynamic. The other principal official actor – the IMF – has been the trigger for two large sovereign defaults (Russia and Argentina) while encouraging at least two others (Pakistan and the Ukraine). Such actions would have been unthinkable during the 1980s debt crisis. As Salmon (2004) observed, with friends like these, the bondholders hardly need enemies.[822]

Finally, regarding productive power, we will examine whether debtor states in middle-income countries have benefited from the change in norms connected with the HIPC initiative.[823] Although not in the same socio-economic basket as HIPC countries, middle-income developing countries began to portray unsustainable levels of sovereign

[820] Rubin (2003a), p. 34.
[821] This change in policy was meant to put banks and bondholders on equal footing with respect to IMF lending.
[822] Salmon (2004a), pp. 42-46.
[823] The HIPC (Highly Indebted Poor Countries) Initiative sought the forgiveness of the unsustainable debt burdens of the world's poorest countries, principally but not limited to those in Sub-Saharan Africa.

debt as the joint responsibility of debtors and creditors, using the rhetoric of HIPC and the "odious debt" doctrine to their advantage.[824]

In the next section, we will look at how sovereign debtors were able to capitalize on shifts in structural power to resist calls for a new and more comprehensive sovereign bankruptcy framework. The result was a regime that retained the character of the market-based debt exchange and incorporated contractual changes that were predominantly debtor-friendly.

7.2 Structural Power and The Regime Debate

While the market-based debt exchange evolved during the latter half of the 1990s, it was not without its challengers.[825] The most radical alternative – the SDRM - was proposed by Anne Krueger, First Deputy Managing Director of the IMF, in 2001. The objective of this mechanism was to remove decision making from the market and vest it instead with a supra-national body. The IMF's goal was to create a new regime that would make the process of sovereign debt restructuring more predictable, equitable, and transparent.

There was a fair amount of resistance to the Fund's proposal from private lenders as well as sovereign debtors. Investors feared that the SDRM "would become a more efficient medium through which the geopolitical wishes of the G-7 governments could be imposed," which was curiously what the SDRM was designed to avoid.[826] They were also wary that the SDRM would boost the power of sovereigns during debt negotiations.[827] Borrowers were not displeased with the market's widely mounting opposition to the SDRM, since they shared its suspicion, albeit for different reasons.[828] Countries like Mexico and Brazil voiced disapproval, principally along the lines that the

---

[824] The "odious debt" defense was first articulated in the early 20th century and argues that a state's debt can be declared "odious" if the loan proceeds were not used to serve the public interest. Private lenders forfeit their right to hold the state liable for the debt if they were aware of its intended hostile use. The debt then ceases to be a liability of the state and instead becomes a liability of the belligerent regime that contracted it.

[825] See Appendix 7A for a summary of competing proposals for sovereign bankruptcy regimes since the 1970s.

[826] Buchheit (2005-2006), p. 343.

[827] Helleiner (2006), p. 19.

[828] Author Interview H.

SDRM would distort market pricing for sovereign debt.[829] But, off the record, emerging markets treasury officials were more concerned about the high sovereignty costs that an SDRM would impose. They were sceptical of submitting to a dispute resolution forum on a matter as politically sensitive as sovereign debt and maintained that the SDRM conflicted with their domestic bankruptcy laws. And, they did not think that a foreign actor should be able to "assert you are a bankrupt state" and then dictate settlement terms.[830] There was also apprehension that a formal bankruptcy regime would make the IMF less willing to lend in a crisis, since it would be easier to simply drop troubled debtors into an international bankruptcy court.[831] And, "to consign all current basket cases permanently to the international welfare rolls" was seen as a fundamentally flawed starting point.[832] By April 2003, the SDRM was formally shelved, with the Fund issuing a statement admitting that "there was no longer enough support" for it.[833] In the end, the IMF's proposal seemed to enjoy only the very limited support of those within the Fund who had proposed it.[834] However, of more interest to our analysis is the role played by sovereign debtors in its demise. More specifically, we will look at how Mexico's unilateral installation of collective action clauses (CACs) in its 2003 benchmark sovereign bond issue helped to consign the SDRM to the intellectual dustbin.

7.2.1 The Rise of Debtor-Designed Collective Action Clauses

Prior to 2003, sovereigns appeared content with the status quo – they saw little value in either a supra-national bankruptcy framework or collective action clauses. If bond amendments weren't feasible, bond exchanges, sometime with the use of exit consents, were rapidly becoming an accepted method of restructuring debt.[835] Successful exchanges were conducted by Pakistan (1999), Ecuador (2000), and the Ukraine (2000)

[829] International Monetary Fund (2002), p. 6; International Monetary Fund (2003a), pp. 10 & 20; Helleiner (2006), pp. 19-20.
[830] Author Interview H.
[831] Author Interview H.
[832] Truman (2002), p. 342.
[833] Helleiner (2006), p. 20.
[834] Blustein (2005), p. 177; Author Interviews D & H.
[835] Buchheit and Gulati (2000), p. 68. Exit consents are disfiguring amendments to the non-payment terms of old bonds being exchanged in a restructuring. Their purpose is to encourage the acceptance of new bonds and reduce creditor holdouts.

with participation rates of 95% or better.[836] Market practitioners in the business of advising sovereigns in distress have commented that bond restructurings were made easier by the mark-to-market nature of the debt: "Since the bondholder takes the hit right away, all the sovereign needs to do is make an offer that it NPV positive."[837] Others have commented: "It was a bit of a myth that there was a gaping hole in the international financial architecture; unilateral bond exchanges have gone pretty well."[838]

Even if investors and issuers could agree that CACs would somehow improve the sovereign debt management process, the question remained: Which CACs? There were several competing templates, and most creditor groups, like the G-10 and the IIF, believed that they would be effective only if they: i) offered a mechanism for the collective representation of debt holders; ii) allowed for a qualified majority of voters to alter the terms and conditions of debt contracts; and, iii) required the sharing among creditors of any assets received from the debtor, including, most critically, those that resulted from successful legal action.[839]

The G-10 later refined these recommendations by providing guidance on threshold levels, suggesting that two thirds of bondholders would be required to elect a bondholder representative, and a 75% vote would be needed to amend payment terms. The group also argued that the power to litigate should be concentrated exclusively with the bondholder representative and any recoveries resulting from litigation should be shared pro-rata among all investors.[840] As time progressed, creditor organizations started to propose model clauses that were increasingly more stringent. For example, in 2003, the IIF suggested that there needed to be an 85% vote in order to amend payment terms, as long as 10% of the bondholders did not object. This translated into a 90% - or near unanimous - approval by bondholders to effect amendments.[841] Such a high threshold was seen as offering little improvement over the status quo. And, unfortunately for debtor states, the creditors' position gained in momentum and consistency when several bondholder associations joined with the IIF to promote model clauses. Roubini and Setser

[836] International Monetary Fund (2001), pp. 5-7.
[837] Author Interview E.
[838] Author Interview D.
[839] Group of Ten (The Rey Report) (1996).
[840] Group of Ten (2002).
[841] Institute of International Finance, International Primary Markets Association et al. (2003).

(2004b) commented that if the creditor groups prevailed, "these changes would give external private creditors increased leverage over a sovereign debtor, and make it harder for a debtor to use the bond's amendment provisions to drive creditors into a deal."[842]

So, why did sovereigns ultimately agree to contractual changes in their bond documents? And, what drove their choice of clauses and voting thresholds? After all, as late as the fall of 2002, things were not looking very promising. The Mexican finance minister "had declared definitively that Mexico had no intention of including CACs in its bond issues."[843] However, the U.S. Treasury continued to encourage a change of policy on CACs. According to Deputy Treasury Secretary, John Taylor:

> We, the Bush administration, promoted the collective action clauses very actively...and we had a lot of help from many people...we kept getting on the phone, kept calling ministers, kept calling our colleagues.[844]

The U.S. also pushed CACs at every country board meeting of the IMF. By January, 2003, Taylor said that the Mexicans were sending signals that they were considering issuing a bond with collective action clauses. However, Mexico's Deputy Finance Minister, Agustin Carstens, wanted to get assurances from Taylor that the Mexicans would not be criticized for the fact that they were deviating from the recommendations of the G-10, the IIF and the bondholder associations. Taylor told Carstens that he could count on America's full support despite these deviations. Carstens then asked if Taylor could get the G-7 to publicly congratulate Mexico for its efforts and Taylor willingly obliged. However, Mexico's real concern would soon surface. According to Taylor:

> They asked me if I could be more public and definitive about my opposition to the SDRM. On this issue, I was pleased that I could do even better...I could ask the [new] Secretary of the Treasury [John Snow] to make things clear...[Snow] was very happy to drop any U.S. support for the SDRM and put all our effort behind collective action clauses.[845]

Mexico's desire to put the SDRM out of its misery was also confirmed by Guillermo Ortiz, the president of Mexico's central bank. He said that the initiative was taken on

---

[842] Roubini and Setser (2004b), p. 5.
[843] Helleiner (2006), p. 22.
[844] Helleiner (2006), p. 22.
[845] Taylor (2007), pp. 126-128.

CACs "because it was a very good way to get rid of the SDRM."[846] While some have argued that the SDRM proposal was simply a tactic by the IMF to get sovereigns to implement CACs, most market actors disagree. According to one source:

> [The SDRM] was not a ploy to push CACs. But, CACs were eventually used by powerful players to diffuse the SDRM. The U.S. Treasury, the French Trésor and HM Treasury all used the SDRM as a threat. They all said: You should take CACs instead![847]

A source within the Mexican treasury confided that Mexico's decision to include CACs was more a political than an economic one. It was made at the highest levels of government, both within and outside the Mexican treasury.[848] The main driver inside the treasury was Alonso Garcia, Vice Minister, who personally made the decision to put CACs in the country's 2003 bond issue. However, his decision also required the approval of Mexico's Deputy Finance Minister, Agustin Carstens.[849] It was fortuitous that Carstens was close to Taylor and the IFIs. According to Taylor, he and Carstens were neighbours; each owned an apartment in the same building in Washington, D.C, and Carstens later went to work for the IMF.[850]

Despite the fact that the U.S. Treasury was extolling the virtues of CACs, Mexico believed that there would be very few immediate economic benefits to issuing a sovereign bond that included CACs. This is because it would take time for these clauses to become operative in all outstanding bond issues. According to a source inside the Mexican treasury:

> We feel that CACs won't help at all over a three year horizon, will help more over a 10 year horizon and will help a lot over a 30 year horizon; and, since politicians think in the short term, the main advantage for us was to be perceived by the market and by the G-7 as a well-behaved international actor taking the initiative to improve the international financial architecture.[851]

---

[846] Helleiner (2006), p. 22.
[847] Author Interview H.
[848] Author Interview H.
[849] Author Interview G.
[850] Taylor (2007), pp. 98-132.
[851] Author Interview H.

In leading by example, Mexico succeeded in making CACs virtually standard in New York law sovereign bonds. In 2003, 47% of new sovereign bonds issued under New York law contained CACs. This figure jumped to 80% by the third quarter of 2004,[852] and close to 100% by the first quarter of 2005.[853] In addition, by moving forward unilaterally with its benchmark issue, Mexico helped to "put the nail in the coffin" of the IMF's proposed bankruptcy regime.[854] Finally, and perhaps most important, Mexico wanted to be sure that it did not leave the field open for creditors to design the standard documentation for New York law bonds, nor did it want to see less creditworthy issuers experiment with a more stringent collection of CACs. If that happened, it would have set a bad precedent.[855] Mexico believed that the main strategic advantage in being the first-mover was to embed CACs in sovereign bonds that would be an expression of the preferences a highly creditworthy borrower.[856] They purposely did not include the more onerous Rey Report, G-10 and IIF recommendations since they did not want to limit Mexico's flexibility in a future debt crisis.[857] The success of Mexico's benchmark bond with its "regulation-lite" CACs was indisputable.[858] The issue was heavily oversubscribed at a spread of 312.5 basis points over treasuries, a price which implied that the inclusion of debtor-friendly CACs did not increase the country's borrowing costs.[859]

7.2.2 CACs: A Reflection of Sovereign Debtor Preferences

Once Mexico launched its 2003 bond issue, a sense of complacency set in among financial architecture reformers. Hadn't Mexico's leadership solved the major problems associated with sovereign bond restructurings? Wasn't the financial system now better equipped to handle sovereign defaults? After all, John Taylor maintained that CACs reform was one of his most important achievements as Deputy Treasury Secretary.[860]

---

[852] Drage and Hovaguimian (2004), p. 3.
[853] Helleiner (2006), p. 20.
[854] Author Interview G. Also see Blustein (2005), p. 230.
[855] Author Interview H. There was some concern in Mexico that Uruguay would issue a bond with CACs, and since Uruguay was a much lower-rated credit, their CACs template might have been more stringent.
[856] Roubini and Setser (2004a), p. 313.
[857] Author Interview H.
[858] Author Interview R.
[859] Taylor (2007), pp. 126-128.
[860] Taylor (2007).

However, those close to Taylor argue that he "highlighted it as a success because he needed a success."[861] The "victory" was largely "symbolic" in the sense that it gave momentum to the CACs approach; it did not involve a "line by line" debate about the legal text that Mexico would use, and the outcome certainly did not reflect G-10 or creditor-country preferences.[862] Yet, except for a few dissenting voices, most overlooked the fact that not all CACs are created equal.[863] The specific choices made by Mexico – choices which were later replicated by most new sovereign issuers - would have an important impact on the resolution of future sovereign debt crisis.[864] While our goal is not to evaluate the optimality of the current CACs regime, we do want to explain the factors that led to its adoption. How was it that Mexico was able to install CACs that differed in meaningful ways from the recommendations made by the G-10 and other creditor groups? What factors enabled Mexico to make these choices, and how might they affect bargaining outcomes between debtor states and bondholders in the future?

When the G-10 originally published the Rey Report in 1996 and followed up with its specific recommendations for CACs in 2002, it was speaking as the representative of the largest creditor governments. In so doing, the G-10 introduced a template for CACs which it believed would improve the efficiency and equity of the sovereign debt restructuring process for debtors and creditors alike. As we mentioned before, the template included three main types of clauses which can be identified broadly as **majority representation, majority amendment and majority enforcement.** Majority representation clauses - sometimes referred to as engagement clauses - provided a mechanism for the establishment of a bondholder committee or some type of creditor representative. Majority amendment clauses were meant to allow a qualified majority of bondholders to vote for a change in the payment terms of bonds. Finally, majority enforcement clauses were intended to dissuade potential creditor litigation insofar as they

[861] Author Interview R.
[862] Author Interview R.
[863] See White (2002); Ghosal and Miller (2003); Kroszner (2003); Sharma (2005) and Ghosal (2005) for a more critical assessment of CACs implementation.
[864] Gelpern and Gulati (2007), p. 69. Author Interview N. In the case of Uruguay, a pro-forma analysis was done after the exchange to see how the exchange might have been affected by the presence of Mexican style-CACs. The analysis suggested that the presence of CACs would have increased investor participation by only a few percentage points. In the case of Belize (2007) the actual presence of CACs was believed to have pushed investor participation by only 1%, from 97% to 98%. So, the effect of CACs has thus far been minimal.

would require some form of sharing of litigation proceeds among all creditors. At the end of 2004, the Bank of England completed a study which examined the CACs contained in every sovereign bond issued since February 2003, the date of the Mexican benchmark issue.[865] They concluded that of the three types of clauses recommended by the G-10, Mexico and other sovereign issuers had included only *one*: the **majority amendment** clause.[866] What accounts for this? We will argue that the way in which CACs have been introduced strongly reflect the preferences, and therefore the growing bargaining leverage, of debtor countries today.[867] Additionally, we believe that this enhanced leverage resulted from important structural changes connected with the new capital market dynamic, most notably the shift from bank to bond financing by sovereigns since the 1990s. It was also impacted by the willingness of major creditor governments – notably the G-7 – to publicly support the choices of debtor states over those of their own creditor groups.

7.2.3 CACs: Majority Representation

There is a common belief that sovereign debtors are always eager to begin discussions with their creditors that will result in debt relief, while creditors always wish to postpone the evil day when they will be asked to grant such relief. This is a breathtaking misconception [868]

Lee Buchheit
Partner, Cleary, Gottlieb, Steen & Hamilton

The original purpose of the majority representation clause was to foster early dialogue, coordination and communication among creditors and the sovereign. The G-10 envisioned the creation of a permanent bondholders' council or the election of a representative body with the power to engage the sovereign debtor in negotiation. However, this recommendation reflects the misperception that debtors in distress are keen to bring creditor groups to the table to obtain a new agreement. This is often far from the case, since the debtor is better off if it simply lets the private sector provide "extended

[865] The Bank of England indicated that this study was not updated since 2004 since there have not been material changes to the original conclusions. This was also confirmed with a market practitioner (Author Interview N).
[866] Drage and Hovaguimian (2004).
[867] Gelpern and Gulati (2007), p. 57. According to Gelpern and Gulati, the bondholder association ECMA was furious upon hearing of Mexico's new issue, calling it a "jam-job."
[868] Buchheit (2003), p. 19.

involuntary financing."[869] In other words, by foregoing interest payments, sovereigns can retain those funds for domestic use. And, as Dhillon, Garcia-Fronti et al. (2006) point out, "trading and consuming while negotiating with creditors who are getting no debt service ...confers a bargaining advantage to the debtor."[870] Kohlscheen and O'Connell (2006) argue in a similar vein that borrowers who can afford to be patient, insofar as they are able to retain their trade lines and some reasonable level international reserves, can shift repayment terms in their favour, and by a larger amount the more patient they are.[871]

Also, sovereigns learned from their experience in the 1980s that unifying creditor groups for bargaining purposes had the effect of undermining debtor negotiating power. For this reason, IMF post-mortems of the successful debt exchanges undertaken by Pakistan, Ecuador and the Ukraine in 1999 and 2000 are remarkably similar in their observation that none of the countries involved wanted to engage in negotiations with bondholders.[872] Officials in Pakistan and Ecuador feared that calling a bondholders' meeting might facilitate the organization of bondholders opposed to the restructuring. The Ukraine refused to call a bondholders' meeting until irrevocable proxies in favour of the proposed amendments had been delivered. Ecuador did ask eight major institutional holders of its bonds to form a "consultative group." However, according to Buchheit (2003), this group was strictly prohibited from engaging in "negotiation" and was told that its sole purpose was to "provide a formal medium through which Ecuador could communicate with the bondholder community and receive the views of bondholders on issues relevant to the exchange offer."[873] Pakistan used a similar approach with a number of its larger Eurobond holders. These cases demonstrate how sovereigns try to avoid convening bondholder meetings out of concern that "once their identities become known to each other, the bondholders may be able to coordinate their response."[874] In all three cases the IMF maintained that "the lack of a negotiating process ...increased the

[869] Yianni (2002), p. 87.
[870] Dhillon, Garcia-Fronti et al. (2006), pp. 394-395.
[871] Kohlscheen and O'Connell (2006), p. 5.
[872] International Monetary Fund (2001), pp. 5-7.
[873] Buchheit (2003), pp. 14-15.
[874] Buchheit (2003), pp. 14-15.

authorities' leverage, and thereby contributed to the degree to which they were able to obtain favourable terms."[875]

Even while undertaking the largest sovereign debt exchange in history, with $98.7 billion in creditor claims, Argentina was advised by its attorneys not to negotiate with the two main bondholder councils that had formed on an ad hoc basis.[876] According to one source familiar with the negotiation:

> Nothing prevents creditors from forming [committees] – but Argentina has ignored them. The lawyers for Argentina tell the country that the best way to succeed is to be aggressive. And, anyway, you can't force a sovereign to live by the prescription of a bondholders' council if it doesn't want to.[877]

Other market practitioners maintain that it is hard to create a bondholder council because the remuneration is too low and the risk is too high. In other words, the incentive structure does not encourage bondholder committees. Bond trustees often resign when there is a default since they want to avoid the liability that attaches to the investors' representative, especially in contentious restructurings.[878]

Roubini argues that investment banks, hired by sovereigns to represent them in their bond exchanges, discharge some of the responsibilities of the old bondholders' councils.[879] Yet, this misses an important point: investment banks are paid to represent the sovereign, not the bondholder. So, the elimination of traditional bondholder councils and their replacement by investment bank debt advisors is a development that increases the leverage of the debtor country in the bargaining exercise. In the end, investment banks are highly incentivized to find the lowest market clearing price for the sovereign; this is in marked contrast the bondholder councils of the 19th century and interwar periods who were seeking the highest price that the sovereign could afford to pay its creditors.[880] As bondholders see it, the main drawback of the current process is that "it is aggressive, non-consensual, take-it-or-leave-it."[881] So, is it reasonable for creditors to continue to call

[875] International Monetary Fund (2001), pp. 20-21.
[876] Republic of Argentina (2005); Author Interview G.
[877] Author Interview D.
[878] Author Interview G.
[879] Roubini and Setser (2004a).
[880] Author Interview K.
[881] Author Interview D.

for a majority representation clause? Would the creation of a permanent bondholder council help?

Several academics and law professionals have argued the case for creating a new bondholder council along the lines of the CFBH and FBPC.[882] In 1995, Eichengreen and Portes called for the establishment of a permanent bondholder committee with "a charter, a permanent secretariat, a minimum set of conventions and a core of permanent members."[883] In the same year, MacMillan called for the resurrection of the CFBH to co-ordinate debt workouts and centralize negotiations with troubled debtor states.[884] More recently, Portes (2004) called for the establishment of a permanent bondholder representative which he labelled the "New York Club." This institution would be modelled on the CFBH and FBPC and would be added to the machinery of the Paris and London Clubs.[885] As Portes sees it, the main benefit of a New York Club would be to engage with all bondholders in simultaneous negotiations, thereby overcoming much of the aggregation problem.[886] He further suggested that there be a mediation agency to coordinate debt workouts between the Paris, London and New York Clubs, with the goal of ensuring that information is disseminated on a timely basis.[887]

Today's market practitioners are extremely wary of the potential efficacy of a bondholder council or committee, even if it could be created. According to one source: "It's hard to get a bondholder group together – bondholders are too diverse."[888] This sentiment was echoed by a former IMF staff member who said: "It is difficult for a bondholders' council to emerge today given the differences within the bondholding investor class."[889] And, there are other problems connected with reviving a bondholder council in the 21st century. Holders of large blocs of a country's bonds may want a voice in the negotiation, but they may also disappear as discussions progress. Investment positions, even large ones, can be sold in the midst of a restructuring, creating a fluid set

[882] Eichengreen and Portes (1995); MacMillan (1995a); Portes (2004); Institute of International Finance (2006); Portes (2000).
[883] Eichengreen and Portes (1995). See also Eichengreen (2000).
[884] MacMillan (1995a); MacMillan (1995b).
[885] Portes (2004).
[886] Problems of aggregation occur when there is no way to coordinate voting across all bond issues, or across different classes of debt.
[887] Portes (2004), p. 13.
[888] Author Interview F.
[889] Author Interview B.

of players that can make ongoing negotiations difficult, if not impossible.[890] So, unless some sort of permanent, standing council could be established, this type of problem would routinely plague the debt restructuring process.

If the current regime remains institutionless, it will be for several reasons: i) debtors are opposed to them; ii) important creditor governments are not willing to support them to the same degree they did in the 19th century and interwar period, and, iii) there is scepticism that they can be efficient and truly representative while providing some sort of continuity to the negotiation process.

7.2.4 CACs: Majority Amendment

The goal of majority amendment clauses is to ensure that there are effective means for debtors and creditors to re-contract, without a minority of bondholders obstructing the process. More specifically, New York law bonds needed to be altered to allow less than 100% of creditors (the previously prevailing standard) to amend the payment terms of the bond.[891] However, as we discussed earlier, creditor groups proposed much higher voting thresholds, generally in the range of 85% - 90% of bondholders.[892] Some went so far as to suggest 95%, a level which Setser (2005) argued was useless since vulture funds only needed to purchase 5% of a bond to block a restructuring.[893] Mexico, having control of the text of its bond indenture, responded by setting the threshold at 75%, a level that would become the new market standard.[894] The fact that Mexican style clauses have prevailed, with only a few exceptions, means that the county was singularly successful in overcoming creditor group pressure.[895]

Emerging market fund managers argued that the exclusive inclusion of majority amendment clauses was "a very narrow solution to a very narrow problem," and "a one-way transfer of value from bondholders to sovereigns."[896] From a bondholder's perspective, the amendment clause would allow Mexico – and other debtor states – to

[890] Author Interview G.
[891] Non-payment terms in New York law bonds were already assigned a super-majority threshold.
[892] Institute of International Finance, International Primary Markets Association et al. (2003).
[893] Setser (2005), p. 9.
[894] Drage and Hovaguimian (2004); Roubini and Setser (2004a). Although Brazil later issued a bond with an 85% threshold, it subsequently said that it would lower it to 75%.
[895] Roubini and Setser (2004b), p. 6.
[896] Salmon (2004a), pp. 42-46. Quotes are taken from two emerging-market fund managers.

engage in a future "cramdown;" in other words, it bestows on sovereigns the power to force minority dissenters into a deal, while at the same time removing any legal rights the dissenters have to protest that deal after the exchange.[897] For these reasons, adoption of this clause was highly appealing to debtor states.

7.2.5 CACs: Majority Enforcement

A judgment is nothing more than a piece of paper.

Bruce Nichols, Partner
Davis, Polk & Wardwell

Once majority restructuring clauses are in place, the risk of disruptive creditor legal action is largely confined to the period when the restructuring is in process and before it is concluded. To limit the risk of creditor lawsuits in this period, the G-10 called for the implementation of majority enforcement clauses, which customarily include provisions for the sharing of litigation proceeds. Such sharing provisions reduce the benefits that individual creditors enjoy from launching unilateral legal action, much in the same way that sharing clauses in 1980s syndicated loan agreements restrained regional banks from suing. The Bank of England found that sovereign bonds issued since 2003 have not normally concentrated the power to litigate with a bondholder representative, nor have they called for the proceeds of litigation to be shared.[898] The reason that CACs have not evolved to include sharing clauses is because sovereigns believe creditor litigation problems to be overstated by the official and policy community.[899] To date, litigation has yet to derail a sovereign debt restructuring. Even vulture funds, long seen as posing the greatest litigation threat "do best in an environment where the overwhelming majority of creditors have migrated to the new deal."[900] The IMF has also weighed in on this subject:

> Litigation against a sovereign has been relatively limited and there is inadequate evidence to suggest that the prospect of such litigation will invariably undermine the sovereign's ability to reach an agreement with a

[897] While there was much protest about the form of amendment clauses in the Mexican bond, they were identical to the ones used since the 19th century in English law bonds.
[898] Drage and Hovaguimian (2004).
[899] Author Interviews D, G & E.
[900] Yianni (2002), p. 88.

> majority of its creditors. Litigation is not an attractive option for many creditors.[901]

It is not an attractive option because sovereigns generally have very little in the way of attachable assets in overseas jurisdictions. Their official properties, like embassies, and their central bank reserves held at the Bank for International Settlements, are exempt from their waiver of sovereign immunity.[902] This makes successful litigation against a sovereign exceedingly difficult, although the landscape may change with over $24 billion in holdout claims remaining after Argentina's 2005 debt exchange.[903] Nevertheless, the current structure of majority enforcement provisions reflects the conviction on the part of debtors that the risks of litigation are not great enough to warrant more sweeping changes in bond indentures.

Some maintain that worries about bondholder litigation are "more an issue for the academic and official community. It's not a huge market problem."[904] Others see holdout creditors as a "nuisance but a fact of life, and the cost of doing business for sovereigns."[905] Yianni (2002) characterized sovereign litigation as an irritating but minor problem in practice.[906] Despite the well-publicized success of Elliott Associates against Peru, it seems that such victories are more the exception than the rule.[907] In fact, the results of a survey taken by Sturzenegger and Zettelmeyer (2005b) demonstrate that even though litigation against defaulting countries is more feasible now than at any other time in history, creditors have been relatively unsuccessful in obtaining post-judgement payments from defaulting nations. The authors note that it is actually the defaulting countries that have "substantially improved their legal tactics to avert litigation losses."[908]

---

[901] Krueger (2002), p. 8. See also Setser (2005), p. 7.
[902] Sovereigns agreed to waive immunity from lawsuits for commercial transactions beginning in the U.S. in 1976.
[903] The World Bank Center for the Settlement of Investment Disputes recorded a claim of $4.4 billion on February 7, 2007 against the Argentine Republic by a group of Italian retail bondholders.
[904] Author Interview D.
[905] Author Interview G.
[906] Yianni (2002).
[907] Buchheit, Gulati et al. (2003).
[908] Sturzenegger and Zettelmeyer (2005b), pp. 3-4. Out of a total of 36 cases of private creditor litigation against sovereign debtors since 1994, 17 resulted in judgements to pay, 12 resulted in out of court settlements, with the remaining cases either pending or dropped. Moreover, in only six cases was 100% of the claim amount received by the private creditor.

In the next section, we will look at the specific elements of structural power that have enabled sovereign debtors to wrest control of the debt management process from their private creditors. We will examine the lack of bondholder collective will and the leniency and buoyancy of the capital markets, both of which have increased the bargaining leverage of debtor states. Also, in contrast to the 1980s, sovereigns now enjoy greater control over the text of their debt contracts. Finally, changes in the IMF's "lending into arrears" policies have largely benefited debtor states by putting IMF resources at their disposal in advance of a final settlement with private creditors. All of these changes have amplified debtor power in the current period, giving them a stronger voice in the design of debt management regimes, and greater control over outcomes.

7.2.6 The Shift from Bank Debt to Bonds and the Myth of Bondholder Collective Will

Whereas commercial banks dominated the business of emerging market lending in the 1980s, bondholders returned to the scene in the 1990s, assuming the historically prominent role of their 19th century and 1920s predecessors. As the table below illustrates, bank lending has been dwarfed by lending from non-bank private creditors since the late 1990s. And, if we look at the contribution of private sector lenders more broadly, we can see that they have largely eclipsed the official sector during this period.

Table 7B: Net External Borrowings by Emerging Markets Countries – Official, Bank and Non-Bank Flows

Billions of U.S. dollars

	1999	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008 (est.)*
Borrowing from Official Creditors	*34.5*	*-8.1*	*24.1*	*10.6*	*0.7*	*-6.4*	*-50.9*	*-64.5*	*14.7*	*23,.6*
Borrowing from Banks	*-13.0*	*-10.9*	*-12.5*	*-18.0*	*13.8*	*30.8*	*40.1*	*57.8*	*41.9*	*40.5*
Borrowing from Non-Bank Private Creditors	*24.3*	*57.2*	*-0.8*	*29.6*	*106.4*	*171.6*	*246.6*	*301.2*	*223.2*	*256.5*

Source: IMF World Economic Outlook, Statistical Appendix, April 2007 (pp. 262-263).

What effects did the transition from bank to bond financing have on the sovereign debt restructuring regime of the late 1990s, and how did this change impact bargaining

outcomes? Well, if we start at the most basic level, commercial banks and bondholders have fundamental differences in their degree of cohesion. So, by shifting the bulk of their debt from banks to bondholders, sovereigns were able to use this new weakness in creditor collaboration to their advantage.

If you examine a bond issue closely enough, you find that it "breaks down atomically into hundreds or thousands of bi-lateral contracts between the bond issuer and each investor; the appearance of an investor [syndicate]...is just that, an appearance with few practical or legal implications."[909] Bond investors, unlike banks, often have no ongoing business relationship with a debtor and are not subject to moral suasion by the official sector.[910] As McGovern (2003) observed, "the era of commercial banks making sovereign loans and holding them to maturity is now a distant memory;" sovereigns are no longer able to sit in a room and negotiate with fifteen lead creditors.[911] They are instead faced with a creditor group that is large, more anonymous and difficult to coordinate.[912] Hedge fund managers are guided by mark-to-market considerations and are not apt to accept a negotiation process that takes years. While banks had incentives to prolong the 1980s negotiations to preserve their loan values, bond investors absorb losses immediately, as the market adjusts to new information about a sovereign's financial difficulties.[913] In addition, bond investors often have conflicting objectives; those who purchased their bond at full face value will fight for a more generous settlement than investors who purchased the same bond in the secondary market at a deep discount. Investors who owned credit default swaps might try to derail a pre-default restructuring and advocate default instead, affording them the opportunity to collect on their credit risk insurance. Hold-out creditors could opportunistically threaten litigation, both prior to and after a restructuring, creating greater uncertainty for sovereign debtors. This is in marked contrast to the 1980s, when "virtually all holders of distressed debt were banks, which had a regulatory incentive against declaring a creditor in default...as this would have required them to write down their loans."[914] That today's bondholders (as a group) cannot

[909] Buchheit and Gulati (2002), p. 1320.
[910] Krueger (2002), p. 7.
[911] McGovern (2003), p. 79.
[912] International Monetary Fund (2003b).
[913] International Monetary Fund (2001), pp. 20-21.
[914] Sturzenegger and Zettelmeyer (2005b), p. 23.

express some form of "collective will" actually works to the benefit of sovereigns in a debt renegotiation. With the disappearance of the powerful creditors' cartel of the 1980s and the decline in systemic risk to the global banking system, sovereigns began to enjoy more room to manoeuvre in debt negotiations. For this reason, they have consciously avoided creditors' attempts to mandate consolidated bondholder representation, either contractually or otherwise, and have been successful at obtaining larger haircuts through unilateral exchanges.

7.2.7 Capital Market Promiscuity

The historical record demonstrates that markets have not particularly punished sovereigns that have chosen to default, and that, contrary to expectation, defaulting countries are not tainted in the long run by their unwillingness to pay today.[915] Even recent IMF studies have found that countries that defaulted in the 1990s "did not experience interruption in their market access."[916] And, if defaulting carries little cost, borrowers will eventually respond to the incentive. It is interesting that today's lenders "seem singularly willing to ignore this risk."[917] Why don't investors punish defaulting countries by driving up the cost of future borrowings or restricting market access?[918] One explanation is that governments in debtor countries have very short life spans, so lenders do not project individual country risks from history. Another is that investors rely more on the current state of macroeconomic policies than they do on historical debt-service history. So, as long as a country has adopted fiscal and monetary policies that promote low inflation and sustained growth, "creditors hear no strong signal from the distant past."[919] For instance, Mexico returned to the capital markets within a year of its 1994/1995 crisis, as did Korea after its 1998 crisis.[920] Others have pointed out that Ecuador was not particularly punished for its default episode in 1999/2000.[921] And, market practitioners believe that Argentina will soon have the ability to tap the capital

[915] Eichengreen and Lindert (1989), pp. 4-5; Jorgenson and Sachs (1989); Cardoso and Dornbusch (1989); Eichengreen and Portes (1989).
[916] Gelos, Sahay et al. (2003), p. 25.
[917] *Financial Times*, Febrary 14, 2007.
[918] Sturzenegger and Zettelmeyer (2005b), p. 4.
[919] Fishlow (1989), pp. 86-105; Eichengreen and Lindert (1989), p. 5.
[920] Author Interview K. See also Rubin (2003a), p. 34.
[921] Author Interview D.

markets, despite the harsh settlement terms it offered its bondholders in early 2005. They argue that the country's presence in the JP Morgan Emerging Market Bond Index gives hedge fund managers, who are measured on relative performance, strong incentives to hold Argentine bonds.[922]

The *Financial Times* recently noted that "with markets awash in liquidity, international investors' appetite for risk means they are willing to buy [Argentine] debt paper issued locally."[923] In addition, Argentina recently signed agreements with Venezuela that allowed for the joint issue of $1.5 billion in bonds. The leaders of the two countries are even discussing the possibility of establishing a "Bank of the South to circumvent the economic reform policies of the IMF and Washington."[924] Contributing to the laxity on the part of the credit markets is the steady growth in private capital flows to developing countries which we discussed earlier. Underpinning these flows is the relentless search for yield. The current global savings glut has driven interest rates and risk premiums in developed countries to historic lows. As a result, money has flooded into emerging markets in the past four years seeking the possibility of higher returns.[925]

Table 7C: National Interest Rates in Selected Developed and Emerging Market Countries

Treasury Bill Rates (%)

	1998	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*
U.S.	*4.82*	*4.66*	*5.84*	*3.45*	*1.61*	*1.01*	*1.37*	*3.15*	*4.89*	*4.87*
Germany	*3.42*	*2.88*	*4.32*	*3.66*	*2.97*	*1.98*	*2.00*	*2.03*	*3.38*	*3.80*
United Kingdom	*6.82*	*5.04*	*5.80*	*4.77*	*3.86*	*3.55*	*4.43*	*4.55*	*5.01*	*5.33*
Mexico	*24.76*	*21.41*	*15.24*	*11.31*	*7.09*	*6.23*	*6.82*	*9.20*	*7.04*	*7.01*
Brazil	*28.57*	*26.39*	*18.51*	*20.06*	*19.43*	*22.10*	*17.14*	*18.76*	*13.04*	*11.77*
Jamaica	*25.65*	*20.75*	*18.24*	*16.71*	*15.54*	*25.94*	*15.47*	*13.39*	*12.30*	*11.65*
Hungary	*17.83*	*14.68*	*11.03*	*10.79*	*8.91*	*8.22*	*11.32*	*6.95*	*8.06*	*7.81*
South Africa	*16.53*	*12.85*	*10.11*	*9.68*	*11.16*	*10.67*	*7.53*	*6.91*	*8.28*	*8.29*
Nigeria	*12.26*	*17.82*	*15.50*	*17.00*	*19.03*	*14.79*	*14.34*	*7.63*	*6.50*	*6.90*

Sources: IMF, International Financial Statistics, May 2002, January 2007, and June 2007.

[922] Author Interview G.
[923] *Financial Times,* February 9, 2007, p. 13
[924] *Washington Times,* March 8, 2007.
[925] *Financial Times,* February 7, 2007, p. 13.

With sovereigns less reliant on banks for funding and secure in the promise of promptly renewed capital market access, debtor countries today are less concerned about the consequences of default than they were in the 1980s. A Mexican treasury official commented that:

> in the 1980s, we had an incentive to pay the banks since they had all the money. This symbiotic relationship no longer exists. Today, there is a lack of incentives for an orderly restructuring. You can get financing from the market in the future. Crises are so big today that you have to break the rules.[926]

Also, with no single point of control over an increasing supply of global credit, today's bondholders do not enjoy the structural power of their 1980s – or 19th century – predecessors.[927]

7.2.8 Debtor Control Over the Text of Bond Indentures

Another important change in the capital market dynamic since the 1980s has been a shift in control over the content of the debt contract. In the 1980s, attorneys representing bank lenders had the job of drafting syndicated loan documents. Protection of the lenders' interests was therefore paramount. By contrast, the content of bond indentures is controlled by counsel representing the issuing country. Although the text of bond indentures is heavily influenced by precedent, the changes made by Mexico to standard collective action clauses (CACs) were made easier by the fact that Mexico's chief counsel, the U.S. law firm Cleary, Gottlieb, was responsible for the documentation. While Gelpern and Gulati (2007) point out that investors "can and do make their views [on legal matters] known to issuers" the fact is that, in the end, the only choice investors have is to "buy or not to buy."[928]

7.2.9 Revision of IMF "Lending into Arrears" Policies

The IMF's policy of not lending into arrears - or not lending to countries in default to their private creditors - was motivated by a desire to maintain the integrity of

[926] Author Interview H.
[927] Miller and Thomas (2006a), p. 23. Miller and Thomas (2006a) argue the threat of attachment which accompanies unpaid claims still effectively prohibits debtor access to primary capital markets, namely in London and New York.
[928] Gelpern and Gulati (2007), p. 56.

the global financial system. More specifically, the IMF wanted to be seen as supporting the proposition that debtor states should honour *all* of their debt contracts. When the Fund made a decision to relax this policy in 1998 with respect to bond debt, one market practitioner commented that the IMF had "lost any meaningful vision" of its original role "as guardian of the financial system."[929] Under the new IMF rules, sovereigns undergoing a bond restructuring could continue to enjoy access to official IMF funding, provided that some "good faith efforts" were being made to engage bondholders "in negotiation."[930] However, the definition of what constituted "good faith efforts" or "negotiation" was left intentionally vague, giving the IMF considerable flexibility to continue to disburse funds in certain restructuring cases. The new policy therefore strengthened the hand of sovereigns by eliminating the power that private creditors previously enjoyed to block IMF loans.[931] As we discussed in Chapter 6, this rule was relaxed with respect to bank debt in 1989, but only *after* the banks had safely provisioned for their expected Latin American losses. The response from bondholders after the 1998 decision was decidedly negative, expressing frustration that creditors had lost an important element of leverage over sovereigns. One market player voiced his disappointed by saying: "Don't creditors deserve any sticks? There is no IMF on their side and no creditor governments."[932]

The result of these structural changes was the gradual evolution of a regime for sovereign debt management since 1998 that produced results favouring debtor states. The unilateral debt exchange emerged from the vacuum which lacked a natural bondholder representative, and the official sector has thus far abdicated its historical role in empowering a bondholder institution. This has permitted sovereigns greater control in deciding the final terms of settlement with their private creditors. And, with respect to regime design, Mexico successfully bargained with the U.S. Treasury to ensure that the

---

[929] Author Interview D. The IMF made the 1998 decision on "lending into arrears" in order to put all private creditors - commercial banks and bondholders – on the same footing. In addition, the Fund wanted to deflect criticism that the old policy gave private bondholders too much leverage in a debt restructuring exercise.

[930] See Cline (1995) and Eichengreen and Portes (1995) for a discussion of the "lending into arrears" policy with respect to the commercial banks.

[931] For an alternative view, see Klimenko (2002), pp. 201-202. Klimenko argued that the shift in leverage to debtor states occurs mainly because the multilaterals have less leverage than before. The new lending into arrears policy allows debtor countries to "extract resources from the IFI's" by remaining longer in a position of overhang.

[932] Author Interview D.

more revolutionary SDRM would be scrapped in favour of a debtor-driven menu of collective action clauses.[933] While the U.S. Treasury saw the implementation of CACs by Mexico as a policy triumph, in fact, the value of CACs has yet to be proven. Virtually all the restructurings completed to date have used the unilateral exchange process without resorting to CACs.[934] Also, market practitioners question the positive political spin that attached itself to the Mexican benchmark issue. According to one "Why did Mexico's sovereign issue in 2003 get so much attention for the use of CACs; it's not as big a deal as everyone makes it out to be. Sovereigns have long issued bonds with CACs under English law."[935] Even those closely connected with the Mexican initiative admit: "CACs today are really not as powerful as they could be. They are really a compromise – a second best solution."[936] Yianni (1999) argued that the fact most restructurings have taken place in a CACs-free environment only serves to prove that the historical absence of CACs has not prevented sovereigns from working out favourable settlements.[937] In other words, the Mexican shift to CACs may have received a good deal of attention, but the practical impact has been minimal.

7.2.10 Creditors Fight Back: The IIF and the Principles – Re-opening the Regime Debate?

In an attempt to compensate for the deficiencies of the unilateral debt exchange and the trajectory of the current CACs templates, the IIF, a group which represents the interests of the financial industry, unveiled a voluntary code of conduct for emerging markets debtors and creditors more formally known as the *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets* (hereafter called the "Principles").[938] According to the IIF, the Principles "articulate a well-defined process for debtor-creditor negotiations on restructuring terms that can attract broad based support from creditors."[939] They are therefore seen as a remedial step, one that will impose order,

[933] See Truman (2002), p. 345, for the concept of an evolutionary versus a revolutionary change in the sovereign debt management regime.
[934] Institute of International Finance (2007), p. 2.
[935] Author Interview F.
[936] Author Interview H.
[937] Yianni (1999).
[938] The *Principles* version under discussion was dated September 2006.
[939] Institute of International Finance (2006), p. 2.

transparency and efficiency on a process that is often seen as disorderly, opaque and inefficient. The IIF maintains that:

> the resolutions of past crises have often been *ad hoc*, protracted, and complicated, involving unnecessary economic dislocation and reductions in the values of emerging market assets, especially in cases that required debt restructuring.[940]

Although no party is legally bound by any of the provisions of the Principles, the IIF hopes that the new code will provide a roadmap for debtor and creditor behaviour in future financial crises.[941] For the purposes of our analysis, we will focus on a few of the more contentious IIF prescriptions for crisis resolution. The first concerns the formation of a creditor committee, with the costs of such a committee borne by the debtor state. The IIF has publicly stated that creditors prefer cooperative negotiations with committees and find "take-it-or-leave-it" unilateral offers inadequate.[942] Yet, virtually all of the restructurings that took place between 1998 and 2005 took the form of unilateral exchanges. And, even after the publication of various drafts of the Principles, market practitioners pointed out that countries like Belize and Iraq "went the non-negotiated route."[943] Emerging markets debtors remain sceptical about the committee process as envisioned by the IIF :

> A big problem is the cost of paying for a bondholder council – why should a sovereign do that? We would have to pay for investors' lawyers and financial advisors and what would be the outcome: to get a better deal for creditors? Countries are voicing their support now to appear cooperative. But, [the Code] is not [legally] enforceable.[944]

Another area of contention has been the IIF's reference to the IMF's "lending into arrears policy." Under the Principles, the IMF is called upon to fully implement its lending into arrears policy, which, from the IIF's perspective, means that the Fund would only lend to states that are "negotiating" with their creditors.[945] In other words, unilateral

---

[940] Institute of International Finance (2006), p. 2.
[941] Institute of International Finance (2006), p. 14.
[942] Institute of International Finance (2006), p. 12.
[943] Author Interview N.
[944] Author Interview H.
[945] Institute of International Finance (2006), p. 13.

exchanges would rule out access to IMF loans. However, in practice, the enforcement of "lending into arrears" has not been tied to a debtor's adherence to IIF negotiating principles. By way of example, the IMF continued to grant Argentina access to official funds in the face of its default and its continuing refusal to engage in negotiations with its bondholders.

The most important question is whether the Principles will succeed as a framework for debtor/creditor negotiations in the future. Although some have expressed surprise at the IIF's persistence and how far they have come, most remain unconvinced about the efficacy of the new code. According to one source: "At the beginning, no one really cared about it, and no one took them seriously. Most people still don't believe that the Principles will work when they are most needed."[946]

Other market sources exhibited more hostility: "Finance ministers may sign on, but their real view is that it is a complete waste of time."[947] Others were dubious that a sovereign that had "just defaulted on its contractual debt obligations would turn around and abide by a voluntary code of conduct."[948] Some sovereign finance officials believe that there is no real incentive for them to abide by the Principles "since all the costs go to the sovereign and all the benefits to the investors and banks."[949] Notwithstanding this protest, those who have publicly supported the IIF's endeavors – important borrowing states like Brazil, Korea, Mexico and Turkey - all took pains to ensure that the final product would not offend debtors' sensibilities. According to Salmon (2004a), emerging markets officials "ensured that virtually everything creditors wanted in such a document was excised."[950] This has allowed sovereigns to publicly support the Principles while at the same time preserving their flexibility to act as a rogue debtor in the future. Although they might never choose to behave in a market-unfriendly manner, there is a good deal of value in safeguarding that option.

[946] Author Interview H. See also Helleiner (2006), pp. 23-24.
[947] Author Interview N.
[948] Author Interview E.
[949] Author Interview H.
[950] Salmon (2004a), pp. 42-46.

7.3 Compulsory Power and the Argentine Default

In general, the official sector is unsympathetic to bondholders' concerns – and in the case of G-7 countries, it can be downright hostile.[951]

Felix Salmon
Euromoney

The official sector –whether bi-laterally or through multilaterals like the IMF – has been an integral part of the sovereign debt restructuring regime through time. As we already discussed, the 19th century witnessed the frequent use of super-sanctions by the British government which had the effect of materially improving bargaining outcomes for private bondholders. Likewise, the favour shown by creditor governments and the IMF in the 1980s toward bank lenders endowed private creditors with significant leverage in their negotiations with troubled Latin American states. By contrast, the 1930s and 1940s saw the U.S. government prioritize the recovery of Latin American debtor states and the maintenance of good diplomatic relationships above the interests of its own bondholders. We would argue that with respect to the exercise of compulsory power in the current period, official creditors exhibit none of the overt partiality that they did in the 19th century and 1980s toward their own creditors; nor are they openly working against them like they did in the interwar period. Instead, they have shown remarkable restraint publicly, while behind the scenes they have pursued a course of action that has had the effect of improving the lot of debtor states.

For instance, the decision by Mexico to install CACs that were much less comprehensive than the templates issued by creditor representatives, ultimately received the full support and praise of the U.S. and the G-7. Pursuant to Taylor's own story, Mexico was never questioned about its choice of CACs; instead, the country was thoroughly commended and held up as an example for others to follow.[952] Also, as history has shown, the collective action problems associated with bondholder groups has meant that official action was mandatory for the creation of bondholder representative bodies like the CFBH and FBPC. Yet, in the current period, creditor governments have

[951] Salmon (2004a), pp. 42-46.
[952] Taylor (2007), pp. 98-132. See also Author Interview R.

shown no interest in helping to establish such a body. And, since 1998, the IMF, partly in response to the criticism it had received for large-scale bailouts in Mexico and Asia, walked away from Russia and Argentina, and even encouraged countries like Pakistan and the Ukraine to default on their bond debt to force investors to the negotiating table.[953] Official sector actions have thus far managed to undermine the bargaining position of private creditors.

7.3.1 Argentina: To Intervene or Not?

Historically, default cases that revolved around large and systemically important countries would attract much in the way of official sector attention and support. Yet, in this period, one of the most prominent defaulters – Argentina - appeared to have been left to its own devices to work out a broad-based solution with private creditors. Argentina's crisis commenced in earnest on December 5, 2001, triggered by the IMF's decision to suspend a scheduled loan instalment. At the time, the country owed $82 billion in principal to hundreds of thousands of investors holding 150 different bond instruments issued in six currencies under the laws of eight jurisdictions.[954] The resolution of this complex crisis took over three years – the longest settlement period in this era - during which time the country suffered severe economic, political and social dislocation. In the end, three quarters of the bondholders agreed to take a haircut of nearly 70%.[955] While some have said that the Argentine case proved that "borrowers and lenders can work out bond defaults on their own," Buchheit (2005-2006) maintains:

> this judgment would no doubt strike some of the bondholders as a bit like concluding that World War I stands for the proposition that, left on their own, nations can work out their differences.[956]

So, on the one hand, the official sector found itself maligned for its unusual detachment from the Argentine debt restructuring process; some went so far as to accuse the official

[953] Brown and Bulman (2006), pp. 23-24.
[954] Gelpern (2005a), p. 19. By the time the exchange offer was made, the claims had grown to nearly $100 billion due to interest arrears.
[955] 76.6% of the bondholders accepted the exchange. The remaining bondholders (totaling approximately $24 billion in claims) were told that Argentina would not honor their debt, and some have filed claims under ICSID as well as in New York courts.
[956] Buchheit (2005-2006), p. 343.

sector of abdicating its responsibility. On the other hand, they found themselves praised for bowing out in favour of a market-based solution.

In this section we will argue that compulsory power did play a role in the Argentine debt exchange, although it was far more subtle than in past eras and ultimately helped Argentina achieve a better result from its restructuring. The principal reason for the shift in creditor government position was political: the new U.S. administration under George W. Bush wanted to distance itself from the interventionist policies of its predecessor, and the IMF, under Republican-appointee Anne Krueger, wanted to put an end to the lending packages that had attracted so much criticism during the Mexican and Asian crises in the 1990s. In the end, the Argentine bondholders were caught in this political sea change. Lacking official support and attention, they registered one of the largest haircuts in the history of sovereign default.

7.3.2 "W" Meets the Argentine Debt Crisis

When George Bush noticed Argentina's President, Nestor Kirchner, walking toward him during a U.N. General Assembly Meeting in 2003, he was reported to have joked aloud to a number of other foreign leaders: "Here comes the conqueror of the IMF."[957] While Bush's reaction might seem unusual - since the U.S. is the IMF's principal shareholder - it nevertheless reflects the overall sentiment of the administration regarding the handling of sovereign debt crises. From the start, the Bush team would express reluctance to support excessive IMF lending in resolving financial crises.[958] The neo-conservatives in the administration saw this as a healthy break from the interventionist policies of the Clinton/Rubin era. Certainly the installation of Anne Krueger, "a free market Republican," as the Fund's First Deputy Managing Director would help cement this policy within the IMF.[959] How did debtor states feel about this IMF transformation? The view from Argentina was not very positive at first. In 2001, the country's finance minister, Domingo Cavallo, argued that the U.S. had singled out

[957] Helleiner (2005), p. 955.
[958] Griffith-Jones (2002).
[959] Helleiner (2005), pp. 961-962.

Argentina "as an example to send the message that the new administration would avoid moral hazard no matter how much that decision would cost Argentina."[960]

In addition to supporting policy change at the IMF, the Bush team also chose to react much less sympathetically to the plight of private creditors than previous administrations in the 1980s and 1990s. In fact, the political aims of the new Bush administration with respect to Latin America were not that dissimilar from the objectives expressed by the Roosevelt administration in the 1930s. Bush hoped to counteract the popularity of the left-leaning governments of Chavez in Venezuela and Lula in Brazil by showing support for, and solidarity with, Argentina. So, in a story reminiscent of the 1930s, Bush was willing to sacrifice the interests of American bondholders to achieve a larger, geo-strategic objective.[961]

7.3.3 US Promotes IMF Mid-Crisis Loan to Argentina

Amid much bondholder protest, the U.S. decided in the fall of 2003 to support a $13.3 billion IMF loan for Argentina while the country remained in default to private creditors.[962] In addition to the problems presented by the previously discussed "lending into arrears" policy, the U.S. pressured the IMF to exclude specific targets for the country's primary budget surplus. These targets are normally critical to any program since they help determine the amounts that would be available for debt servicing. Randy Quarles, a U.S. Treasury officer, later admitted that "the U.S.A. had deliberately pushed for the budget targets to be left undefined in the second and third years – over IMF objections – because it wanted the IMF *not to take a stance* in the debt negotiations with private creditors."[963]

Even John Taylor, Deputy Treasury Secretary, conceded that during the Argentine crisis he believed that:

---

[960] Helleiner (2005), p. 962.
[961] Helleiner (2005), pp. 959 – 964. According to Helleiner: "While it is true that Italian and Swiss investors held the largest share of total private debt (15% and 10%, respectively), the U.S. share at 9% was not far behind and its absolute size left U.S. investors facing much larger losses than in other recent debt crises."
[962] Author Interview O.
[963] Helleiner (2005), p. 954. *Italics mine.*

> neither the United States nor the IMF should take sides as Argentina negotiated with its creditors. There was a lot of pressure for us to take sides, usually the side of the creditors, but we resisted this pressure.[964]

Taylor was openly hostile toward the IMF and the policies followed by Clinton and Rubin. He expressed disdain for the poor handling of the 1998 Russian crisis and the excessive conditionality embedded in the 1997 Indonesian rescue loan. According to Taylor: "I began to think that no IMF would be better than the one we had, and I said so in a TV interview in 1998. [I said]: 'I agree it should be abolished. I'd like to do it.'"[965]

However, U.S. Treasury Secretary Snow and Taylor remained supportive, sympathetic and engaged behind the scenes as Argentina undertook some very tense negotiations with the IMF in January 2004. Sources inside the U.S. Treasury confided that the U.S. was "very involved," spending "an enormous amount of time in Buenos Aires."[966] In fact, American support was so appreciated by the Argentines that their finance minister "publicly thanked Snow for this help after the IMF board meetings."[967] While it was not the aim of the American government to "disenfranchise bondholders," there was an equally strong desire to avoid moral hazard.[968] This was not easy to do when "Citigroup was in [the Treasury Secretary's] office every week...pounding the table...and demanding public action."[969] Yet, the Treasury remained firm in its resolve not to be swayed by the banking community. A treasury official commented that "we were just not going to operate that way."[970] So, with U.S. help, the Argentine's were given the lifeline they needed in the form of an IMF loan, much to the chagrin of private creditors. Yet, despite the enormous amount of U.S. effort that went into establishing the IMF credit facility, Taylor suggested to the Argentine treasury staff that they repay it as quickly as possible. According to Taylor: "that way, they would not have to worry about the IMF over-prescribing."[971]

---

[964] Taylor (2007), p. 93.
[965] Taylor (2007), pp. 100-101.
[966] Author Interview R.
[967] Helleiner (2005), p. 956.
[968] Author Interview R.
[969] Author Interview R.
[970] Author Interview R.
[971] Taylor (2007), pp. 93-94. Argentina did pay back the IMF in full in January 2006.

7.3.4 The IMF and the Power of the Debt Sustainability Model

It is important to point out that the IMF wields a great deal of power in any negotiating process by virtue of its monopoly in the modelling of debt sustainability. These models ultimately determine how much will be available for private creditors to share. For instance, when a country finds itself in financial distress, the Fund staff must create a model that projects the country's future debt servicing capacity. This model specifically identifies the amount that will be available for the servicing of all classes of debt. Because the IMF receives priority over other creditors, it first removes from the calculation the monies required to service IMF loans. What remains can then be divided among the remaining official and private creditors.

Buchheit (2005-2006) describes the IMF's debt sustainability analysis as the "genetic code, the financial DNA" of any debt restructuring exercise since it necessarily puts an upper limit on what bondholders could hope to receive. He then marvels at the fact that private lenders, while never being "bluntly deprived of the illusion of free will" in their negotiations with sovereigns, nevertheless fail to see that "behind the scenes a Calvinistic predestination has already been at work."[972] The IIF maintains that they are very aware of this unilateral power wielded by the IMF and have pushed to get the private sector involved in debt sustainability modelling. A combined public-private effort was more the norm during the 1980s debt crisis, when the banks' economic sub-committees had a seat at the IMF's table. The IIF believes that the Fund currently "has too much power to determine how much is left over for private creditors."[973] Citing Iraq as an example, the IIF pointed out how that country's debt sustainability model used an oil price of only $23 dollars a barrel, a figure that was well below market, due to political pressure from the Americans. This ultimately forced lenders to take an 80% haircut on their Iraqi debt.[974]

7.3.5 Argentina to the IMF: "Ciao"

The unhappy relationship between Argentina and the IMF came to an end rather abruptly. President Kirchner announced that the country had repaid its remaining $10

[972] Buchheit (2005-2006), p. 342.
[973] Author Interview O.
[974] Author Interview O. The Iraq case is not included in our analysis since it settled after 2005 and involved creditors that were primarily official as opposed to private. It was cited for illustrative purposes only.

billion obligation to the Fund in January, 2006. Kirchner toasted the event by raising a cheer and bidding goodbye to the IMF "with a derisive 'ciao.'"[975] Kirchner was reported to have called the IMF "pathetic," adding that, "there is life after the IMF and it is a good life."[976] Small investors – both holdouts and non-holdouts – were shocked by Argentina's decision to pay off its $10 billion obligation to the IMF in full and well ahead of schedule. Many felt that if the country had that much liquidity, it should have first done more to honour the contracts with its foreign bondholders. According to Nicola Stark, the Co-Chairman of GCAB, small investors felt that they were being treated by Argentina like "lambs for the slaughter" and a "resource to be milked."[977]

With their IMF obligation satisfied, a member of Kirchner's treasury team decided to unleash an even more vitriolic indictment of the IMF's staff and policies in a scathing *Euromoney* article. According to Argentina's deputy finance minister, Guillermo Nielsen:

> Anne Krueger...took Argentina into her own hands...It became clear that she didn't have the sensitivity to deal with Argentina. There was no earnest effort to grasp the realities...Naively, I expected IMF missions to arrive in Argentina with a set of well-developed suggestions successfully tested in previous economic crises elsewhere. That was not the case...Most of the IMF officials we had to deal with in those early days found it difficult to distinguish between running an Excel spreadsheet and running a country.[978]

Nielsen was determined to bypass the IMF and develop strong bi-lateral relationships with important members of the IMF board instead, especially the G-7 countries. He credited a 2002 meeting between Bush and Spain's prime minister, Jose Maria Aznar, as the event which convinced the U.S. administration to give Argentina the chance to "rebuild its economy with the support of the international community." Nielsen was careful to say that Argentina never reached agreements with the IMF, but with its individual board members instead.[979]

---

[975] *Financial Times,* February 9, 2007, p. 13
[976] *Washington Times*, March 8, 2007.
[977] Statement by Nicola Stark, President of the Association Task Force Argentina at the Paris Club 50th Anniversary Celebration in Paris, France on June 14, 2006.
[978] Nielsen (2006), p. 66.
[979] Nielsen (2006), p. 67.

7.3.6 Creditor Governments and the IMF Ignore Bondholder Concerns

Lacking creditor government and IMF support, the Argentine bondholders were faced with having to accept what they viewed to be a meagre settlement. Prior to the exchange, Hans Hume, a co-chairman of the bondholder council GCAB, said: "If Argentina's offer succeeds it will dramatically lower the cost of defaulting and strip power from creditors."[980]

Unfortunately for the dissenting creditors, the Argentine debt exchange was a resounding success. Attracting 76.6% investor participation on claims of nearly $100 billion, Argentina was able to materially scale down its foreign debt burden.[981] The fact that the exchange was concluded against the backdrop of more than 200 law suits filed in New York, Italy and Germany makes it all the more remarkable.[982] According to Gelpern (2005a), Argentina's financial crises left the impression that sovereign default shifted the balance of power to debtors in the absence of official intervention.[983] Others argued that the crisis forced the acknowledgement of the limited bargaining power of bondholders "in a context where the U.S.A. and IMF were not supportive of their interests."[984] As the head of the Emerging Markets Group at JP Morgan Chase, Joyce Chang, pointed out in 2004: "Argentina raises the question of what leverage do you have over a country once they stop payments...The answer is, not much."[985]

While the Argentine exchange might have proven that market-based restructurings are possible absent a statutory mechanism, or for that matter, CACs,[986] the question remains: What is the cost of official sector abstention? After all, a decision by the official sector not to take sides is hardly neutral. In the context of a sovereign default, such a decision by definition reduces the bargaining leverage of private creditors. This is because only a sovereign (or a multilateral) has the power to directly compel another sovereign to action. We would therefore argue that with the official sector standing aside

[980] Helleiner (2005), p. 965.
[981] Gelpern (2005a), p. 4.
[982] Miller and Thomas (2006a), p. 14. The 200 lawsuits include 15 class action suits.
[983] Gelpern (2005a), p. 4.
[984] Helleiner (2005), p. 965.
[985] Helleiner (2005), p. 965; Soederberg (2005). Out of all these voices, only Soederberg (2005) sees the new debt regime as one that gives creditors power over debtors. She argues that creditors use debt as a weapon to keep debtors in the capitalist system.
[986] Roubini (2005), p. 1.

- or in some instances working covertly to assist Argentina - the bondholders paid the price.[987]

7.3.7 The Reaction of Holdout Creditors and Possible Remedies

With ad hoc bondholder councils like GCAB condemning "Argentina's cramdown," what had seemed to be a modern attempt at creating a new creditor representative body had failed. As Gelpern (2005a) noted, "true to atomistic stereotype, sovereign bondholders could not hold a coalition."[988] At the moment, dissenting creditors are either waiting for judgments in lawsuits - or hoping to collect on judgments already awarded – and as time progresses, their options are narrowing.[989] The IMF attempted to push Argentina into a settlement with holdouts, but the Fund's leverage materially diminished once the country repaid the IMF's $10 billion loan. Argentina has publicly stated that it will never honour the claims of holdout creditors. And, to further enhance its commitment, the country adopted domestic laws which prohibit it from making payments to dissenting creditors. In addition, the "most-favoured-creditor" clause in its bond indenture requires Argentina, absent a judgment, to pay holdouts no more than bondholders who agreed to the original exchange.[990] Italian holders of $4.4 billion in Argentine bonds have filed a claim with ICSID in the hopes of receiving a judgment.[991] If the test case is a success for creditors, it may push for a re-evaluation of the provisions of bi-lateral investment treaties by states. For instance, sovereigns may ask that debt related to a restructuring be excluded from the definition of "investment." Or, they may try to protect themselves against claims of expropriation from minority dissenters who have been outvoted through the use of collective action clauses.[992]

Finally, it is important to note that although participating creditors did poorly in the exchange and dissenting creditors remain unpaid, the broader markets did not punish

---

[987] Dhillon, Garcia-Fronti et al. (2006), p. 378; Roubini and Setser (2004a).
[988] Gelpern (2005a), p. 3.
[989] Buchheit (2005-2006), pp. 338-339. See also Sturzenegger and Zettelmeyer (2005b), pp. 10 -12. Although sovereigns technically waived immunity with respect to their debt obligations under the Foreign Sovereign Immunities Act ("FSIA") in 1976 and the State Immunities Act ("SIA") in 1978, it is still difficult for a creditor to succeed in attaching a sovereign's assets.
[990] Republic of Argentina (2005).
[991] The claim was filed on February 7, 2007, Case ARB/07/5, Giovanna Beccara and others vs. Argentine Republic. Details can be found at www.worldbank.com/icsid.
[992] Gelpern (2005a), p. 7. "Uruguay's treaty with the United States specifically shields it from expropriation claims by holdout creditors who have been outvoted using collective action clauses in Uruguay's bonds."

Argentina. By writing off the debt and improving the country's economic performance, Argentina saw the spread on its bonds narrow to around 400 basis points above Treasuries only six months after its debt exchange. To put this in context, this spread was "only very modestly above that of other emerging markets in the EMBI basket."[993]

7.4 Productive Power

We have argued throughout this dissertation that discursive practices surrounding debt restructurings between sovereign states and private creditors have largely been underpinned by material power configurations. In our three historical case studies, we have shown how the disposition of creditor governments toward their own lenders and the dynamics of capital export have been influential in answering the question: What does it mean for a sovereign to default and how should a defaulting state be treated?[994] When Britain was the centre of capital export and a dominant military and imperial power in the last quarter of the 19th century, we found that adherence to the terms of a debt contract was seen as the moral undertaking of a civilized nation. Sovereign default was therefore regarded as an immoral and uncivilized act, a characterization which allowed for a good deal of interference by creditor governments in the affairs of financially distressed sovereigns. Oftentimes this interference coincided conveniently with the larger geo-strategic objectives of Britain relative to a particular defaulting state or region.

This 19th century portrayal was challenged, however, in the 1930s and 1940s when great powers – including Britain, France and Germany- found themselves unable to meet payments on their own debt, much of it incurred in the finance of war. Suddenly, default became less of a moral failing and more the rational policy choice of a government looking to protect the economic well-being of its citizenry. Further buttressing this mutation in the meaning of sovereign default was the anti-banking rhetoric of the Roosevelt administration. The U.S. government publicly blamed the banks for making unsound loans to Latin America, thereby shifting the fault and responsibility to lenders. This permitted the administration to deal softly (and covertly) with Southern

[993] Roubini (2005), p. 4.
[994] Lavelle (2005), pp. 2 & 28. Lavelle argues that constructivism fails to account for important material factors the influence the relations between sovereign debtors and creditors.

debtors, an approach which fostered politically desirable trade agreements in the run up to World War II. America's strategic goals in this period were largely achieved at the expense of its own bondholders, and the discourse of reckless loan-making helped frame the poor settlements bondholders were offered.

During the 1980s, the characterization of default was in some ways reminiscent of the 19th century. Debtors were to blame, but the failing was less moral than technocratic. Borrowing countries were accused of having pursued reckless economic policies, but fortunately there was a remedy - the implementation of market reforms and austerity programs under the auspices of IMF structural adjustment loans.[995] Underlying this discourse of reform and technocratic failure was the overriding necessity that creditor governments protect the solvency of their own banking systems. Therefore, a prescriptive remedy that gave rise to a lengthy rescheduling process served the interests of the main credit-exporting states. As the negotiations wore on, the world's major banks were given the breathing room they needed to replenish their capital.

With this as background, what observations can we make about productive power in today's regime? Although the current regime is evolving, it seems that productive power configurations in the current period bear some similarity to those in the interwar and post-war periods. Bondholders are believed to bear some of the blame for imprudent lending, and, as a result, creditor governments and the IMF have insisted that they be bailed-into the restructuring process. It may also be that the current crop of debt restructurings have taken place in the context of the public advancement of the Highly Indebted Poor Countries ("HIPC") Initiative, a proposal which sought the forgiveness of the unsustainable debt burdens of the world's poorest countries. While the middle-income developing countries covered in this study enjoy bond market access and would not qualify as HIPCs, they have often cloaked themselves in HIPC rhetoric to enhance their bargaining position with creditors. For instance, Argentina's President was reported to have announced publicly in February 2004 that paying more to bondholders "would be the equivalent of a genocide against the Argentine people."[996] Leaders in Bolivia and Ecuador have suggested that they might follow Argentina's lead and "expropriate

[995] Ferguson and Schularick (2006) have noted how IMF structural adjustment programs were not that dissimilar from the debt administrations of the 19th century.
[996] Helleiner (2005), p. 956. Statement from Argentina's President Kirchner.

property, renegotiate international contracts and default on their foreign debts."[997] In fact, the newly elected president of Ecuador, Rafael Correa, referred to his country's external debt as "illegitimate, adding that he might pursue his own 'Argentine-style' default."[998]

DeGoede (2005) argues that underlying most modern debtor-creditor power relations is a "strict regime of guilt and punishment"[999] For this reason, many creditor states initially resisted the HIPC Initiative. They believed that if borrowers were not properly punished for failing to repay debt, the resulting moral hazard would encourage continued fiscal irresponsibility. DeGoede believes that creditors approach troubled debtors in the same way that one approaches an "unruly child" or "credit card junkie;" they see sovereigns as agents that have been repeatedly warned about the dangers of debt accumulation, and yet they continue to borrow recklessly.[1000] As long as debtor states can be seen as solely responsible, they are the ones who must suffer the costs of a crisis, whether though economic dislocation, political upheaval, or adherence to austerity measures under IMF programs.

By comparison, the discourse of the HIPC Initiative and the Jubilee Debt campaign was one of *shared* responsibility – with debtor and creditor each bearing some of the cost in cases of unsustainable debt. This contrasts sharply to the debt regime of the 1980s and early 1990s. In fact, for the first time since the 1930s, western creditors were being asked to admit culpability for the part they played in making loans to developing countries. Ann Pettifor, of the Jubilee Debt Campaign, went so far as to ban the word "forgiveness" from the debt literature. According to Pettifor: "This would imply that the 'sin' of falling into debt was committed solely by elites in debtor countries. Rather, the elites of the more powerful nations are considered to co-responsible."[1001] At the Paris Club's 50th Anniversary Celebration, the Jubilee Debt Campaign, along with other NGO's, criticized the Club for "privileging creditors' interests" and doing little "to

[997] *Washington Times*, March 8, 2007.
[998] *Washington Times*, March 8, 2007. Despite Correa's rhetoric, he did make the scheduled debt service payment.
[999] DeGoede (2005), p. 157.
[1000] DeGoede (2005), p. 157.
[1001] DeGoede (2005), pp. 159-161.

guarantee a fair and transparent setting of sustainable outcomes for debt crisis resolution."[1002]

How relevant has the HIPC discourse been to debt restructurings for middle income countries? One sovereign debt advisor said: "It holds no weight with private creditors. They don't care."[1003] Others thought that the HIPC discourse may have had some marginal influence on bi-lateral (government) lenders in the Paris Club. And, since the Paris Club works on the principle of comparability of treatment, it is conceivable that incremental debt relief could start with the Paris Club and migrate though the private creditor base.[1004] However, we would clearly need a larger case sample of debt restructurings to reach a more definitive conclusion about the influence of HIPC discourse on bargaining outcomes.

Another question is why large defaulters have not availed themselves of the "odious debt" defence first articulated in the early 20th century by Alexander Sack, an international legal scholar. Under Sack's doctrine, a debt can be declared "odious" if the proceeds were not used by the state to serve the public interest. And, to the extent that private creditors were aware that their loans were being used for such potentially hostile purposes, their right to hold the state responsible for repayment is forfeited. In other words, once debts are declared to be "odious," a state and its citizenry cease being liable for them; the debts are transformed from a sovereign obligation to an obligation of the belligerent regime that originally contracted them.[1005] Despite the availability of this doctrine, Gelpern (2005b) observes that "no national or international tribunal has ever cited Odious Debt as grounds for invalidating a sovereign obligation."[1006] Why? Gelpern suggests that countries are in fact able to get better deals by sidestepping the doctrine and using the unilateral debt exchange or some other restructuring mechanism. This is because the international tribunals at the heart of the doctrine require a painstaking examination of each loan to establish how the funds were used and whether the creditors

[1002] Statement by 24 development NGOs including the Jubilee Debt Campaign, Christian Aid and Eurodad at the Paris Club 50th Anniversary Celebration on June 14, 2006.
[1003] Author Interview N.
[1004] Author Interview G.
[1005] Gelpern (2005b), p. 403.
[1006] Gelpern (2005b), p. 406.

were indeed complicit with the hostile regime.[1007] In other words, by today's standards, "it is an inefficient tool for securing quick debt relief."[1008] What Argentina and other sovereign debtors have learned is that the current market-based debt exchange offers them much greater flexibility in a sovereign debt negotiation, although they can still make use of the rhetoric of HIPC and the odious debt doctrine to influence public opinion and put pressure on private creditors.

7.5 Power and the Production of Bargaining Outcomes in Today's Markets

While today's debt restructuring regime remains a work in progress, we have been able to make a few observations, both relative to the 1980s regime and to our hypothesis that structural and compulsory power help to drive the formation and bargaining outcomes of sovereign debt restructuring regimes.

As banks relinquished control over the supply and distribution of credit in the early 1990s and the risk of solvency to the global financial system receded, sovereign debtors began to tap the global bond markets for their financing. Since bond investors were more widely dispersed and less organized than the banks, they found it difficult to speak with a common voice when it came to matters of sovereign debt restructuring. And, with hedge funds, institutional investors, pension funds and mutual funds all in a determined search for yield, the demand for emerging market sovereign debt in the 1990s surged. The result was a shift in structural power away from the homogenous bankers' cartel to a heterogeneous pool of bondholders. However, the lack of collective will on the part of bondholders made it easier for sovereigns to control the bargaining process. Settlement periods were dramatically cut when compared to previous eras, and haircuts were closer to the levels last seen in the 1930s. This is because sovereigns used their newly found advantage to design a debt management regime that reflected their interests and preferences. Mexico's 2003 benchmark bond issue buried the SDRM debate and helped standardize a series of debtor-friendly collective action clauses. The country set a lower threshold for majority amendment clauses than the one demanded by the G-10, and most sovereign issuers have followed Mexico's example. This means that the current

[1007] Adams (1991), Chapter 17.
[1008] Gelpern (2005b), p. 414. See also Salmon (2004b); Buchheit, Gulati et al. (2006); Adams (1991); and, Kremer and Jayachandran (2002).

trend in CACs has been to include majority amendment clauses but exclude majority representation and enforcement clauses, once again contravening recommendations made by creditor groups and falling far short of the optimizing solutions proposed by policymakers and academics.

The emerging regime of contractual, market-based, unilateral debt exchanges has permitted sovereigns to recapture some of the negotiating leverage they had lost in the 1980s. Yet, as we found in the 1980s, a regime that is designed on the basis of power is not necessarily a model of efficiency or equity. For example, even with the rising use of majority amendment clauses, it will be years before they are operative in most of the outstanding debt stock, at which point the problem of aggregation across creditor classes will remain unaddressed. Also, the framework for negotiation is still uncertain. After Argentina defaulted on its debt in 2001, bondholders had to wait more than three years before the country was willing and able to present them with an exchange offer. Lastly, the efficacy of the IIF's Principles - an attempt to advance the interests of creditors in the face of debtor power - has yet to be measured. Whether the Principles successfully guide the next crisis to a more orderly conclusion - or are completely ignored by debtor states - remains to be seen.

Not since the 1930s have sovereign debtors been accorded such support from officials of creditor states, something that can be illustrated not only by the case of the Mexican shift to CACs, but also by the process and settlement terms associated with the Argentine default. The unsympathetic disposition of creditor governments toward their own bondholders, coupled with changes to the IMF's lending into arrears policy, has made today's regime for sovereign debt management unfriendly, and sometimes even hostile, to the interests of private creditors. Perhaps today's investors would do well to remember Borchard's admonition over a half century ago to a generation of 1930s bondholders:

> He who contracts with the sovereign or the state has nothing but the state's honour and credit as a sanction...[T]he contract is...a gambling contract, depending for its performance entirely on the good faith and capacity of the debtor to pay.[1009]

[1009] Borchard and Wynne (1951a), p. 3.

Appendix 7A
Proponents of a Statutory Approach to Sovereign Debt Restructuring

G-77 (1977)	Proposed that creditors deal with sovereign debt problems in the broader context of development goals.[1010]
Oeschli (1981)	The first to propose a Chapter 11 framework for sovereign debt workouts. He argued that inefficiencies stemmed from poor coordination among private and official creditors.[1011]
Cohen (1989)	Proposed an International Debt Restructuring Agency ("IDRA") as an impartial intermediary established by multilateral convention as a joint subsidiary of the IMF/WB that would facilitate negotiations between debtors and creditors. The terms of relief would be decided by debtors and a qualified majority of creditors and would be enforced via cramdown.[1012]
Sachs (1995)	Argued that the IMF should shed its advisory role and act more like an international bankruptcy court. Recommended that private sector involvement take precedence over IMF official lending. Also argued that debt reduction needed to be more aggressive to all governments to re-establish solvency.[1013]
Chun (1996)	Recommended the creation of an International Bankruptcy Agency ("IBA"), under the IMF's umbrella, but separate and neutral. The IBA would force debtors and creditors to work together and overcome coordination problems. Chun suggested the use of Chapter 9 as a model. Argued that "a bankruptcy agency, not an emergency fund, is the more effective method for providing the fast, decisive action required to counter the extraordinary speed with which creditors can relocate their money worldwide."[1014]
Schwarcz (2000)	Argued that you should use ideas from international bankruptcy law. Suggested the adoption of a new international convention whereby: 1. A state can commence restructuring through a unilateral decision to suspend payments. 2. Debtor-in-possession financing is encouraged by granting priority. 3. Super-majority voting by each class of creditors would bind all the creditors to a plan of reorganization. 4. The IMF would play its customary role of surveillance but not act as a LOLR. 4. ICSID would be used for settlement disputes.[1015]
Clementi (2001)	Saw the key problem as debtor-creditor coordination and argued that it would be helpful to have recourse to a neutral mediator or even the IMF to arbitrate.[1016]
Krueger (2002)	Proposed a Sovereign Debt Restructuring Mechanism with features that included: i) an IMF-endorsed standstill; ii) super-majority voting, both within and across classes of debt; iii) an impartial and independent dispute resolution forum; and, iv) incentives for debtor-in-possession financing.[1017]

[1010] Rogoff and Zettelmeyer (2002).
[1011] Oechsli (1981).
[1012] Cohen (1989).
[1013] Sachs (1995).
[1014] Chun (1996), p. 2653.
[1015] Schwarcz (2000).
[1016] Clementi (2001).
[1017] Krueger (2002).

Cooper (2002)	Supported the IMF's proposal for an internationally sanctioned standstill on sovereign debt as something that would represent a modest improvement on existing financial arrangements. Argued that a plan to empower the IMF to issue SDRs in an emergency, under stringent conditions, would also represent some progress.[1018]
Cymot (2002)	Argued for a Chapter 9 (as opposed to a Chapter 11) approach to sovereign debt workouts since Chapter 9 is used for municipalities. It therefore recognizes the sovereign immunity of the state and its need to retain operational control over its financial decisions. He suggests that ICSID be used as an arbiter since it exists as a forum where 134 sovereigns resolve their business differences. ICSID has established credibility as a neutral forum for investors and sovereigns.[1019]
Miller (2002)	Argued that contractual and statutory approaches should be complementary and pursued along a parallel track. Believed that by keeping the threat of statutory intervention alive, it would motivate lawyers to write ingenious contracts for creditor coordination.[1020]
Bossone (2002)	Pro-SDRM, but argued that it should not be the primary vehicle for sovereign debt renegotiation – it should be a Phase II option. Phase I should consist of Private Sector Involvement ("PSI"). If PSI and the SDRM fail, then all-out-default would be the result. Since all-out default would carry the highest costs, the process would incentivize debtors to stay in Phases I and II.[1021]
White (2002)	Argued that contractual changes like CACs were unlikely to accomplish an orderly restructuring since they lack the features that are key to a more complete bankruptcy regime. CACs would not eliminate individual lawsuits, they would not give you a way to reconcile bondholder interests across bond issues or across classes of creditors, and they would not make up for the lack of new private loans after a default.[1022]
Griffith-Jones (2002)	Suggested the need for a "large and strong IMF" to provide financial assistance PLUS an institutional framework for standstills and orderly debt workouts along the lines suggested by Krueger [in the SDRM.][1023]
Miller and Zhang (2003)	Called for mandated standstills followed by a debt restructuring to avoid the problems of big bailouts.[1024]
Ghosal and Miller (2003)	Argued that the SDRM is a better alternative than CACs because a temporary stay on litigation is an important element in reducing the moral hazard associated with large IMF crisis loans. CACs, as currently structured, do not provide for this standstill.[1025]
Kroszner (2003)	Pointed out the benefits of some type of dispute resolution forum in addition to CACs. He believed that instead of the SDRM, we should "insert a clause into each debt instrument that would name a Forum as the venue for negotiation and resolution of sovereign debt claims. The Forum would operate akin to a

[1018] Cooper (2002).
[1019] Cymot (2002).
[1020] Miller (2002).
[1021] Bossone and Sdralevich (2002).
[1022] White (2002).
[1023] Griffith-Jones (2002).
[1024] Miller and Zhang (2003).
[1025] Ghosal and Miller (2003).

	domestic bankruptcy court in that a borrower could approach the Forum and request the initiation of proceedings of a restructuring."[1026]
IMF (2003c)	Argued that post-default, it would be best to work through a creditor committee and recommended the possible use of mediation and arbitration in a restructuring.[1027]
Sharma (2004)	Remained sceptical that CACs on their own would be sufficient to satisfactorily mediate debt crises. Instead, "a complementary approach that combines elements of both the CAC and the SDRM...has the potential to help reduce the unacceptably large costs associated with disorderly defaults by sovereign governments."[1028]
Ghosal (2005)	Maintained that strengthening CACs has limited efficacy. Argued instead that there is "a role for an appropriately designed formal sovereign bankruptcy mechanism, like the SDRM."[1029]
Miller and Thomas (2006b)	Argued that, in theory, bonds with CACs can be restructured to ensure engagement and aggregation, but in practice, the courts remain vital to the process. They see a future for sovereign debt restructuring that includes CACs and courts, aided by creditor committees and codes of conduct. In short, collective action clauses will not suffice; some judicial process will be required.[1030]

[1026] Kroszner (2003), p. 77.
[1027] International Monetary Fund (2003c).
[1028] Sharma (2004).
[1029] Ghosal and Thampanishvong (2005), p. 5.
[1030] Miller and Thomas (2006b).

Appendix 7B
Author Interviews

(A) January 27, 2005	Credit Officer for Latin America, Citibank, N.A. (1980s)
(B) January 28, 2005	International Monetary Fund Staff Member (2000s)
(C) January 30, 2005	Chief Credit Officer for Latin America, The Chase Manhattan Bank, N.A. (1980s)
(D) February 4, 2005	Head of Latin American Debt Research for a major European investment bank (1990s, 2000s)
(E) February 7, 2005	Head of Sovereign Debt Advisory Services for a major European investment bank (1990s, 2000s)
(F) February 9, 2005	Head of Emerging Markets Origination (Eastern Europe) for a major European investment bank (1990s, 2000s)
(G) February 11, 2005 March 13, 2007	Head of Emerging Markets Origination (Latin America) for a major European Bank (1990s, 200s)
(H) February 17, 2005 March 12, 2007	Former senior Mexican treasury official (2000s)
(I) March 5, 2005	Head of Capital Markets Credit for Bank of America – Asia (1990s)
(J) March 5, 2005	Head of Capital Markets for Deutche Bank – New York (2000s)
(K) March 8, 2005	Board Member of IPMA (International Primary Markets Association) (2000s)
(L) June 27, 2006	John Petty, President of Foreign Bondholders Protective Council
(M) October 19/20, 2006	Christian Suter, University of Neuchâtel, Switzerland
(N) March 9, 2007	Head of Sovereign Debt Advisory Services for a major U.S. consulting firm (2000s)
(O) March 15, 2007	Senior Official at the Institute of International Finance (2000s)
(P) March 19, 2007	Rating Agency Official (Standard and Poor's) (2000s)
(Q) April 23, 2007	Sovereign Debt Arbitration Specialist (2000s)
(R) April 26, 2007	Senior U.S. Treasury Official (2000s)

Chapter 8

Sovereign Debt Management: Implications for Theory and Policy

Once upon a time, long, long ago in a place far, far away, crisis prevention and crisis management were so straightforward that they could be delegated to macroeconomists.

Barry Eichengreen

8.1 Theoretical Implications: Beyond the Sanctions-Reputation Debate

While the regimes that have emerged over the centuries to resolve sovereign debt crises have been far from optimal, they have nonetheless produced a pattern of bargaining outcomes that begs the question: why have debtor states paid more to creditors in some periods than in others? By answering this question using our "four faces of power" analytical framework, this study has contributed to both the theoretical discussion of sovereign repayment incentives as well as the policy debate surrounding the efficacy of bondholder councils.

We suggested that the "sanctions vs. reputation" debate portrays these two sovereign repayment incentives as competing, although empirical data suggest that they operate contemporaneously. And, if sovereigns take both factors into account – the potential for creditor government sanctions and loss of market access – when weighing their default options, it is more useful to examine how they might operate jointly to produce a negotiating result. What we found in our case study chapters was that compulsory and structural power (our analytical equivalent of sanctions and reputation, respectively) tended to reinforce each other in each historical period, producing outcomes which were highly favourable to creditors in the 19th century and 1980s, and highly favourable to debtors in the interwar and post-war periods as well as today. Not only does the model account for the results, it also helps to explain the historical pattern of the outcomes.

Table 8A: Power and the Production of Bargaining Outcomes

Time Period	*Dominant Creditor Representative Body*	*Debt Forgiveness*	*Compulsory Power*	*Structural Power*
1871-1925	Corporation of Foreign Bondholders	15.9%	Favours creditors: Official sector provides moral suasion along with the threat of super-sanctions.	Favours creditors: Tightly controlled markets reward settlement with renewed access.
1926-1975	Foreign Bondholders Protective Council	55.9%	Favours debtors: U.S. government prioritizes deep haircuts for geo-political reasons and undermines negotiating position of bondholders.	Favours debtors: Private market collapse eliminates the "carrot" of renewed market access. Lending into arrears by official sector (U.S. govt. and IMF) further weakens bondholders.
1980-1997	The London Club	35%	Favours creditors: G-7 and IMF unite behind commercial banks to stave off systemic collapse. Debtor states are intimidated and threatened by official sector.	Favours creditors: Commercial banks and the IMF control credit access and coordinate lending. IMF refuses to "lend into arrears" until crisis passes for banking system.
1998-2005	Market-Based Debt Exchange	48.67%	Favours debtors: Creditor governments more sympathetic to the plight of debtor states, preferring to de-politicize the work-out process.	Favours debtors: Investors highly decentralized, and markets highly liquid and forgiving. IMF willing to "lend into arrears" for bank and bond debt, thereby diminishing creditor leverage.

Outcomes in the 1980-1997 period reflect the final terms of settlement offered under the Brady Plan and not the interim settlements reached under the multi-year rescheduling agreements.

8.1.1 The 19th Century and the 1980s: Outcomes Favour Creditors

In the 19th century, we argued that creditors achieved such favourable results principally because the British government was willing to employ a wide range of coercive devices –from moral suasion to military action – to positively impact their position. And, from a structural perspective, the large and highly controlled pool of 19th century British capital remained attractive enough to developing country debtors to force them into settlements, especially if they needed or wanted to regain market access.

In a similar vein, the 1980s London Club could rely on the supportive disposition of G-7 governments and the IMF while it negotiated with distressed sovereigns. In fact, intimidation and threats aimed at debtor states by creditor governments were as relevant in the 1980s as they were in the 19th century. Even the centralized market structure of the 19th century reappeared in the 1980s. The commercial banks (along with the IMF)

effectively controlled all lending to troubled debtors, and the banks' monopoly position afforded them considerable leverage in their London Club negotiations. Access to credit – including politically sensitive trade lines - could be blocked until lenders were satisfied with the settlement terms proffered by distressed sovereigns.

8.1.2 The Interwar/Post-War Periods and 1998-2005: Outcomes Favour Debtors

During the 1930s, the U.S. government interceded directly in sovereign debt negotiations, coercing bondholders to accept meagre settlements so that America's geo-strategic interests in the Western Hemisphere could be advanced. U.S. bondholders routinely subsidized their country's political ambitions, albeit without compensation. What influence did the 1930s markets exert on outcomes? Well, the private bond markets had collapsed and would not open again to emerging market sovereigns until the late 1980s. This meant that the sole source of credit during this period was official, lodged chiefly with the U.S. government, its agencies and the new multilateral financial institutions. The tendency of these credit suppliers to "lend into arrears" for political reasons materially impeded the settlement prospects of bondholders.

While the moribund markets of the 1930s could not be more different from the highly liquid and forgiving markets of today, they have nonetheless exerted a similar effect on sovereign repayment incentives. Since 1998, the wide dispersion of credit supply and the lack of bondholder collective will have made it easier for sovereigns to make aggressive, unilateral offers to creditors. Additionally, the global savings glut and the low interest rate environment in G-7 countries have made capital even more promiscuous as it searches out the higher yields promised by emerging markets bonds. As a result, countries that default can restructure and regain market access faster today than in previous periods, a state of affairs that has tended to push today's bargaining outcomes in favour of debtor states. However, structural power has not operated alone. Compulsory power in the form of creditor government intervention has amplified these good results. Today's creditor governments exhibit a more sympathetic disposition toward the plight of their fellow sovereigns in distress than they did in the 1980s. The case of Argentina illustrated the willingness of the Bush administration to assist a defaulting sovereign in its negotiations with the IMF, while at the same time refusing to consider requests for help

from its own private creditors. Apart from the case of Argentina, we have recounted several instances where the IMF has either triggered or encouraged sovereign defaults on bond debt in order to bring private investors into the restructuring process. Some have suggested that the choices made by the official sector have been fundamentally hostile to the interests of contemporary bondholders,[1031] as well as partly responsible for the deep haircuts observed since 1998.

By using a framework that allows for the simultaneous (and reinforcing) operation of structural and compulsory power, we have been able to better explain the variation in bargaining outcomes over four discrete historical periods since 1870. This approach has also allowed for comparisons that have not customarily been made - like the ones we have drawn between the 19th century and the 1980s, and between the 1930s and today.

8.2 Policy Implications: The Efficacy of Bondholder Councils

Our analytical framework has also enabled us to assess the independent effect of private creditor bodies on bargaining outcomes. As an element of institutional power, we have uncovered some surprising facts about these organizations. Most importantly, our study challenges the received wisdom about their contributions to the sovereign state-private creditor negotiation process. We contend that they have been either incorrectly credited – or blamed – for the bargaining outcomes produced concurrent with their operation. More specifically, we argued that the British CFBH, routinely praised for shortening default durations and increasing bondholder recoveries in the 19th century, would have been essentially powerless if it did not operate in an era dominated by British capital export and a sympathetic, activist government. Similarly, we maintain that the FBPC, often dismissed as a failed experiment, would have been judged more favourably by history had it not been consistently challenged by the State Department and the multilaterals during a period of private market collapse. Finally, we claim that the London Club, viewed nostalgically by today's market reformers as an idealized mechanism of creditor coordination, would never have held together without the heavy-handed exercise of control and coercion by the official sector and the mandated

[1031] Salmon (2004a).

coordination of private and official lending. In other words, over long historical periods, private creditors - even with institutional representation – are not chiefly responsible for producing bargaining outcomes in sovereign debt restructurings. These outcomes are driven instead by structural and compulsory regime elements that lay outside the institution. This finding has important relevance to the current debate concerning the resurrection of bondholder councils.[1032]

When the IIF published its *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets* in 2006, it called for "early and structured negotiations with a creditor committee," in the event of a sovereign debt crisis.[1033] Richard Portes has also advocated the creation of a new bondholder council to be labelled the "New York Club," and Rory MacMillan suggested that we resurrect the CFBH.[1034] Although these recommendations have gone unheeded for the moment, there appears to be a growing consensus, at least among the financial institutions represented by the IIF, that bondholders need some type of institutional representative. Our analysis of the sovereign debt management process over the past 135 years implies that the IIF should proceed with caution in this endeavour. If the goal is to create an organization that can positively influence distributional outcomes for bondholders, then the IIF (and its constituents) could very well be disappointed. As we have argued, any policy which calls for the resurrection of bondholder councils rests on an important misconception: that these councils were either singularly or even largely responsible for improving the historical bargaining outcomes for private creditors. We have found that these results were instead highly circumscribed by the structural and compulsory power configurations unique to each historical period. That being the case, any newly minted, 21st century bondholder council would find itself no match for today's promiscuous capital markets and the detached sentiment of the official sector.

Those who highlight the efficiency gains that can be reaped from the establishment of a new bondholder council are similarly challenged by our findings. The shortest average duration from default to settlement has been observed since 1998, when

[1032] Institute of International Finance (2007); Institute of International Finance (2006); MacMillan (1995a); Portes (2004).
[1033] Institute of International Finance (2006), pp. 14-17.
[1034] Portes (2004); MacMillan (1995a).

no bondholder council was in operation. Of course, one could argue that these institutions require some trade-off between fairness and efficiency. Yet, the experiences of the FBPC call that assumption into question as well. Beginning in the 1930s, the presence of the American bondholder council seemed to do very little to improve either settlement times or distributional outcomes for bondholders. The interwar and post-war periods recorded the longest durations for settlements and the deepest haircuts for investors. Even the 1980s London Club could not improve on the purported efficiency of the 19th century CFBH. One might, however, respond by saying that the British CFBH delivered something approximating a balance between fairness and efficiency. After all, an average settlement period of 6.3 years was not unimpressive in light of the limitations imposed by the communications technology and transport infrastructure of the time. Similarly, the 15.9% level of debt forgiveness was the best for creditors across all four periods. We would reply that these findings with respect to the CFBH provide only anecdotal evidence that bondholder councils can deliver improvements to the fairness and efficiency of the sovereign debt restructuring process. To draw a conclusion from that one era would require us to discard the conflicting evidence we have uncovered from investigating the remaining three eras. It would also ask us to set aside our conclusions about the significant impact the other regime elements had on bargaining outcomes. In summary, then, we believe it is necessary to question any contemporary policy recommendation for a resurrected bondholder council that regards such bodies as a route to faster and more equitable debt settlements.

8.3 Areas for Further Research

This study relied to a great extent on data collected by other sovereign debt researchers, and we are especially grateful to Dr. Christian Suter for providing us with his original data set for the period 1820 – 1975. This has permitted us to put the historical measurements (from 1820 – 1975) on a comparable basis with the post-1980 calculations. That being said, creating a unified data set was not the principal objective of this dissertation. It would therefore be extremely valuable if scholars could continue to improve on the available data by creating a single study from primary sources that was regularly updated and utilized a consistent collection methodology. It would also be

constructive if more work could be done on intra-period results for bondholders of different nationalities. This would permit researchers to better assess the connections between national interest and bargaining outcomes.

One of the goals of this dissertation was to provide a detailed analysis of the workings of the FBPC, an institution that has received little coverage in the academic literature. While we believe that Chapter 5 offers much in the way of original insight into the FBPC, it would nonetheless be useful to expand the available literature on this largely misunderstood organization. More specifically, our research in the FBPC archives could be supplemented by other primary sources, including the letters of Francis White, former President of the FBPC, and Herbert Feis, the principal State Department contact for the FBPC in its early years of operation. This type of supplemental research unfortunately exceeded the scope of our research project, but we believe that it would add a good deal to our understanding of the FBPC and the difficult environment in which it operated. There is also very little written about other bondholder councils – most notably those from France, Germany, and the Netherlands. It would be particularly useful to understand how these other councils operated and how they collaborated in negotiations with the CFBH and FBPC.

Our brief discussions of productive power in the case study chapters have highlighted an area of sovereign debt management that has received very little attention – notably the element of discursive power that is embedded in the debtor-creditor negotiation process. We believe that further study along critical constructivist lines that would link discourse and power in sovereign debt restructuring and build on the work done by Rosenberg (1999) and deGoede (2005) would be a welcome addition to the literature.[1035]

From a theoretical perspective, we would challenge other researchers to assess the utility of the "four faces of power" analytical framework. While we have found it to be valuable for our particular research agenda – specifically for the rigor it instilled into the collection and analysis of our historical data - we would be interested to know of its efficacy in other issue-areas of international relations and international political economy. The one drawback of the model we noted was the occasional difficulty of ascribing an

[1035] Rosenberg (1999); DeGoede (2005).

empirical finding to the correct power "basket." For instance, in Chapter 5, the question arose as to whether the installation of clearing arrangements against Germany by the British government represented an element of structural power – given the fact that the nature of the trade imbalance permitted such an arrangement – or compulsory power, since the UK government was making a deliberate policy decision that benefited British bondholders. We decided that the appropriate power characterization was "compulsory," since the UK government could have elected *not* to establish a clearing arrangement. By way of comparison, when the US government was asked by the FBPC to link the signing of new trade agreements with debt settlements, the US government refused. In both cases, it was the orientation of creditor government action (compulsory power) that was decisive; the structural elements simply presented the respective governments with a policy option.

Any drawbacks associated with using the framework were far outweighed by the benefits. First, the application of the model to our four empirical cases firmly planted our study within the realm of international relations and IPE theory, drawing on their rich tradition of research in regimes and power. Second, each element of power highlighted by the framework could be aligned quite closely with an aspect of the sovereign debt restructuring regime. Finally, the taxonomy is easily transferable to other areas of inquiry which means that, over time, its use could lead to improvements in existing social science theory or perhaps even the unification of certain elements embedded in different theoretical schools.[1036]

8.4 Sovereign Debt Management and the Implications for Global Finance Governance

Finally, we want to look at what sovereign debt management can teach us about global financial governance more broadly. Given that these regimes are hybrids – having both public and private elements – we hoped that our framework would make the actions of private actors more visible. Did lenders, for example, use public goods for private benefit? Did they press their own governments into action to improve their bargaining

[1036] Fuchs (2005a); Fuchs (2005b). It is also important to note that our approach bears some similarity to the one proposed by Doris Fuchs (2005a, 2005b) to analyze the impact of private business interests on rule-making in global governance. While Fuchs adopts a three-pronged model encompassing instrumental, structural, and discursive power, our model goes one step further, offering scholars the opportunity to examine the independent impact of institutional sources of power.

positions with sovereign debtors? How might they have influenced the decision-making of the IMF in post-default situations?

Private actors – more specifically bankers and investors – have often found themselves criticized for skewing the rules of global finance in their favour. For instance, Stiglitz (2002) argued that "the institutions of global economic governance are no longer directly accountable to the public, but are politically and ideologically predisposed towards bankers and investors from the major capitalist countries."[1037] Scholte (2002) has gone so far as to argue that the rules governing global finance have become self-referential, such that "finance becomes an end in its own right rather than a means to general material betterment."[1038] Backing these arguments with empirical evidence, Hurrell (2005) observed that after the Asian crisis had subsided (and the world's major financial institutions were stabilized), much of the talk about reforms to the international financial architecture "slipped off Washington's agenda," despite the fact that developing countries remained at considerable risk.[1039] In other words, it appeared that the governance of global finance needed reform only to the extent that banks and investors in the industrialized world needed protection. It is therefore not surprising that the rules governing global finance are often accused of failing to meet the goals of equity and social justice, especially when there were times – like the 19th century and the 1980s - when they appeared to cater largely to private and commercial interests.

Our findings with respect to the development and operation of sovereign debt regimes were therefore surprising in this context. We expected to observe much more in the way of blatant private influence over public decision-making. What we found instead was that, despite considerable effort on the part of private creditors, the exercise of their home government's power was largely confined to those cases where there was an alignment of public and private interest. For example, the employment of super-sanctions in the 19th century – illustrated best by the cases of Turkey, Egypt and Venezuela - was closely linked to the enhancement of British geo-strategic interests. Similarly, Whitehall's decision to install clearing arrangements with Germany in the interwar period was designed to boost declining British national income. And, in America, the refusal of

[1037] Rupert (2005), p. 207. See also Stiglitz (2002).
[1038] Scholte (2002), pp. 197-199.
[1039] Hurrell (2005), pp. 41-42.

the Roosevelt administration to countenance repeated requests for help from the FBPC came at a time when public and private interests were in conflict. It was not until those interests coincided again in the 1980s – with the threatened collapse of the commercial banking system – that we observed renewed official sector involvement. However, it is important to note that when the interests of creditor governments and private lenders did historically align, the dynamic of the regime was altered such that private creditors benefited and their bargaining outcomes improved. But, since investors lacked control over the context in which national interests were created, they had to remain opportunistic and find ways to link their plight to some larger, national objective whenever possible.

Private actors have also had little influence over the structure and condition of the capital markets, although they were able to benefit from particular market configurations. For instance, when markets were highly controlled in the 19th century and 1980s, creditors were successful in creating rules to bar defaulters and limit access. However, they could not always block access to all available capital. Competing global exchanges and differing national priorities made that impossible, and bi-lateral and multi-lateral lending would generally flow with the sentiments of the official sector. So, as with compulsory power, the structural power elements of the larger regime favoured private lenders only intermittently.

This implies that debtor states have also managed to capitalize on certain power configurations to improve their bargaining results. As we demonstrated in Chapter 7, emerging markets borrowers have thus far succeeded in altering the rules of today's regime and pushing outcomes in their favour by taking advantage of the wider dispersion of yield-hungry investors and the relative detachment of the official sector. So, while debtor states are often portrayed as rule-takers or even "victims" in matters relating to global finance, our analysis has shown that this depiction is not entirely accurate. In fact, since 2001, there have been no major emerging markets financial crises. This is because developing countries have taken determined steps to shield themselves from economic distress by adopting flexible exchange rates, building reserves, developing local currency capital markets, and pursuing prudent fiscal policies. The result is that developing

countries are now net *exporters* of capital.[1040] Their governments appear to have concluded that the best defence against future financial dislocation is a good offence.

Since sovereign debt restructuring more closely resembles a zero-sum bargaining game, it may not be directly comparable to other areas of global financial governance that emphasize cooperation. However, even in matters that can be painted as cooperative - like global financial regulation - it is possible to observe power at work. For example, Basle I, which was meant to strengthen the capital bases of global commercial banks, relied to an important extent on US and UK market (i.e., structural) power for its adoption.[1041] Additionally, if we look at the IMF's creation of financial market standards – like ROSC and SDDS – it is hard to ignore the role played by compulsory power.[1042] By choosing to publish a country's level of compliance with these standards on its website, the IMF was essentially coercing member states to adopt them and observe them as closely as possible. Finally, there are likely to be issue-areas in global financial governance where outcomes are more heavily dependent on productive power. Therefore, it may be useful to examine how various aspects of power contribute to outcomes more broadly in global financial governance, regardless of whether cases are seen as primarily redistributive or cooperative.

Although private capital might have some power when it enters a country, it seems to be relatively powerless when it tries to exit.[1043] As Stiglitz and Hurrell pointed out earlier, the rules of global financial governance in certain issue-areas seem to favour private interests, but we have found that the rules regarding post-default settlement have not been as consistent – they have favoured private creditors in some periods and sovereign debtors in others. The tipping point seems to be the role played by creditor governments in the workout process and the availability of capital – either private or official – to distressed or recovering debtors. And, these two elements have managed to reinforce one another over the past 135 years. That being the case, we would argue that sovereign debt management is one area of global financial governance where the interests

[1040] *Financial Times*, February 9, 2007, p. 13.
[1041] Oatley and Nabors (1998). See also Simmons (2001).
[1042] ROSC: Reports on Observance of Standards and Codes; SDDS: Special Data Dissemination Standards.
[1043] Mosley (2000). Mosley asserts that private capital has more power to dictate policy to emerging market governments than to developed county governments, since a broader array of economic indicators are scrutinized by emerging market investors.

of private lenders are less likely to enjoy uninterrupted prominence, being constrained instead by the expediencies of national interest and the systemic configuration of the international financial markets.

PRIMARY SOURCES

Archives of the Corporation of Foreign Bondholders, Guildhall Library, City of London, United Kingdom

Archives of the Foreign Bondholders Protective Council, Green Library Special Collections, Stanford University, California

Annual Reports of the Council of the Corporation of Foreign Bondholders (1873-1987)

Annual Reports of the Foreign Bondholders Protective Council (1936-1977)

BIBLIOGRAPHY

Adams, P. (1991). Odious Debts: Loose Lending, Corruption and the Third World's Environmental Legacy. London, Earthscan Publishing.

Adamson, M. R. (2002). "The Failure of the Foreign Bondholders Protective Council Experiment: 1934-1940." Business History Review(76): 479-514.

Adamson, M. R. (2005). ""Must We Overlook All Impairment of Our Interests?" Debating the Foreign Aid Role of the Export-Import Bank, 1934-1941." Diplomatic History(29/4): 589-623.

Adamson, M. R. (2006). "Debating Sovereign Bankruptcy: Postrevolutionary Mexico, 1919-1931." Financial History Review(13/2): 197-215.

Adler, E. (1997). "Seizing the Middle Ground: Constructivism in World Politics." European Journal of International Relations(3/3): 319-363.

Aggarwal, V. (1987). International Debt Threat. Berkeley, University of California.

Aggarwal, V. (1989). Interpreting the History of Mexico's External Debt Crisis. The International Debt Crisis in Historical Perspective. B. Eichengreen and P. Lindert. Cambridge, The MIT Press: 140-187.

Aggarwal, V. (1996). Debt Games: Strategic Interaction in International Debt Rescheduling. Cambridge, Cambridge University Press.

Aggarwal, V. and B. Granville, Eds. (2003). Sovereign Debt: Origins, Crises and Restructuring. London, Royal Institute of International Affairs.

Armella, P. A., R. Dornbusch, et al., Eds. (1983). Financial Policies and the World Capital Market: The Problem of Latin American Countries. Chicago, The University of Chicago Press.

Aronson, J. D. (1979). The Politics of Private Bank Lending and Debt Renegotiations. Debt and the Less Developed Countries. J. D. Aronson. Boulder, Westview Press: 283-315.

Bachrach, P. (1962). "Two Faces of Power." The American Political Science Review(56/4): 947-952.

Bachrach, P. and M. S. Baratz (1963). "Decisions and Non-Decisions: An Analytical Framework." The American Political Science Review(57/3): 632-642.

Baldwin, D. A. (2002). Power and International Relations. Handbook of International Relations. W. Carlsnaes, T. Risse and B. A. Simmons. London, Sage Publications Ltd.: 177-191.

Barnett, M. and R. Duvall (2005). "Power in International Politics." International Organization(59): 39-75.

Barnett, M. and M. Finnemore (2004). Rules for the World: International Organizations in Global Politics. Ithaca, Cornell University Press.

Bayne, N. and S. Woolcock (2003). The New Economic Diplomacy. Hampshire, Ashgate Publishing Limited.

Becker, T., A. Richards, et al. (2001). "Bond Restructuring and Moral Hazard: Are Collective Action Clauses Costly?" IMF Working Paper(01/92).

Best, J. (2004). "Hollowing Out Keynesian Norms: How the Search for a Technical Fix Undermined the Bretton Woods Regime." Review of International Studies(30): 383-404.

Best, J. (2005). The Limits of Transparency: Ambiguity and the History of International Finance. Ithaca, Cornell University Press.

Biersteker, T. J. (1993). International Financial Negotiations and Adjustment Bargaining: An Overview. Dealing With Debt: International Financial Negotiations and Adjustment Bargaining. T. J. Biersteker. Boulder, Westview Press: 1-15.

Biersteker, T. J. and R. B. Hall (2002). Private Authority as Global Governance. The Emergence of Private Authority in Global Governance. R. B. Hall and T. Biersteker. Cambridge, Cambridge University Press: 203-222.

Birdsall, N. and J. Williamson (2002). Delivering on Debt Relief: From IMF Gold to New Aid Architecture. Washington, D.C., Institute for International Economics.

Blustein, P. (2005). And the Money Kept Rolling In (And Out): Wall Street, The IMF and the Bankrupting of Argentina. New York, Public Affairs.

Bogdanowicz-Bindert, C. A., Ed. (1989). Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. New York, Harper and Row.

Bolton, P. and O. Jeanne (2005). "Structuring and Restructuring Sovereign Debt: The Role of Seniority." National Bureau of Economic Research Working Paper(11071).

Borchard, E. M. and W. H. Wynne (1951a). State Insolvency and Foreign Bondholders, Volume I. New Haven, Yale University Press.

Borchard, E. M. and W. H. Wynne (1951b). State Insolvency and Foreign Bondholders, Volume II. New Haven, Yale University Press.

Bordo, M., B. Eichengreen, et al. (1998). "Was There Really an Earlier Period of Financial Integration Comparable to Today?" NBER Working Paper(6738).

Bordo, M. and H. James (2000). "The International Monetary Fund: Its Present Role in Historical Perspective." NBER Working Paper(7724).

Borensztein, E., M. Chamon, et al. (2004). "Sovereign Debt Structures for Crisis Prevention." IMF Occasional Paper(237).

Bossone, B. and C. Sdralevich (2002). "The New Approach to Sovereign Debt Restructuring: Setting the Incentives Right." IMF Working Paper(03/134).

Boughton, J. (2001). Silent Revolution: The International Monetary Fund, 1979-1989. Washington, D.C., International Monetary Fund.

Boughton, J. (2004). "The IMF and the Force of History: Ten Events and Ten Ideas That Have Shaped the Institution." IMF Working Paper(04/75).

Bourdieu, P. (1991). Language and Symbolic Power. Cambridge, Polity Press.

Bowe, M. and J. Dean (1997). "Has the Market Solved the Sovereign Debt Crisis?" Princeton Studies in International Finance(83): 1-70.

Brandt Commission (1980). North-South: A Program for Survival. Cambridge, The MIT Press.

Brown, C. I. (1983). Sovereign Debt: How Should It Be Treated in the Accounts? The Need for a Coherent International Approach. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Brown, R. P. C. and T. J. Bulman (2006). "The Evolving Role of the Clubs in the Management of International Debt." International Journal of Social Economics(33/1): 11-32.

Broz, J. L. (1997). The Domestic Politics of International Monetary Order: The Gold Standard. Contested Social Orders and International Politics. D. Skidmore. Nashville, Vanderbilt University Press: 53-91.

Buchheit, L. (2003). Sovereign Debtors and their Bondholders. United Nations Institute for Training and Research, New York.

Buchheit, L. (2005-2006). "The Role of the Official Sector in Sovereign Debt Workouts." Chicago Journal of International Law(6): 333-344.

Buchheit, L. and G. M. Gulati (2000). "Exit Consents in Sovereign Bond Exchanges." UCLA Law Review(48): 59-84.

Buchheit, L. and G. M. Gulati (2002). "Sovereign Bonds and the Collective Will." Emory Law Journal(51/4): 1318-1363.

Buchheit, L., G. M. Gulati, et al. (2003). The Pari Passu Clause in Sovereign Debt Instruments: Available at http://www.law.georgetown.edu/international/documents/Pam.pdf. Last accessed March 25, 2005.

Buchheit, L., G. M. Gulati, et al. (2006). "The Dilemma of Odious Debts." Duke Law School Working Paper Series(49).

Bulow, J. (2002). "First World Governments and Third World Debt." Brookings Papers on Economic Activity(1): 229-255.

Bulow, J. and P. Klemperer (1996). "Auctions Versus Negotiations." The American Economic Review(86/1): 180-194.

Bulow, J. and K. Rogoff (1989a). "A Constant Recontracting Model of Sovereign Debt." Journal of Political Economy(97/1): 155-178.

Bulow, J. and K. Rogoff (1989b). Multilateral Negotiations for Rescheduling Developing Country Debt. Analytical Issues in Debt. J. A. Frenkel, M. P. Dooley and P. Wickham. Washington, D.C., International Monetary Fund: 194-207.

Bulow, J. and K. Rogoff (1989c). "Sovereign Debt: Is to Forgive to Forget?" American Economic Review(79): 43-50.

Buria, A., C. Welch, et al. (2004). Do Developing Countries Have a Say at the IMF?: Transcript of an IMF Book Forum, February, 5. Available at http://www.imf.org/external/np/tr/204/tr040205.htm. Last accessed April 2, 2005.

Cardoso, E. and R. Dornbusch (1989). Brazilian Debt Crises: Past and Present. The International Debt Crisis in Historical Perspective. B. Eichengreen and P. H. Lindert. Cambridge, The MIT Press.

Carlsnaes, W., T. Risse, et al., Eds. (2002). Handbook of International Relations. London, Sage Publications Ltd.

Carr, E. H. (1964 [1981]). The Twenty Years' Crisis, 1919-1939: An Introduction to the Study of International Relations. Hampshire, Palgrave.

Chang, R. (1995). "Private Investment and Sovereign Debt Negotiations." International Economic Review(36/2): 387-405.

Chui, M. and P. Gai (2005). Private Sector Involvement and International Financial Crises: An Analytical Perspective. Oxford, Oxford University Press.

Chun, J. H. (1996). "Post-Modern Sovereign Debt Crises: Did Mexico Need an International Bankruptcy Forum?" Fordham Law Review(64): 2647-2700.

Clavin, P. (2003). Money Talks: Competition and Cooperation with the League of Nations, 1929-40. Money Doctors: The Experience of International Financial Advising, 1850-2000. M. Flandreau. London, Routledge: 219-248.

Clementi, D. (2001). "Debt Workouts for Corporates, Banks and Countries: Some Common Themes." Financial Stability Review(December): 203-210.

Cline, W. (1983). International Debt and Stability of the World Economy. Washington, D.C., Institute for International Economics.

Cline, W. (1995). International Debt Reexamined. Washington, D.C., Institute for International Economics.

Cline, W. (2003). The Role of the Private Sector in Resolving Financial Crises in Emerging Markets. Economic and Financial Crises in Emerging Market Countries. M. Feldstein. Chicago, University of Chicago Press: 459-496.

Cohen, B. (1986a). In Whose Interest? International Banking and American Foreign Policy. New Haven, Yale University Press.

Cohen, B. (1986b). International Debt and Linkage Strategies: Some Foreign Policy Implications for the United States. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 127-155.

Cohen, B. (1989). "A Global Chapter 11?" Foreign Policy(75): 109-128.

Cohen, B. (1998). The Geography of Money. Ithaca, Cornell University Press.

Cohen, D. (1991). Private Lending to Sovereign States: A Theoretical Autopsy. Cambridge, The MIT Press.

Cole, H. L., J. Dow, et al. (1995). "Default, Settlement and Signalling: Lending Resumption in a Reputational Model of Sovereign Debt." International Economic Review(36/2): 365-385.

Cooper, R. (2002). "Chapter 11 for Countries?" Foreign Affairs(81/4): 90-103.

Cooper, R. and J. Sachs (1985). Borrowing Abroad: The Debtor's Perspective. International Debt and the Developing Countries. G. W. Smith and J. T. Cuddington. Washington, D.C., International Bank for Reconstruction and Development: 21-60.

Copeland, D. C. (2000). "The Constructivist Challenge to Structural Realism." International Security(25/2): 187-212.

Corden, M. (1988). "Debt Relief and Adjustment Incentives." IMF Staff Paper(35/4): 628-643.

Corden, M. (1989). An International Debt Facility? Analytical Issues in Debt. J. A. Frenkel, M. P. Dooley and P. Wickham. Washington, D.C., International Monetary Fund: 151-171.

Corden, M. and M. P. Dooley (1989). Issues in Debt Strategy: An Overview. Analytical Issues in Debt. J. A. Frenkel, M. P. Dooley and P. Wickham. Washington, D.C., International Monetary Fund: 10-37.

Cornelli, F. and L. Felli (1995). The Theory of Bankruptcy and Mechanism Design. Crisis? What Crisis? Orderly Workouts for Sovereign Debtors. B. Eichengreen and R. Portes. London, Centre for Economic Policy Research: 71-85.

Cox, R. W. (2004). Social Forces, States and World Orders: Beyond International Relations Theory. Global Governance: Critical Concepts in Political Science, Volume I. T. Sinclair. London, Routledge: 11-47.

Cuddington, J. T. and G. W. Smith (1985). International Borrowing and Lending: What Have We Learned from Theory and Experience? International Debt and the Developing Countries. G. W. Smith and J. T. Cuddington. Washington, D.C., International Bank for Reconstruction and Development: 3-17.

Cutler, A. C. (2002). Private International Regimes and Interfirm Cooperation. The Emergence of Private Authority in Global Governance. R. B. Hall and T. Biersteker. Cambridge, Cambridge University Press: 23-40.

Cutler, A. C., V. Haufler, et al. (2004). Private Authority and International Affairs. Global Governance: Critical Concepts in Political Science, Volume III. T. Sinclair. London, Routledge: 319-342.

Cymot, M. (2002). "Why Lenders Should Back Sovereign Bankruptcy Rules." International Financial Law Review(21/10): 19-21.

Dahl, R. (1957). "The Concept of Power." Behavioral Science(2/3): 201-215.

Damill, M., R. Frankel, et al. (2005). The Argentinian Debt: History, Default and Restructuring: Available at http://www0.gsb.columbia.edu/ipd/pub/SDR_Argentina_English_Revised_9_5_05.pdf. Last accessed October 10, 2005.

Dammers, C. (1984). A Brief History of Sovereign Defaults and Rescheduling. Default and Rescheduling: Corporate and Sovereign Borrowers in Difficulty. D. Suratgar. London, Euromoney Publications: 77-84.

D'Arista, J. (1979). Private Overseas Lending: Too Far, Too Fast? Debt and the Less Developed Countries. J. D. Aronson. Boulder, Westview Press: 57-101.

Davis, R. (1992). Coping with "Fatigue" in the Debt-Restructuring Process. Current Legal Issues Affecting Central Banks. R. C. Effros. Washington, D.C., International Monetary Fund: 147-153.

DeGoede, M. (2005). Virtue, Fortune, and Faith: A Genealogy of Finance. Minneapolis, University of Minnesota Press.

DeLong, J. B., R. Cooper, et al. (1999). "Financial Crises in the 1890's and the 1990's: Must History Repeat?" Brookings Papers on Economic Activity(2): 253-294.

Devlin, R. (1989). Debt and Crisis in Latin America: The Supply Side of the Story. Princeton, Princeton University Press.

Dhillon, A., J. Garcia-Fronti, et al. (2006). "Debt Restructuring and Economic Recovery: Analysing the Argentine Swap." The World Economy(29/4): 377-398.

Diaz-Alejandro, C. F. (1983). Stories of the 1930s for the 1980s. Financial Policies and the World Capital Market: The Problem of Latin American Countries. P. A. Armella, R. Dornbusch and M. Obstfeld. Chicago, University of Chicago Press.

Diaz-Alejandro, C. F. (1984). "Latin American Debt: I Don't Think We Are in Kansas Anymore." Brookings Papers on Economic Activity(2): 335-404.

Diwan, I. and D. Rodrik (1992). "Debt Reduction, Adjustment Lending, and Burden Sharing." NBER Working Paper(4007).

Dixon, L. and D. Wall (2000). "Collective Action Problems and Collective Action Clauses." Financial Stability Review(June): 142-151.

Dooley, M. P. (1989). Market Valuation of External Debt. Analytical Issues in Debt. J. A. Frenkel, M. P. Dooley and P. Wickham. Washington, D.C., International Monetary Fund: 75-82.

Dooley, M. P. (1994). "A Retrospective on the Debt Crisis." National Bureau of Economic Research Working Paper(4963).

Dornbusch, R. and S. Marcus, Eds. (1991). International Money and Debt: Challenge for the World Economy. San Francisco, International Center for Economic Growth.

Drage, J. and C. Hovaguimian (2004). "Collective Action Clauses: An Analysis of Provisions Included in Recent Sovereign Bond Issues." Financial Stability Review Working Paper(November).

Eaton, J. and M. Gersovitz (1981). "Debt with Potential Repudiation: Theory and Estimation." Review of Economic Studies(48): 289-309.

Eaton, J., M. Gersovitz, et al. (1986). "The Pure Theory of Country Risk." European Economic Review(30): 481-513.

Effros, R. C., Ed. (1992). Current Legal Issues Affecting Central Banks. Washington, D.C., International Monetary Fund.

Eichengreen, B. (1991). "Historical Research in International Lending and Debt." The Journal of Economic Perspectives(5/2): 146-169.

Eichengreen, B. (1996). Globalizing Capital: A History of the International Monetary System. Princeton, Princeton University Press.

Eichengreen, B. (1999). Toward a New International Financial Architecture: A Practical Post-Asia Agenda. Washington, D.C., Institute for International Economics.

Eichengreen, B. (2000). "Can the Moral Hazard Caused by IMF Bailouts Be Reduced?" Geneva Reports on the World Economy Special Report 1(August).

Eichengreen, B. (2002). Financial Crises and What To Do About Them. Oxford, Oxford University Press.

Eichengreen, B. and A. Fishlow (1996). Contending with Capital Flows: What is Different About the 1990's? New York, Council on Foreign Relations.

Eichengreen, B., K. Kletzer, et al. (2005). "The IMF in a World of Private Capital Markets." NBER Working Paper(11198).

Eichengreen, B. and P. Lindert, Eds. (1989). The International Debt Crisis in Historical Perspective. Cambridge, The MIT Press.

Eichengreen, B. and A. Mody (2000). "Would Collective Action Clauses Raise Borrowing Costs? An Update and Additional Results." National Bureau of Economic Research Working Paper(7458).

Eichengreen, B. and A. Mody (2001). "Bail-Ins, Bailouts and Borrowing Costs." IMF Staff Paper(47/3): 155-188.

Eichengreen, B. and A. Mody (2003). "Is Aggregation a Problem for Sovereign Debt Restructuring?" Centre for Economic Policy Research Discussion Paper(3771).

Eichengreen, B. and M. Mussa (1998). Capital Account Liberalization: Theoretical and Practical Aspects. Washington, D.C., The International Monetary Fund.

Eichengreen, B. and R. Portes (1986). "Debt and Default in the 1930's: Causes and Consequences." European Economic Review(30): 599-640.

Eichengreen, B. and R. Portes (1989). After The Deluge: Default, Negotiation and Readjustment During the Interwar Years. The International Debt Crisis in Historical Perspective. B. Eichengreen and P. Lindert. Cambridge, The MIT Press: 12-47.

Eichengreen, B. and R. Portes, Eds. (1995). Crisis? What Crisis? Orderly Workouts for Sovereign Debtors. London, Centre for Economic Policy Research.

English, W. B. (1996). "Understanding the Costs of Sovereign Default: American State Debts in the 1840's." The American Economic Review(86/1): 259-275.

Esteves, R. P. (2005). Quis custodiet quem? Sovereign Debt and Bondholders' Protection Before 1914. Berkeley, University of California, Berkeley. Unpublished manuscript.

Feis, H. (1950). The Diplomacy of the Dollar: First Era, 1919-1931. Baltimore, The John Hopkins Press.

Feldstein, M. (2002). "Argentina's Fall." Foreign Policy(81/2): 8-13.

Feldstein, M., Ed. (2003). Economic and Financial Crises in Emerging Market Countries. Chicago, University of Chicago Press.

Ferguson, N. and M. Schularick (2006). "The Empire Effect: The Determinants of Country Risk in the First Age of Globalization, 1880-1913." Journal of Economic History(66/2): 283-312.

Fernandez, R. and S. Ozler (1997). "Debt Concentration and Bargaining Power: Large Banks, Small Banks and Secondary Prices." Centre for Economic Policy Research Discussion Paper(1655).

Fernandez, R. and R. W. Rosenthal (1990). "Strategic Models of Sovereign Debt Renegotiations." The Review of Economic Studies(57/3): 331-349.

Ferrer, A. (1983). Vivir con Lo Nuestro (Living on Our Own). Buenos Aires, El Cid.

Finnemore, M. and K. Sikkink (1998). "International Norm Dynamics and Political Change." International Organization(52/4): 887-917.

Finnemore, M. and K. Sikkink (2001). "Taking Stock: The Constructivist Research Program in International Relations and Comparative Politics." Annual Review of Political Science(4): 391-416.

Fischer, S. (1999). "On the Need for an International Lender of Last Resort." Journal of Economic Perspectives(13/4): 85-104.

Fischer, S. (2004). "Financial Crises: Review of Eichengreen and Tirole." Journal of Economic Literature(42/4): 1094-1097.

Fishlow, A. (1986). Lessons from the Past: Capital Markets During the 19th Century and the Interwar Period. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 37-93.

Fishlow, A. (1989). Conditionality and Willingness to Pay: Some Parallels from the 1890's. The International Debt Crisis in Historical Perspective. B. Eichengreen and P. Lindert. Cambridge, The MIT Press: 86-105.

Flandreau, M., Ed. (2003). Money Doctors: The Experience of International Financial Advising, 1850-2000. London, Routledge.

Flandreau, M., J. LeCacheux, et al. (1998). "Stability Without a Pact? Lessons from the European Gold Standard, 1880-1914." Economic Policy(April): 117-162.

Flandreau, M. and N. Sussman (2004). "Old Sins: Exchange Rate Clauses and European Foreign Lending in the 19th Century." Centre for Economic Policy Research Discussion Paper(4248,).

Foot, R., S. N. MacFarlane, et al., Eds. (2003). U.S. Hegemony and International Organizations. Oxford, Oxford University Press.

Foreign Bondholders Protective Council (1936-1977). Annual Report.

Foreign Bondholders Protective Council (1941-1944). Annual Report.

Fox, F. W. (1980). J.Reuben Clark: The Public Years. Provo, Brigham University Press.

Franks, J. (1995). Some Issues in Sovereign Debt and Distressed Reorganizations. Crisis? What Crisis? Orderly Workouts for Sovereign Debtors. B. Eichengreen and R. Portes: 89-117.

Frenkel, J., M. P. Dooley, et al., Eds. (1989). Analytical Issues in Debt. Washington, D.C., International Monetary Fund.

Frenkel, J. and N. Roubini (2003). The Role of Industrial Country Policies in Emerging Market Crises. Economic and Financial Crises in Emerging Market Economies. M. Feldstein: 155-278.

Fuchs, D. (2005a). "Commanding Heights? The Strength and Fragility of Business Power in Global Politics." Millennium Journal of International Studies(33/3): 771-801.

Fuchs, D. (2005b). Understanding Business Power in Global Governance. Baden-Baden, Germany, NomosVerlagsgesellschaft.

Garten, J. E. (1982). "Rescheduling Sovereign Debt: Is There a Better Approach?" World Economy(5/3): 279-289.

Geldart, C. and P. Lyon (1981). "The Group of 77: A Perspective View." International Affairs(57/1): 79-101.

Gelos, R. G., R. Sahay, et al. (2003). "Sovereign Borrowing by Developing Countries: What Determines Market Access?" IMF Working Paper(03/xx).

Gelpern, A. (2004). "Building a Better Seating Chart for Sovereign Restructurings." Emory Law Journal(53): 1115-1158.

Gelpern, A. (2005a). "After Argentina." Institute for International Economics Policy Brief(PB05-2).

Gelpern, A. (2005b). "What Iraq and Argentina Might Learn from Each Other." Chicago Journal of International Law(6/1): 391-414.

Gelpern, A. and G. M. Gulati (2007). Public Symbol in Private Contract: A Case Study: Unpublished manuscript.

Ghosal, S. and M. Miller (2003). "Coordination Failure, Moral Hazard and Sovereign Bankruptcy Procedures." Centre for Economic Policy Research Discussion Paper(3729).

Ghosal, S. and K. Thampanishvong (2005). "Sovereign Debt Crisis: Coordination, Bargaining and Moral Hazard." Centre for the Study of Globalisation and Regionalisation Working Paper(159/05).

Gibbs, N. (1984). "A Regional Bank's Perspective: An Analysis of the Differences and Similarities in the U.S. Banking Community's Approach to and Participation in the Mexican Restructuring." Columbia Journal of Transnational Law(23): 11-28.

Gill, S. R. and D. Law (1989). "Global Hegemony and the Structural Power of Capital." International Studies Quarterly(33/4): 475-499.

Gilpin, R. (2002). A Realist Perspective on International Governance. Governing Globalization: Power, Authority and Global Governance. D. Held and A. McGrew. Cambridge, Blackwell Publishers Ltd.: 237-248.

Global Credit Solutions (2006). Sovereign Advisors: China's Unfair Advantage. Global Credit Solutions - Credit and Collection News: Available at http://www.gcs-group.com/printcreditnews.asp?newsid=603. Last accessed April 25. 2006.

Goldstein, M. (2003). IMF Structural Programs. Economic and Financial Crises in Emerging Market Economies. M. Feldstein. Chicago, University of Chicago Press: 363-437.

Goodman, J. and L. Pauly (1993). "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets." World Politics(46/1): 50-82.

Gordon, C., Ed. (1980). Power/Knowledge: Selected Interviews and Other Writings, 1972-1977, Michel Foucault. Hemel Hempstead, The Harvester Press Ltd.

Gould, E. (2003). "Money Talks: Supplementary Financiers and International Monetary Fund Conditionality." International Organization(57/3): 551-586.

Gray, R. (2003). Bailouts, Moral Hazard and Burden Sharing. Sovereign Debt: Origins, Crises and Restructuring. V. Aggarwal and B. Granville. London, Royal Institute of International Affairs: 142-151.

Greenwood, C. and H. Mercer (1995). Considerations of International Law. Crisis? What Crisis? Orderly Workouts for Sovereign Debtors. B. Eichengreen and R. Portes. London, Centre for Economic Policy Research: 103-117.

Grieco, J. M. (1988). "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism." International Organization(42/3): 584-507.

Grieve, M. (1993). Debt and Imperialism: Perspectives on the Debt Crisis. The Politics of Global Debt. S. Riley. New York, St. Martin's Press: 51-68.

Griffin, P. and A. Farren (2005). "How ICSID Can Protect Foreign Bondholders." International Financial Law Review(24/9): 21-24.

Griffith-Jones, S. (2002). "Financial System Reform and Argentina." Central Banking(12/3): 32-39.

Group of Ten (2002). Report of the G-10 Working Group on Contractual Clauses: Available at http://www.bis.org/publ/gten08.htm#pgtop. Last accessed February 15, 2005.

Group of Ten (The Rey Report) (1996). The Resolution of Sovereign Liquidity Crises: A Report to the Ministers and Governors Prepared Under the Auspices of the Deputies: Available at http://www.bis.org/publ/gten03.pdf. Last Accessed February 12, 2005.

Gruber, L. (2000). Ruling the World: Power Politics and the Rise of Supranational Institutions. Princeton, Princeton University Press.

Gruson, M. (1984). The Johnson Debt Default Act and U.S. Banks. Sovereign Lending: Managing Legal Risk. M. Gruson and R. Reisner. London, Euromoney Publications Limited: 13-20.

Gruson, M. and R. Reisner, Eds. (1984). Sovereign Lending: Managing Legal Risk. London, Euromoney Publications.

Guenther, J. (1983). The Role of Bank Economists. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Haas, P. M. (1992). Introduction: Epistemic Communities and International Policy Coordination. Knowledge, Power and International Policy Coordination. P. M. Haas. Columbia, University of South Carolina Press: 1-35.

Haas, P. M. (1993). Epistemic Communities and the Dynamics of International Environmental Cooperation. Regime Theory and International Relations. V. Rittenberger. Oxford, Oxford University Press: 168-201.

Haberler, G. (1976). The World Economy, Money and the Great Depression: 1919-1939. Washington, D.C., American Enterprise Institute for Policy Research.

Haggard, S. and R. Kaufman (1989). The Politics of Stabilization and Structural Adjustment. Developing Country Debt and Economic Performance: The International Financial System. J. D. Sachs. Chicago, University of Chicago Press.

Haggard, S. and B. A. Simmons (1987). "Theories of International Regimes." International Organization(41/3): 491-517.

Haldane, A. and M. Kruger (2001). "The Resolution of International Financial Crises: Private Finance and Public Funds." Financial Stability Review(December): 193-202.

Hall, R. B. and T. Biersteker, Eds. (2002). The Emergence of Private Authority in Global Governance. Cambridge, Cambridge University Press.

Hamilton, J. and M. Flavin (1986). "On the Limitations of Government Borrowing: A Framework for Empirical Testing." The American Economic Review(76/4):808-819.

Hanke, S. and K. Schuler (2002). "What Went Wrong in Argentina?" Central Banking(12/3): 43-48.

Hasenclever, A., P. Mayer, et al. (1997). Theories of International Regimes. Cambridge, Cambridge University Press.

Haufler, V. (1993). Crossing the Boundary Between Public and Private: International Regimes and Non-State Actors. Regime Theory and International Relations. V. Rittenberger. Oxford, Oxford University Press: 94-111.

Haufler, V. (2001). A Public Role for the Private Sector: Industry Self-Regulation in a Global Economy. Washington, D.C., Carnegie Endowment for International Peace.

Hay, C. (1997). "Divided by a Common Language: Political Theory and the Concept of Power." Politics(17/1): 45-52.

Heinman, J. C. (1983). Banking Regulations and Supervision. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Held, D. and A. McGrew, Eds. (2002). Governing Globalization: Power, Authority and Global Governance. Cambridge, Blackwell Publishers Ltd.

Heldring, F. (1989). The Debt Crisis: A Regional Bank's Point of View. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 29-34.

Helleiner, E. (2001). Financial Globalization and Social Response? A Polanyian View. Structure and Agency in International Capital Mobility. T. Sinclair and K. Thomas. Hampshire, Palgrave: 168-185.

Helleiner, E. (2003). The Southern Side of "Embedded Liberalism": America's Unorthodox Money Doctoring During the Early Post-1945 Years. Money Doctors: The Experience of International Financial Advising, 1850-2000. M. Flandreau. London, Routledge: 249-275.

Helleiner, E. (2005). "The Strange Story of Bush and the Argentine Debt Crisis." Third World Quarterly(26/6): 951-969.

Helleiner, E. (2006). The Long and Winding Road Towards a Sovereign Debt Restructuring Regime. Unpublished manuscript, May.

Helpman, E. (1989). Voluntary Debt Reduction. Analytical Issues in Debt. J. A. Frenkel, M. P. Dooley and P. Wickham. Washington, D.C., International Monetary Fund: 279-310.

Hershey, A. S. (1907). "The Calvo and Drago Doctrines." American Journal of International Law(1): 26-28.

Hewson, M. and T. Sinclair (2004). The Emergence of Global Governance Theory. Global Governance: Critical Concepts in Political Science, Volume I. T. Sinclair. London, Routledge: 226-242.

Hoeflich, M. (1984). Historical Perspectives on Sovereign Lending. Sovereign Lending: Managing Legal Risk. M. Gruson and R. Reisner. London, Euromoney Publications Limited: 21-27.

Hurlock, J. (1984). "Advising Sovereign Clients on the Renegotiation of their External Indebtedness." Columbia Journal of Transnational Law(23): 29-48.

Hurrell, A. (2005). Power, Institutions and the Production of Inequality. Power in Global Governance. M. Barnett and R. Duvall. Cambridge, Cambridge University Press: 33-58.

Hurrell, A. and N. Woods (1995). "Globalisation and Inequality." Millennium Journal of International Studies(24/3): 447-470.

Husain, I. and I. Diwan, Eds. (1989). Dealing with the Debt Crisis. Washington, D.C., The World Bank.

Institute of International Finance (2001). Institute of International Finance Comments on Sovereign Country Bankruptcy Proposals: Available at http://www.iif.com/press/pressrelease.quagga?id=34. Last accessed April 4, 2005.

Institute of International Finance (2006). Principles for Stable Capital Flows and Fair Restructuring in Emerging Markets: Report on Implementation by the Principles Consultative Group: Available at http://www.iif.com/emp/principles. PDF file: principles_0906[1].pdf. Last accessed October 1, 2007.

Institute of International Finance (2007). Best Practices for Formation and Operation of Creditor Committees: Unpublished manuscript.

Institute of International Finance, International Primary Markets Association, et al. (2003). Model Collective Action Clauses for Sovereign Bonds and a Code of Conduct for Emerging Markets: Available at http://www.emta.org/ndevelop/Final_merged.pdf. Last accessed March 17, 2005.

International Financial Institution Advisory Commission (2000). Report of the International Financial Institution Advisory Commission, Allen H. Meltzer, Chairman: Available at http://www.eldis.org/static/DOC7563.htm. Last accessed February 22, 2005.

International Monetary Fund (1997). "Capital Flows to Emerging Markets - A Historical Perspective." International Capital Markets Annex IV(November).

International Monetary Fund (2001). Involving the Private Sector in the Resolution of Financial Crises - Restructuring International Sovereign Bonds: Available at http://www.imf.org/external/pubs/ft/series/03/ips.pdf. Last accessed January 18, 2005.

International Monetary Fund (2002). Transcript of a Teleconference on the Sovereign Debt Restructuring Mechanism with Washington Journalists and First Deputy Managing Director, Anne Krueger: Available at http://www.imf.org/external/np/tr/2002/tr020401.htm. Last accessed March 28, 2005.

International Monetary Fund (2003a). A New Approach to Sovereign Debt Restructuring: An IMF Proposal: Available at http://www.imf.org/external/np/tr/2003/tr030122.htm. Last accessed February 6, 2005.

International Monetary Fund (2003b). Proposals for a Sovereign Debt Restructuring Mechanism: Available at http://www.imf.org/external/n/exr/facts/sdrm.htm. Last accessed January 5, 2005.

International Monetary Fund (2003c). Reviewing the Process for Sovereign Debt Restructuring within the Existing Legal Framework: Available at http://www.imf.org/external/np/pdr/sdrm/2003/080103.htm. Last accessed April 12, 2005.

Ivanova, I. (2003). "What Determines the Implementation of IMF-Supported Programs?" IMF Working Paper(08/03).

Ives, P. (2004). Gramsci's Politics of Language. Toronto, University of Toronto Press.

James, H. (1996). International Monetary Cooperation Since Bretton Woods. New York, Oxford University Press.

Jeanne, O. (2004). "Debt Maturity and the International Financial Architecture." IMF Working Paper(04/137).

Jeanne, O. and J. Zettelmeyer (2001). "International Bailouts, Moral Hazard and Conditionality." Economic Policy: A European Forum(16/33): 407-432.

Jenks, L. H. (1927). The Migration of British Capital to 1875. London, Jonathan Cape.

Jorgenson, E. and J. Sachs (1989). Default and Renegotiation of Latin American Foreign Bonds in the Interwar Period. The International Debt Crisis in Historical Perspective. B. Eichengreen and P. Lindert. Cambridge, The MIT Press: 48-85.

Kahler, M. (1986a). Politics and International Debt: Explaining the Crises. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 11-36.

Kahler, M. (1986b). Politics and Proposals for Reform. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 245-272.

Kahler, M., Ed. (1986c). The Politics of International Debt. Ithaca, Cornell University Press.

Kahler, M. (1993). Bargaining with the IMF: Two Level Strategies and Developing Countries. Double-Edged Diplomacy: International Bargaining and Domestic Politics. P. Evans, H. Jacobson and R. Putnam. Berkeley, University of California Press: 211-229.

Kaletsky, A. (1985). The Costs of Default. New York, Priority Press.

Kapstein, E. B. (1992). "Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence." International Organization(46/1): 265-287.

Kapur, D. (1998). "The IMF: A Cure or Curse?" Foreign Policy(111): 114-129.

Kaufman, R. (1986). Democratic and Authoritarian Reponses to the Debt Issue: Argentina, Brazil and Mexico. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 187-217.

Kearney, C. (1993). The Creditor Clubs: Paris and London. Dealing with Debt: International Financial Negotiations and Adjustment Bargaining. T. Biersteker. Boulder, Westview Press: 61-75.

Kelly, T. (1998). "Ability and Willingness to Pay in the Age of Pax Britannica." Explorations in Economic History(35): 31-58.

Kenen, P. B. (1983). Third World Debt: Sharing the Burden - A Bailout Plan. The New York Times. New York: March 6.

Kenen, P. B. (1990). "Organizing Debt Relief: The Need for a New Institution." Journal of Economic Perspectives(4/1): 7-18.

Kenen, P. B. (1991). "Debt Buybacks and Forgiveness in a Model with Voluntary Repudiation." International Economic Journal(5/1): 1-13.

Kenen, P. B. (2001). The International Financial Architecture: What's New? What's Missing? Washington, D.C., Institute for International Economics.

Kenen, P. B. (2003). "Refocusing the Fund: A Review of James M. Boughton's Silent Revolution: The International Monetary Fund, 1979-1989." IMF Staff Paper(50/2): 291-319.

Kennedy, R. C. (1994). Sovereign Debt Restructuring Since 1982: A Practical Perspective. Oxford, University of Oxford. PhD Dissertation.

Keohane, R. O. (1983). The Demand for International Regimes. International Regimes. S. D. Krasner. Ithaca, Cornell University Press: 141-171.

Keohane, R. O. (1984). After Hegemony: Cooperation and Discord in the World Political Economy. Princeton, Princeton University Press.

Keohane, R. O. (1993). The Analysis of International Regimes: Toward a European-American Research Program. Regime Theory and International Relations. V. Rittenberger. Oxford, Oxford University Press: 23-45.

Keohane, R. O. (2001). "Governance in a Partially Globalized World, Presidential Address, American Political Science Association, 2000." The American Political Science Review(95/1): 1-13.

Keohane, R. O. (2002). Governance in a Partially Globalized World. Governing Globalization: Power, Authority and Global Governance. D. Held and A. McGrew. Cambridge, Blackwell Publishers Ltd.: 324-347.

Keohane, R. O. and J. S. Nye (2001). Power and Interdependence. New York, Longman.

Khalfan, A. (2007). Odious Debt: Definition, Application and Context: Available at www.odiousdebts.org/odiousdebts/index.cfm?DSP=titles&SubID=519. Last accessed May 23, 2007.

Kindelberger, C. (1978 [2002]). Manias, Panics and Crashes: A History of Financial Crises. Hampshire, Palgrave.

King, G., R. O. Keohane, et al. (1994). Designing Social Inquiry: Scientific Inference in Qualitative Research. Princeton, Princeton University Press.

Kletzer, K. (2003). "Sovereign Bond Restructuring: Collective Action Clauses and Official Crisis Intervention." IMF Working Paper(03/134).

Kletzer, K. and B. D. Wright (2000). "Sovereign Debt as Intertemporal Barter." The American Economic Review(90/3): 621-639.

Klimenko, M. (2002). "Trade Interdependence, the International Financial Institutions and the Recent Evolution of Sovereign Debt Renegotiations." Journal of International Economics(58): 177-209.

Klingen, C., B. Weder, et al. (2004). "How Private Creditors Fared in Emerging Debt Markets: 1970-2000." IMF Working Paper(04/13).

Kohlscheen, E. and S. O'Connell (2006). "A Sovereign Debt Model with Trade Credit and Reserves." World Economy and Finance Research Programme Working Paper(0004).

Krasner, S. D. (1978). Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy. Princeton, Princeton University Press.

Krasner, S. D. (1981). "Transforming International Regimes." International Studies Quarterly(25/1): 119-148.

Krasner, S. D., Ed. (1983). International Regimes. Ithaca, Cornell University Press.

Krasner, S. D. (1992). "Global Communications and National Power: Life on the Pareto Frontier." World Politics(43/3): 336-366.

Krasner, S. D. (1993). Sovereignty, Regimes and Human Rights. Regime Theory and International Relations. V. Rittenberger. Oxford, Oxford University Press: 139-167.

Kremenyuk, V. (1991). International Negotiations: Problems and New Approaches. San Francisco, Jossey-Bass Publications.

Kremer, M. and S. Jayachandran (2002). "Odious Debt." National Bureau of Economic Research Working Paper(8953).

Kroszner, R. S. (2003). "Sovereign Debt Restructuring." American Economic Review(93/2): 75-79.

Krueger, A. (1991). Decision Making at the Outset of the Debt Crisis: Analytical and Conceptual Issues. International Money and Debt: Challenge for the World Economy. R. Dornbusch and S. Marcus. San Francisco, International Center for Economic Growth: 27-49.

Krueger, A. (2002). A New Approach to Sovereign Debt Restructuring. Washington, D.C., International Monetary Fund.

Krueger, A. (2003). "Sovereign Debt: Messy or Messier?" The American Economic Review(93/2): 70-74.

Krugman, P. (1988). "Financing vs. Forgiving a Debt Overhang." Journal of Development Economics(29/3): 253-268.

Krugman, P. (1989a). Market-Based Debt Reduction Schemes. Analytical Issues in Debt. J. A. Frankel, M. P. Dooley and P. Wickham. Washington, D.C., International Monetary Fund: 258-278.

Krugman, P. (1989b). Private Capital Flows to Problem Debtors. Developing Country Debt and the World Economy. J. Sachs. Chicago, University of Chicago Press: 285-298.

Krugman, P. (1995). "Dutch Tulips and Emerging Markets." Foreign Affairs(74/4): 28-44.

Krugman P. and M. Obstfeld (2003). International Economics: Theory and Policy. Boston, Addison-Wesley.

LaPorta, R., F. Lopez-de-Silanes, et al. (1997). "Legal Determinants of External Finance." Journal of Finance(52/3): 1131-1150.

Lasswell, H. (2004). Elite. Global Governance: Critical Concepts in Political Science, Volume I. T. Sinclair. London, Routledge: 245-254.

Lavelle, K. C. (2005). Governing Sovereign Debt: Formal and Informal Alliances in Emerging Market Financial Politics. Canadian Association for the Study of International Development, June 2-4, Ontario, Canada.

Laves, W. H. C. (1934). "Toward a Consistent Foreign Loan Policy." The American Political Science Review(28/6): 1047-1052.

Leeds, R. S. and G. Thompson (1993). Mexico, 1982: Paving the Way with Exceptions. Dealing with Debt: International Financial Negotiations and Adjustment Bargaining. V. Rittenberger. Boulder, Westview Press: 79-105.

Leland, M. E. (1983). Rescheduling from a United States Perspective. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Lentner, H. H. (2004). Power and Politics in Globalization: The Indispensable State. New York, Routledge.

Lerrick, A. and A. H. Meltzer (2001). Beyond IMF Bailouts: Default Without Disruption. Quarterly International Economics Report, Gaillot Center for Public Policy (May).

Lerrick, A. and A. H. Meltzer (2002). Sovereign Default: The Private Sector Can Resolve Bankruptcy Without a Formal Court. Quarterly International Economics Report, Gaillot Center for Public Policy (April).

Levy, M. A., O. Young, et al. (1995). "The Study of International Regimes." European Journal of International Relations(1/3): 267-330.

Lieberman, J. W. (1989). The History of External Sovereign Debt: The Reaction of Creditors and Debtors to Disruption of Debt Service (An International Relations Perspective). Oxford, University of Oxford. PhD Dissertation.

Lindert, P. (1989). Response to the Debt Crisis: What is Different About the 1980's? The International Debt Crisis in Historical Perspective. B. Eichengreen and P. Lindert. Cambridge, The MIT Press: 226-275.

Lindert, P. and P. Morton (1989). How Sovereign Debt Has Worked. Developing Country Debt and the World Economy. J. Sachs. Chicago, University of Chicago Press: 225-235.

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

Lipson, C. (1985b). Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Century. Berkeley, University of California Press.

Lipson, C. (1986). International Debt and the International Institutions. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 219-243.

Logan, F. D. (1992). Creditor Concerns About the Debt-Restructuring Process. Current Legal Issues Affecting Central Banks. R. C. Effros. Washington, D.C., International Monetary Fund: 154-157.

Macdonald, J. (2003). A Free Nation Deep in Debt. New York, Farrar, Straus and Giroux.

MacMillan, R. (1995a). New Lease on Life for Bondholder Councils. Financial Times. London, August 15.

MacMillan, R. (1995b). "Toward a Sovereign Debt Work-Out System." Northwestern Journal of International Law and Business(16/1): 57-75.

Maiden, B. (2003). "Uruguay Faces Up to Challenges of Emerging Market Debt." International Financial Law Review(22/5): 10-12.

Manasse, P. and N. Roubini (2005). "Rules of Thumb for Sovereign Debt Crises." IMF Working Paper(05/42).

Mandelbrot, B. B. (2004). The (Mis)Behavior of Markets: A Fractal View of Risk, Ruin and Reward. London, Profile Books Ltd.

Mandeng, O. J. (2004). "Intercreditor Distribution in Sovereign Debt Restructuring." IMF Working Paper(04/183).

Mander, B. (2002). "Argentina: The Story so Far..." Central Banking(12/3): 32-39.

Mann, M. (1986). The Sources of Social Power: Volume I. Cambridge, Cambridge University Press.

Marsh, D. and G. Stoker, Eds. (2002). Theory and Methods in Political Science. Hampshire, Palgrave Macmillan.

Martinson, M. G. (1989). Accounting and Regulatory Policies Affecting Debt Restructuring. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 143-161.

Mauro, P. and Y. Yafeh (2003). "The Corporation of Foreign Bondholders." IMF Working Paper(03/107).

McGovern, D. (2003). Different Market Windows on Sovereign Debt: Private Sector Credit from the 1980's to the Present. Sovereign Debt: Origins, Crises and Restructuring. V. Aggarwal and B. Granville. London, Royal Institute of International Affairs: 69-91.

McGrane, R. C. (1935). Foreign Bondholders and American State Debts. New York, The Macmillan Company.

McNamara, K. (1998). The Currency of Ideas: Monetary Politics in the European Union. Ithaca, Cornell University Press.

Mearsheimer, J. J. (2001). The Tragedy of Great Power Politics. New York, W.W. Norton.

Mendelsohn, M. S. (1983). Commercial Banks and the Restructuring of Cross-Border Debt. New York, Group of Thirty.

Miller, M. (2002). "Sovereign Debt Restructuring: New Articles, New Contracts - or No Change." Institute for International Economics Policy Brief(02/3).

Miller, M. and D. Thomas (2006a). "Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights." CEPR Working Paper(5710).

Miller, M. and D. Thomas (2006b). Transition to CACs: The Judge, the Vultures and the Future of Creditor Rights: Unpublished manuscript.

Miller, M. and L. Zhang (2003). Sovereign Liquidity Crises: The Strategic Case for a Payments Standstill. Sovereign Debt: Origins, Crises and Restructuring. V. Aggarwal and B. Granville. London, Royal Institute of International Affairs: 153-198.

Mills, C.W. (1963). Power, Politics and People. New York, Oxford University Press.

Mitchener, K. J. and M. D. Weidenmier (2004). "Empire, Public Goods and the Roosevelt Corollary." NBER Working Paper(10729).

Mitchener, K. J. and M. D. Weidenmier (2005). "Supersanctions and Sovereign Debt Repayment." National Bureau of Economic Research Working Paper(11472).

Moore, P. (2001). Chinese Bonds Valuable? Investors Demand Cash After 88 Years. The Denver Business Journal: Available at http://denver.bizjournals.com/denver/stories/2001/07/02/story2.html. Last accessed April 25, 2006.

Morgenthau, H. J. (1954). Politics Among Nations: The Struggle for Power and Peace, 3rd ed. Chicago, University of Chicago Press.

Mosley, L. (2000). "Room to Move: International Financial Markets and National Welfare States." International Organization(54/4): 737-773.

Mudge, A. (1984). "Sovereign Debt Restructuring: A Perspective of Counsel to Agent Banks, Bank Advisory Groups and Servicing Banks." Columbia Journal of Transnational Law(23): 59-74.

Mudge, A. (1992). Country Debt Restructure, 1982-1987: An Overview. Current Legal Issues Affecting Central Banks. R. C. Effros. Washington, D.C., International Monetary Fund: 141-146.

Musumeci, J. J. and J. F. Sinkey (1990). "The International Debt Crisis and the Bank Loan-Loss-Reserve Decisions: The Signaling Content of Partially Anticipated Events." Journal of Money, Credit and Banking(22/3): 370-387.

Nachmanoff, A. (1983). Major Considerations in Advising Sovereign Borrowers on Debt Restructuring. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Naim, M. (1999). "Washington Consensus or Washington Confusion?" Foreign Policy(118): 86-103.

Naylor, R. T. (2004). Hot Money and the Politics of Debt. Montreal, McGill-Queen's University Press.

Nielsen, G. (2006). "Inside Argentina's Financial Crisis." Euromoney(37/443): 64-71.

North, D. C. (1977). "Markets and Other Allocation Systems in History: The Challenge of Karl Polanyi." Journal of European Economic History(6/3): 703-716.

North, D. C. (1981). Structure and Change in Economic History. New York, W.W. Norton & Company.

North, D. C. (1990). Institutions, Institutional Change and Economic Performance. Cambridge, Cambridge University Press.

Nye, J. S. (1990). "Soft Power." Foreign Policy(80): 153-172.

Oatley, T. and R. Nabors (1998). "Redistributive Cooperation: Market Failure, Wealth Transfers and the Basle Accord." International Organization(52/1): 35-54.

O'Brien, P. (1993). The Latin American Debt Crisis. The Politics of Global Debt. S. Riley. New York, St. Martin's Press: 85-112.

O'Brien, R. (2000). Contesting Global Governance. Cambridge, Cambridge University Press.

Obstfeld, M. and A. M. Taylor (2002). "Sovereign Risk, Credibility and the Gold Standard: 1870-1913 versus 1925-31." NBER Working Paper(9345).

Odell, J. (2000). Negotiating the World Economy. Ithaca, Cornell University Press.

Oechsli, C. G. (1981). "Procedural Guidelines for Renegotiating LDC Debts: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act." Virginia Journal of International Law(21/2): 305-341.

Olson, M. (1980 [1965]). The Logic of Collective Action: Public Goods and the Theory of Groups. Cambridge, Harvard University Press.

Ozler, S. (1993). "Have Commercial Banks Ignored History?" The American Economic Review(83/3): 608-620.

Palan, R. (2000). "A World of Their Making: An Evaluation of the Constructivist Critique in International Relations." Review of International Studies(26): 575-598.

Patrikis, E. (1992). Sovereign Immunity and Central Bank Immunity in the United States. Current Legal Issues Affecting Central Banks. R. C. Effros. Washington, D.C., International Monetary Fund: 159-167.

Pereira, L. C. B. (1989). A Debtor's Approach to the Debt Crisis. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 85-105.

Platt, D. C. M. (1960). "British Bondholders in Nineteenth Century Latin America - Injury and Remedy." Inter-American Economic Affairs(14): 3-43.

Portes, R. (2000). The Role of Institutions for Collective Action. Managing Financial and Corporate Distress: Lessons from Asia. C. Adams, R. Litan and M. Pomerleano. Washington, D.C., The Brookings Institution.

Portes, R. (2004). "Resolution of Sovereign Debt Crises: The New Old Framework." Centre for Economic Policy Research Discussion Paper(4717).

Przeworski, A. and J. R. Vreeland (2000). "The Effect of IMF Programs on Economic Growth." Journal of Development Economics(62): 385-421.

Puchala, D. and R. Hopkins (1983). International Regimes: Lessons from Inductive Analysis. International Regimes. S. Krasner. Ithaca, Cornell University Press.

Putnam, R. (1988). "Diplomacy and Domestic Politics: The Logic of Two-Level Games." International Organization(42/3): 427-460.

Putnam, R. and N. Bayne (1984). Hanging Together: Cooperation and Conflict in the Seven-Power Summits. London, Royal Institute of International Affairs.

Radelet, S., J. Sachs, et al. (1998). "The East Asian Crisis: Diagnoses, Remedies, Prospects." Brookings Papers on Economic Activity(1): 1-90.

Reinicke, W. H. (1995). Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980-1990. Aldershot, Edward Elgar Publishing Limited.

Reisman, D. (1990). Theories of Collective Action: Downs, Olson and Hirsch. Hampshire, The Macmillan Press Ltd.

Republic of Argentina (2005). Prospectus and Prospectus Supplement: Available at http://www.mecon.gov.ar/finanzas/download/us_prospectus_and_prospectus_supplement .pdf. Last accessed October 1, 2007.

Rhodes, W. R. (1983). The Role of the Steering Committee: How It Can Be Improved. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Rhodes, W. R. (1989). A Negotiator's View. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 19-28.

Richards, A. and M. Gugiatti (2003). "Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets." International Finance(6/3): 415-447.

Rieffel, A. (2003). Sovereign Debt Restructuring: The Case for Ad Hoc Machinery. Washington, D.C., The Brookings Institution.

Riesenfeld, S. (1984). Government Powers to Induce Claim Settlements. Sovereign Lending: Managing Legal Risk. M. Gruson and R. Reisner. London, Euromoney Publications Limited: 245-253.

Riley, S., Ed. (1993). The Politics of Global Debt. New York, St. Martin's Press.

Rippy, J. F. (1934). "The British Bondholders and the Roosevelt Corollary of the Monroe Doctrine." Political Science Quarterly(49/2): 195-206.

Rittenberger, V., Ed. (1993). Regime Theory and International Relations. Oxford, Oxford University Press.

Rogoff, K. (1999). "International Institutions for Reducing Global Financial Instability." Journal of Economic Perspectives(13/4): 21-42.

Rogoff, K. and J. Zettelmeyer (2002). "Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001." IMF Staff Paper(49/3): 470-507.

Rohatyn, F. (1983). A Plan for Stretching Out Global Debt. Business Week: February, 26.

Ronit, K. and V. Schneider (2004). Global Governance Through Private Organizations. Global Governance: Critical Concepts in Political Science, Volume III. T. Sinclair. London, Routledge: 343-367.

Rose, A. K. (2002). "One Reason Countries Pay Their Debts: Renegotiation and International Trade." NBER Working Paper(8853).

Rosenau, J. N. (2004). Governance in the Twenty-First Century. Global Governance: Critical Concepts in Political Science, Volume I. T. Sinclair. London, Routledge: 179-209.

Rosenberg, E. (1999). Financial Missionaries to the World: The Politics and Culture of Dollar Diplomacy, 1900-1930. Cambridge, Harvard University Press.

Roubini, N. (2001). Why Should the Foreign Creditors of Argentina Take a Greater Haircut than the Domestic Ones?: Available at http://pages.stern.nyu.edu/~nroubini/papers/discriminationforeigndebt.doc. Last accessed October 1, 2007.

Roubini, N. (2002). "Do We Need a New International Bankruptcy Regime?" Brookings Papers on Economic Activity(1): 321-333.

Roubini, N. (2005). A Post-Mortem on the Argentine Debt Restructuring: How to Deal with the Holdout Creditors: Available at http://www.rgemonitor.com/blog/roubini/107721. Last accessed November 16, 2005.

Roubini, N. and B. Setser (2003). Improving the Sovereign Debt Restructuring Process: Problems in Restructuring, Proposed Solutions, and a Roadmap for Reform. Institute for International Economics Conference on Improving the Sovereign Debt Restructuring Process, Paris, France.

Roubini, N. and B. Setser (2004a). Bailouts or Bail-Ins? Responding to Financial Crises in Emerging Market Economies. Washington, D.C., Institute for International Economics.

Roubini, N. and B. Setser (2004b). The Reform of the Sovereign Debt Restructuring Process: Problems, Proposed Solutions and the Argentine Episode: Unpublished manuscript.

Rubin, R. (2003a). In An Uncertain World: Tough Choices from Wall Street to Washington. New York, Random House.

Rubin, R. (2003b). The Role of Industrial Country Policies in Emerging Market Crises. Economic and Financial Crises in Emerging Market Economies. M. Feldstein. Chicago, University of Chicago Press: 281-287.

Ruggie, J. G. (1998). "What Makes the World Hang Together? Neo-utilitarianism and the Social Constructivist Challenge." International Organization(52/4): 855-885.

Runciman, W.G., Ed. (1978). Max Weber: Selections in Translation. Cambridge, Cambridge University Press.

Rupert, M. (2005). Class Powers and the Politics of Global Governance. Power in Global Governance. M. Barnett and R. Duvall. Cambridge, Cambridge University Press: 205-228.

Russell, G. (2006). "Theodore Roosevelt, Geopolitics, and Cosmopolitan Ideals." Review of International Studies(32/2): 541-559.

Sachs, J. (1983). "Theoretical Issues in International Borrowing." NBER Working Paper(1189).

Sachs, J. (1986). "Managing the LDC Debt Crisis." Brookings Papers on Economic Activity(2): 397-440.

Sachs, J., Ed. (1989). Developing Country Debt and the World Economy. Chicago, University of Chicago Press.

Sachs, J. (1995). Do We Need an International Lender of Last Resort?: Frank D. Graham Lecture at Princeton University, April 20. Available at http://www.ksg.harvard.edu.cid/ciddirector/publicat.htm. Last accessed January 15, 2005.

Sachs, J. (2002). "Resolving the Debt Crisis of Low Income Countries." Brookings Papers on Economic Activity(1): 257-286.

Sachs, J. and H. Huizinga (1987). "U.S. Commercial Banks and the Developing-Country Debt Crisis." Brookings Papers on Economic Activity(2): 555-606.

Salmon, F. (2004a). Bondholders Won't Back New Principles. Euromoney: 42-46.

Salmon, F. (2004b). Seeking Forgiveness of Saddam-Era Debt. Euromoney: 72-78.

Sandler, T. (2004). Global Collective Action. Cambridge, Cambridge University Press.

Schmidt, B. C. (2005). "Competing Realist Conceptions of Power." Millennium Journal of International Studies(33/3): 523-549.

Schneider, G. (2005). "Capacity and Concessions: Bargaining Power in Multilateral Negotiations." Millennium Journal of International Studies(33/3): 665-690.

Scholte, J. A. (2002). Governing Global Finance. Governing Globalization: Power, Authority and Global Governance. D. Held and A. McGrew. Cambridge, Blackwell Publishers Ltd.: 189-208.

Schuker, S. A. (2003). Money Doctors Between the Wars: The Competition Between Central Banks, Private Financial Advisors, and Multilateral Agencies, 1919-1939. Money Doctors: The Experience of International Financial Advising, 1850-2000. M. Flandreau. London, Routledge: 50-77.

Schumer, C. E. (1989). The Debt Crisis - A Political Perspective. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 225-237.

Schwarcz, S. L. (2000). "Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach." Cornell Law Review(85): 956-1034.

Scott, J. B. (1915). The Hague Conventions and Declarations of 1899 and 1907. New York, Oxford University Press.

Sebenius, J. K. (1992). Challenging Conventional Explanations of International Cooperation: Negotiation Analysis and the Case of Epistemic Communities. Knowledge, Power and International Policy Coordination. P. M. Haas. Columbia, University of South Carolina Press: 323-365.

Sessions, G. A. (1974). Prophesying Upon the Bones: J. Reuben Clark, the Foreign Bondholders, and the Great Depression. Florida, Florida State University. PhD Dissertation.

Setser, B. (2005). The Political Economy of Sovereign Bankruptcy. Global Economic Governance Centre Conference on Sovereign Debt Restructuring, University College, Oxford.

Sgard, J. (2004). "Are There Such Things as International Property Rights?" The World Economy(27/3): 387-401.

Sharma, S. D. (2004). "Resolving Sovereign Debt: Collective Action Clauses or the Sovereign Debt Restructuring Mechanism." Journal of World Trade(38/4): 627-646.

Shea, D. R. (1955). The Calvo Clause. Minneapolis, Minnesota, Lund Press.

Shihata, I. F. I. (1992). The Settlement of Disputes Regarding Foreign Investments: The Role of the World Bank, with Particular Reference to ICSID and MIGA. Current Legal Issues Affecting Central Banks. R. C. Effros. Washington, D.C., International Monetary Fund: 173-187.

Shleifer, A. (2003). "Will the Sovereign Debt Market Survive?" National Bureau of Economic Research Working Paper(9343).

Silva-Herzog, J. (1991). Problems of Policy Making at the Outset of the Debt Crisis. International Money and Debt: Challenge for the World Economy. R. Dornbusch and S. Marcus. San Francisco, International Center for Economic Growth: 51-60.

Simmons, B. A. (2001). "The International Politics of Harmonization: The Case of Capital Market Regulation." International Organization(55/3): 589-620.

Sinclair, T. (2001). International Capital Mobility: An Endogenous Approach. Structure and Agency in International Capital Mobility. T. Sinclair and K. Thomas. Hampshire, Palgrave: 93-110.

Sinclair, T. (2004). Reinventing Authority: Embedded Knowledge Networks and the New Global Finance. Global Governance: Critical Concepts in Political Science, Volume III. T. Sinclair. London, Routledge: 369-388.

Sinclair, T. (2005). The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness. Ithaca, Cornell University Press.

Sinclair, T. and K. Thomas, Eds. (2001). Structure and Agency in International Capital Mobility. Hampshire, Palgrave.

Singh, M. (2003). "Recovery Rates from Distressed Debt: Empirical Evidence from Chapter 11 Filings, International Litigation and Recent Sovereign Debt Restructurings." IMF Working Paper(03/161).

Skidmore, D., Ed. (1997). Contested Social Orders in International Politics. Nashville, Vanderbilt University Press.

Slaughter, A.-M. (2004). The Real New World Order. Global Governance: Critical Concepts in Political Science, Volume. III. T. Sinclair. London, Routledge: 309-318.

Smith, A. (1776 [2000]). Wealth of Nations. New York, Modern Library.

Smith, G. W. and J. T. Cuddington, Eds. (1985). International Debt and the Developing Countries. Washington, D.C., International Bank for Reconstruction and Development.

Snidal, D. (1985). "Coordination versus Prisoners' Dilemma: Implications for International Cooperation and Regimes." The American Political Science Review(79/4): 923-942.

Snidal, D. (1991). "Relative Gains and the Pattern of International Cooperation." The American Political Science Review(85/3): 701-726.

Soederberg, S. (2005). "The Transnational Debt Architecture and Emerging Markets: The Politics of Paradoxes and Punishment." Third World Quarterly(26/6): 927-949.

Soros, G. (1998). Crisis of Global Capitalism. New York, Public Affairs Press.

Staley, E. (1967). War and the Private Investor: A Study in the Relations of International Politics and International Private Investment. New York, H. Fertig.

Stiglitz, J. (2002). Globalization and its Discontents. London, Penguin Books Ltd.

Strange, S. (1979). Debt and Default in the International Political Economy. Debt and the Less Developed Countries. J. D. Aronson. Boulder, Westview Press.

Strange, S. (1983). Cave! Hic Dragones: A Critique of Regime Analysis. International Regimes. S. D. Krasner. Ithaca, Cornell University Press: 337-354.

Strange, S. (1999). States and Markets. London, Cassell.

Strange, S. (2004). The State of the State. Global Governance: Critical Concepts in Political Science, Volume III. T. Sinclair. London, Routledge: 287-307.

Sturzenegger, F. and J. Zettelmeyer (2005a). "Haircuts: Estimating Investor Losses in Sovereign Debt Restructuring, 1998-2005." IMF Working Paper(05/137).

Sturzenegger, F. and J. Zettelmeyer (2005b). Has the Legal Threat to Sovereign Debt Restructuring Become Real?: Available at www.hbs.edu/units/bgie/pdf/legal_threat.pdf. Last accessed August 30, 2006.

Summers, L. and J. Williamson (2001). "An Analysis of Russia's 1998 Meltdown: Fundamentals and Market Signals." Brookings Papers on Economic Activity(1): 51-68.

Suratgar, D. (1984). The International Financial System and the Management of the International Debt Crisis. Default and Rescheduling: Corporate and Sovereign Borrowers in Difficulty. D. Suratgar. London, Euromoney Publications: 151-161.

Suter, C. (1990). Schuldenzyklen in der Dritten Welt. Frankfurt, Anton Hain.

Suter, C. (1992). Debt Cycles in the World Economy. Boulder, Westview Press.

Swedberg, R., Ed. (1999). Max Weber: Essays in Economic Sociology. Princeton, Princeton University Press.

Taylor, J. (2002). Sovereign Debt Restructuring: A U.S. Perspective: Available at http://www.ustreas.gov/press/releases/po2056.htm. Last accessed March 30, 2005.

Taylor, J. (2007). Global Financial Warriors: The Untold Story of International Finance in the Post-9/11 World. New York, W.W. Norton & Company.

Thacker, S. (1999). "The High Politics of IMF Lending." World Politics(52/1): 38-75.

The Corporation of Foreign Bondholders (1873-1987). Annual General Report.

The World Bank (1996). World Bank Debt Tables. Washington, D.C., The World Bank.

Thomas, K. (2001). Expanding the Debate on Capital Mobility. Structure and Agency in International Capital Mobility. T. Sinclair and K. Thomas. Hampshire, Palgrave: 111-125.

Thomas, K. and T. Sinclair (2001). Structure and Agency in International Capital Mobility: An Introduction. Structure and Agency in International Capital Mobility. T. Sinclair and K. Thomas. Hampshire, Palgrave: 1-6.

Tomz, M. (2001). How Do Reputations Form? New and Seasoned Borrowers in International Capital Markets. Annual Meeting of the American Political Science Association, San Francisco, California.

Tomz, M. (2004). Finance and Trade: Issue Linkage and the Enforcement of International Debt Contracts. Annual Meeting of the American Political Science Association, Chicago, Illinois.

Trevino, J. A. G. (1989). The LDC Debt Crisis: A Debtor's View. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 71-83.

Truman, E. (2002). "Debt Restructuring: Evolution or Revolution?" Brookings Papers on Economic Activity(1): 341-346.

Tubin, M. R. (2006). Embedded Realism and Institutional Evolution in Sovereign Debt. Unpublished manuscript, August.

U.S. Department of State (1933). Organizing the Foreign Bondholders Protective Council. Foreign Relations of the United States Diplomatic Papers (General), Volume I: 934-939.

U.S. House of Representatives (2003). Statement of the American Bondholders Foundation on Chinese Debt Repudiation: Available at http://wwwc.house.gov/international_relations/108/bian2021.htm. Last accessed April 25, 2006.

VanHarten, H. H. A. (2005). The Emerging System of International Investment Arbitration. London, The London School of Economics and Political Science. PhD Dissertation.

Vitale, G. (1995). Multilateral Sovereign Debt Restructuring: The Paris Club and the London Club. Crisis? What Crisis? Orderly Workouts for Sovereign Debtors. B. Eichengreen and R. Portes. London, Centre for Economic and Policy Research: 121-134.

Volcker, P. A. and T. Gyohten (1992). Changing Fortunes: The World's Money and the Threat to American Leadership. New York, Times Books.

Wagner, R. (1989). The LDC Debt Problem. Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders. C. A. Bogdanowicz-Bindert. New York, Harper and Row: 35-39.

Walker, M. A. and L. Buchheit (1984). Legal Issues in the Restructuring of Commercial Bank Loans to Sovereign Borrowers. Sovereign Lending: Managing Legal Risk. M. Gruson and R. Reisner. London, Euromoney Publications Limited: 139-156.

Wallich, H. (1943). "The Future of Latin American Dollar Bonds." The American Economic Review(33/2): 321-335.

Wallich, H. (1983). U.S. Federal Reserve: A Current U.S. View. Rescheduling Techniques: An International Conference on Sovereign Debt, London.

Wallis, J. J., R. E. Sylla, et al. (2004). "Sovereign Debt and Repudiation: The Emerging Market Debt Crisis in the U.S. States, 1839-1843." NBER Working Paper(10753).

Walter, A. (2003). Intellectual and Institutional Convergence in East Asia: The Voluntary Euthanasia of the Asian Model? International Studies Annual Convention, Portland, Oregon.

Waltz, K. N. (1959). Man, the State, and War. New York, Columbia University Press.

Waltz, K. N. (1979). Theory of International Politics. New York, Random House.

Waltz, K. N. (1999). "1999 James Madison Lecture: Globalization and Governance." American Political Science Association(December): 693-700.

Weber, M. (1968). Economy and Society. New York, Bedminster Press.

Weidenmier, M. D. (2004). "Gunboats, Reputation and Sovereign Repayment: Lessons from the Southern Confederacy." NBER Working Paper(10960).

Weinberg, C. B. (1985). "The Language and Techniques of Multiyear Restructuring of Sovereign Debt: Lessons from the Mexican Experience." Journal of Policy Modeling(7/3): 477-490.

Wellons, P. A. (1985). "International Debt: The Behavior of Banks in a Politicized Environment." International Organization(39/3): 441-471.

Wellons, P. A. (1986). International Debt: The Behavior of Banks in a Politicized Environment. The Politics of International Debt. M. Kahler. Ithaca, Cornell University Press: 95-125.

Wendt, A. (1987). "The Agent-Structure Problem in International Relations Theory." International Organization(41/3): 335-370.

Wendt, A. (1991). "Bridging the Theory/Meta-Theory Gap in International Relations." Review of International Studies(17): 383-392.

Wendt, A. (1994). "Collective Identity Formation and the International State." The American Political Science Review(88/2): 384-396.

White, M. (2002). "Sovereigns in Distress: Do They Need Bankruptcy?" Brookings Papers on Economic Activity(1): 287-319.

Widmaier, W. (2003). "The Keynesian Bases of a Constructivist Theory of the International Political Economy." Millennium Journal of International Studies(32/1): 87-107.

Widmaier, W. (2004). "The Social Construction of the "Impossible Trinity": The Intersubjective Bases of Monetary Cooperation." International Studies Quarterly(48): 433-453.

Williams, J. F. (1923). International Law and International Financial Obligations Arising from Contract. Three Lectures at the Hague Academy for International Law (reproduced in Bibliotheca Visseriana II), The Hague, Netherlands.

Williamson, J. (1988). Voluntary Approaches to Debt Relief. Washington, D.C., Institute for International Economics.

Williamson, J. (1996). "Review of Crisis? What Crisis? Orderly Workouts for Sovereign Debtors." International Journal of Finance and Economics(1/3): 225-226.

Williamson, J. (2003). Our Agenda and the Washington Consensus. After the Washington Consensus: Restarting Growth and Reform in Latin America. J. Williamson and P.-P. Kuczynski. Washington, D.C., Institute for International Economics.

Williamson, J. (2005). Curbing the Boom-Bust Cycle: Stabilizing Capital Flows to Emerging Markets. Washington, D.C., Institute for International Economics.

Williamson, J. and P.-P. Kuczynski, Eds. (2003). After the Washington Consensus: Restarting Growth and Reform in Latin America. Washington, D.C., Institute for International Economics.

Winkler, M. (1933). Foreign Bonds: An Autopsy. Philadelphia, Roland Swain Company.

Woods, N., Ed. (2000). The Political Economy of Globalization. Hampshire, Palgrave.

Woods, N. (2002). Global Governance and the Role of Institutions. Governing Globalization: Power, Authority and Global Governance. D. Held and A. McGrew. Cambridge, Blackwell Publishers Ltd.: 25-45.

Woods, N. (2003). The United States and the International Financial Institutions: Power and Influence Within the World Bank and the IMF. U.S. Hegemony and International Organizations. R. Foot, S. N. MacFarlane and M. Mastanduno. Oxford, Oxford University Press.

Woods, N. (2006). The Globalizers: The IMF, the World Bank and Their Borrowers. Ithaca, Cornell University Press.

Yang, D.-Y. (1999). "A Cooperative Perspective on Sovereign Debt: Past and Present." Contemporary Economic Policy(17/1): 44-53.

Yianni, A. (1999). "Resolution of Sovereign Financial Crises - Evolution of the Private Sector Restructuring Process." Financial Stability Review(April): 78-84.

Yianni, A. (2002). "Proposed New Approach to Sovereign Debt Restructuring: A Practitioner's Perspective." Central Banking(12/3): 78-88.

Young, O. (1979). Compliance and Public Authority. Washington, D.C., Resources of the Future.

Young, O. (1983). Regime Dynamics: The Rise and Fall of International Regimes. International Regimes. S. D. Krasner. Ithaca, Cornell University Press: 93-113.

Young, O. and G. Osherenko (1993). Testing Theories of Regime Formation: Findings from a Large Collaborative Research Project. Regime Theory and International Relations. V. Rittenberger. Oxford, Oxford University Press: 223-251.

Yue, V. (2004). Sovereign Default and Debt Renegotiation: Unpublished manuscript.