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THE RESPONSES OF INTERNATIONAL LENDERS TO FOUR DEBT CRISES Interplay of Politics and Finance in Mexico, 1880-1996.

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THE RESPONSES OF INTERNATIONAL LENDERS TO FOUR DEBT CRISES: The Interplay of Politics and Finance in Mexico, 1880-1996

A general review of the literature on public external debts suggests that economists and historians have adopted markedly different conceptual and methodological frameworks to analyze the diverse aspects of this phenomenon.[1] Economists have tended to focus their attention on the exploration of theoretical problems of fundamental importance to the explanation or prediction of economic behavior of borrowers and lenders. Among the questions they have most frequently raised are the following: those which address the problem of selecting optimal borrowing strategies for governments and the constraints established by fiscal policies and trends; the analysis of rational expectations of lenders with particular emphasis on the risks involved in sovereign lending; the problem of defining and determining the role of an international lender of last resort; and, more generally, the study of the links between external debt trends and the evolution of diverse macroeconomic variables, in particular foreign trade, balance of payments and gross national product.[2]

[1] Fishlow (199).

[2] Sachs (1983) does a nice job summarizing several of these fundamental theoretical issues and proposes new analytical models for them. See Eichengreen and Lindert (1989) on rational expectations of investors in external debts. See the massive study by Cline (1995) on relation between Latin American debts and

Historians, on the other hand, have *traditionally* looked more closely at the political, legal and diplomatic contexts to diverse loan negotiations, although they have also accompanied their studies with what are often detailed analysis of the empirical tendencies of indebtedness over time. Numerous historians have focused on series of non-exclusively economic factors in the study of debt policies and practice. These include, for instance, the alliances or contradictions between bankers and politicians, the shifting diplomatic relations between the lending and borrowing countries involved and the legal analysis of loan contracts.[3] Nonetheless, it is also true that many of the studies carried out by economic historians also provide a combination of relevant data series as well as some basic explanatory models of the tendencies disclosed by empirical research.[4]

Inevitably, the different preoccupations and methodologies adopted by economists and historians have tended to create a gulf in interpretations which are not easy to bridge. Quite recently, however, economic historians (as well as economists with historical curiosity) have attempted to combine elements of both

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macroeconomic variables in the recent debt crises of the 1980s.

[3] The classic literature on finance and diplomacy is vast. For the Latin American case ample bibliographical sources can be found in Liehr (1995) and Miller (1993). Wynne (1951) continues to be a fundamental reference work on the historical/legal context to the renegotiation of Latin American debts.

[4] See the diverse empirical studies on Latin American external debts which are cited in the notes and bibliographies in Liehr (1995) and Marichal (1989). For an important empirical and theoretical study on US portfolio investment in Latin America in the 20th century see Stallings (1987).

approaches to allow both a fuller comprehension of the evolution of external debts as well as to stimulate a more intense and meaningful dialogue with theoretical economists.[5] It is the purpose of the present paper- and other papers in this session- to suggest the value of continuing the task of construction of such intellectual bridges.

The fundamental issue which we explore here centers on the different strategies adopted by lenders to confront four major debt crises in a significant historical case, that of Mexico from the late 19th century to the present. Historical and theoretical questions are raised which can be of interest to both economists and financial historians. The first question of a basically historical nature is *to compare how effective were the collective strategies adopted by lenders* in response to the different debt crises. The historical record would appear to indicate that the power and efficiency of such collective strategies and actions has augmented over time but often in ways unexpected.

A second question of interest to both historians and economists consists in *debating whether the concept of lender of last resort is useful* to understand responses by lenders to the last two debt crises studied and/or whether a broader analytical concept or framework is required to make sense of the collective

[5] Among these Díaz Alejandro (1983), Fishlow (1985, 1989, 1995), Eichengreen and Lindert (1989) and Stallings (1987) have been forerunners.

strategies adopted by the major creditors in the resolution of these financial crises.

Underlying the arguments put forth, there is an additional concern which runs through the essay which consists in emphasizing the importance of *the reciprocal relations that exist between politics and finance* both in the formulation of loan policies and the resolution of debt crises.[6] Nonetheless, it should be emphasized that the present paper does not deal with the overall evolution of the various Mexican debt cycles but more specifically with the issue of lenders' responses to external debt crises and their final resolution in order to illustrate important parallels and even more significant contrasts. We will begin with the study of the resolution of the long-standing Mexican debt crisis of the 19th century and move on from there to analyze subsequent debt crises, concluding with the those of the late 20th century.

[6] The nature of this relationship varies over time, but a historical perspective suggest that the analysis of the long-term path of external debts cannot be defined exclusively in terms of supply and demand in financial markets, for in the case of public debts (which constitute the bulk of Mexican - and Latin American- external debts) political factors have exercised a fundamental role in each phase of the loan cycle: contracting of loans, payment of interest and/or capital, renegotiation of debts in times of default, etc. On the other hand, it is also manifest that economic and financial factors have had an enormous input on the politics and policy of debt of different public administrations. This reciprocal relationship therefore should not be ignored in order to achieve a more comprehensive understanding of the evolution and impact of foreign indebtedness, a fundamental issue of *political economy*.

The resolution of the longest debt crisis: the failure of the bondholders committee and the success of financial intermediaries in Mexico in the 1880s

A comparative review of the financial history of the nineteenth century indicates that Mexico is in the unenviable position of being the debtor country with the record of longest-standing non-payment *in that era*. Indeed, for a period of sixty years- from 1828 to 1888- Mexico was basically excluded from international capital markets for public loans because of a chronic inability to meet debt payments. This historical experience therefore provides an opportunity for the study of an extreme case of failure of international lenders to get a wayward debtor to renew payments on its external public obligations.

By the mid-nineteenth century, the Mexican government had accumulated a considerable foreign debt composed of a variety of bond issues, the most important being derived from two old loans issued in London in 1824 and 1825 and the interest backlog on them. A debt conversion of 1851 had established that Mexico owed 10.2 million pounds sterling to the British bondholders, but since debt service was afterwards conducted only sporadically, an additional debt (interest backlog) accumulated subsequently. [7]

The basic response of the British bondholders to this chronic debt crisis consisted initially in the organization of a committee

[7] A basic empirical source for the evolution of Mexican debts

which would represent their collective interests, negotiating with the Mexican authorities and urging the British government to support their claims diplomatically or militarily. As historian D.C.M. Platt argued, they were largely unsuccessful in this effort because Mexico did not belong to the formal British Empire. But subsequently they found an opportunity to recoup some of their losses as a result of the invasion of Mexico in 1861 carried by the joint military and naval forces of France, Great Britain and Spain.

Nonetheless, after the expulsion of the French army (which occupied Mexico between 1863 and 1867) the Mexican government headed by Benito Juárez once again suspended payments on external debts, a situation which would only be resolved in the 1880s.[8]

A summary analysis of the strategies adopted by the bondholders associations during a half-century of non-payment by Mexico of its debts suggests that extreme measures (military intervention) were no more successful than more moderate measures (negotiations) in obtaining repayment. According to Tellez, that this proved so was not due to faulty information on the evolution of the Mexican economy or local politics.[9] But then the question is what impeded repayment? The basic factor -it would appear- that explains the reluctance of the Mexican government to renew debt

in the period is Bazant (1981).

[8] The classic analysis of the legal and diplomatic context of Mexican external debt controversies is found in Wynne (1951).

service was that there were few ostensible benefits to be obtained from international capital markets which were unlikely to provide the wayward government it with new loans given its chronic deficits. Moreover, foreign direct investment in Mexico was meagre at best before the late 1870s and therefore could not be used by bondholders as a metaphorical "carrot" in debt negotiations.

However, after the rise to power in 1876 of a new political and military elite headed by Porfirio Díaz this situation began to change. In the mid and late 1880s the restructuring and conversion of the outstanding Mexican public debt was successfully accomplished. The financial negotiations brought to a close six decades of conflicts between the Mexican government and its foreign creditors. Indeed, it may be argued that these renegotiations were the most complex transactions undertaken by Latin American politicians and European bankers up until that date. The conversion of the Mexican external debt, however, should not be seen merely as an attempt to get the foreign bondholders off the back of the government by complying with their demands. Mexican public officials had long demonstrated that they could prove impervious to the demands of foreign creditors.[10]

The reasons for seeking to restructure Mexican public debts as of the 1880s were linked to a set of new conditions. Most

[9] Téllez (1992).

[10] Indeed, from 1867 to 1885, no payments were forthcoming to European bondholders on Mexican foreign public debts.

important was the need to raise capital both locally and abroad for public and private economic expansion. During the administration of General Manuel González (1880-1884), entrepreneurs and investors from the United States began to channel a significant flow of funds into Mexican railroads and mines, but European capitalists, in contrast, proved reticent to commit their monies in similar enterprises. The Mexican elite believed that by converting the external debt (mostly held in England), the government would facilitate access to European capital markets for new loans and additional direct investment. In addition, they felt that the conversion of internal debts would stabilize public finances and make local sources of credit more readily available.

The urgency of reaching an agreement with local and foreign creditors became manifest by the end of 1884 as a result of ballooning government expenditures and deficits. Following a brief but intense fiscal and financial crisis in Mexico City in 1885, the new finance minister Manuel Dublán published a decree on June 22, 1885 which constituted the first step in the resolution of the old debt quandary. The decree established that the conversion agreement of 1851 would be recognized in full (that is 10.2 million pounds) but that the greater part of the interest backlog from 1851 would be struck from the books. Thus a savings of 7.7 million pounds was established by the finance ministry and accepted by the British bondholders. The remaining foreign debts included a pot pourri of bonds, the value of which also was reduced substantially.[11] In all cases, the foreign bondholders were to receive new 3% bonds payable in gold.

It should be noted, however, that the Mexican government did not only conduct negotiations with the *Committee of Mexican Bondholders* (which was now part of the larger *Council of Foreign Bondholders* in London). There was also a long list of local creditors who requested payment on their claims, some dating from as far back as 1850 but most stemming from financial advances made to the armies of Benito Juárez and to the administrations in power from 1867 to the 1880. In toto these claims were estimated at 57 million pesos and were converted to approximately 25 million pesos in 3% bonds, although it was stipulated they were only payable in silver. This internal debt consolidation-in combination with the foreign debt conversion-thus marked a substantial advance in the stabilization of Mexican finances and projected a new image which modified the views of foreign bankers and investors with respect to the creditworthiness of the nation.

[11] On the labyrinthine negotiations related to these additional external bonds there is an abundant contemporary literature, including the works of 19th century Mexican financial experts, Casasús, Bulnes and Ortiz de Montellano. Additional information can be found in the annual reports of the Secretaría de Hacienda and in those of the Corporation of Foreign Bondholders. It should also be noted that there was a large block of outstanding "Mexican Imperial Bonds" held in France, which had been issued by the regime of Maximilian (1863-67) but which were subsequently repudiated by Mexico since they served mainly to finance the invasion and occupation of Mexico by French troops.

As may be observed it was not the traditionally aggressive tactics of the foreign bondholders which led to a solution but rather a change in the perceptions of the Mexican political and economic elite with respect to the benefits of obtaining reentry into European capital markets. In this respect it was not the collective actions of the bondholders but rather those of a financial intermediary, the French banker Edouard Noetzlin, which played the key role in changing official perceptions on the *benefits* to be obtained from participation in international financial markets.

In order to convince European investors that Mexico was a credit-worthy nation, Noetzlin urged Mexican public authorities to adopt new financial instruments that could guarantee the future service of the debt. The most important initiative taken in this regard was the establishment of the Banco Nacional de México in February, 1884, which became the agency for transfer of interest payments abroad.[12] The new institution not only had sufficient local capital resources to assist the government with short-term credits for current account but also had excellent financial connections in Europe since the leading stockholders of the Banco Nacional de México (BANAMEX) were prominent financiers in Paris, London and Berlin.

[12] This bank was created by the fusion of the Banco Mercantil Mexicano and the Banco Nacional Mexicano (both of which had been founded in 1881). For details see Ludlow and Marichal (1986), pp.

In order to guarantee the external debt conversion, Dublán made arrangements with the BANAMEX for the transfer of the bianual debt payments from Mexico to London, and throughout 1887 the Mexican bank advanced the sums required and placed them with Glyn, Mills.[13] It was from this time that BANAMEX became the formal agent for the government for all its foreign debt operations and payments, a role it would continue to exercise until 1913.

But this was not the only contribution of the bank to the restructuring of Mexican finance, for once again the ubiquitous Noetzlin, head of the BANAMEX board in Paris, was charged by the Mexican government with the negotiation of a foreign loan. In contrast to a previous but failed effort in 1884, Noetzlin was now able to pull off a major financial coup by arranging the issue of the great 1888 conversion loan in London and Berlin, which finally gave Mexico access to European money markets.[14]

In summary, during the nineteenth century the collective actions of foreign bondholders proved to be singularly inefficient instruments to resolve the chronic Mexican suspension of payments. It was only when the Mexican political elite came to perceive that reentry into European capital markets could be beneficial for the

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299-345.

[13] See Archivo Histórico del Banco Nacional de México, *Carpeta de contratos empréstitios públicos, 1883-1914*, in particular contracts 12-17 (November 27, 1886 and January 2, 1888) which relate to these debt service payments.

national economy that debt service was renewed and the old external debts consolidated.

Renegotiating debts after the Mexican revolution: The International Committee of Bankers in the 1920s and 1930s and its failure

In 1914 as a result of the increasing turbulence and internal conflicts generated by the Mexican revolution (which had begun a few years before in the shape of a series of prolonged, regional civil wars) the financial authorities in Mexico City decided to suspend payments on a relatively substantial foreign public debt, totaling approximately 1 billion pesos (close to 500 million dollars). Subsequently and for almost a decade, the Mexican government remained in a situation of technical bankruptcy, a fact which impeded the renewal of debt service on foreign obligations.

It was only in the early 1920s, after the end of the revolutionary wars, that negotiations were renewed on a systematic scale to resolve this new but already chronic debt crisis. While a number of bondholders' committees began to press claims on behalf of their members, the major creditors of the Mexican government resolved to adopt a new strategy which consisted in forming a committee of influential bankers to negotiate with the financial authorities. This organization became known as the *International Committee of Bankers on Mexico* and included representatives of United States, French, British and later Dutch, Swiss, Belgian and

[14] For details see Marichal (1995).

German bankers.

It is worthwhile pointing out that the leaders of this new bankers' pressure group were members of J.P. Morgan and Co., the most respected financial firm on Wall Street, in particular Thomas P. Lamont, the banker who effectively ran this institution after the death of J.P. Morgan in 1913. That this individual banking house should have assumed such protagonism was in part the result of its close ties to the also influential firm of Morgan, Grenfell of London.[15] Together they had been in charge of the financial transactions between the American and British governments during the Frist World War, a fact which underscores their strategic place in the world of international finance. The complexity and multiplicity of interests involved in the Mexican debt quandary required the services of bankers who could bridge the Atlantic and establish a basic consensus among the thousands of bondholders and financial firms that held Mexican government bonds, including bonds in Mexican publicly-controlled railway and banking enterprises.

During a period of two decades the *International Committee of Bankers on Mexico* carried out a series of negotiations with the Mexican government which resulted in four debt major debt agreements and conversions and several secondary accords. The

[15] See Meyer (1991), pp.182, 307, 341, 393 on the American-British connections sustained by the Morgan firms and the International Committee of Bankers on Mexico.

basic strategy of this collective body of creditors was to use a series of incentives to convince the Mexican government of the benefits to be obtained by renewing debt payments and therefore obtaining access to international financial markets. Among the "carrots" offered by the bankers to Mexico were assistance in obtaining diplomatic recognition by the United States and other governments of the post-revolutionary regime, an increase in foreign direct investments and financial advances to help establish the projected Mexican central bank.[16]

While Mexican finance ministers were apparently wiling to comply- as indicated for instance in the Lamont-De la Huerta debt agreement of 1922, and the Lamont-Pani accord of 1925- there existed several constraints of a national and international character which made effective application unlikely. Locally, the major constraint was the fall in fiscal revenue, particularly those derived from petroleum taxes which declined steadily after 1922. The finance ministry's chronic scarcity of foreign exchange made it difficult to meet the annual debt service which was covered only sporadically. A second limitation was the unstable and weak situation of local financial markets and of the banking system which had partially collapsed during the revolution. The post-revolutionary government struggled to reconstruct the financial system but had little interest in allowing foreign bankers to assume a decisive position within it. As a result, the

[16] See Freeman Smith (1972) and Zebadúa (1994) for detailed

creation of the central bank in 1925, the Banco de México, was carried out with domestic resources without relying on foreign capital.

Furthermore, from an international point of view the incentives offered by the bankers proved to be relatively weak. Offers to assist in the promotion of foreign investment flows were weakened by the aggressive tactics of the foreign-owned petroleum companies in Mexico which fought the government tax policies tooth and nail at the same time as they gradually *disinvested* in Mexico and moved equipment to the increasingly lucrative oilfields in Venezuela.[17] On the other hand, it was quite clear to Mexican officials that the possibility of obtaining additional investments in other sectors was limited by the weakness of the Mexican economy and the lack of interest of European bankers, absorbed by the problems of reconstruction and severe monetary instability in Europe. The only important external source of investments was the United States and, in this case, the complaints and aggressive tactics of the petroleum firms had a dampening effect on other investors.

A review of the strategies adopted by the International Committee of Bankers on Mexico indicates that while successful in mobilizing the vast majority of external creditors to Mexico, this

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analyses of the bankers' strategies.

[17] Brown (1995).

did not guarantee success with the borrower.[18] By the end of the 1920s the Mexican debt crisis had become chronic and the Great Depression only aggravated the situation as a large number of other Latin American countries also went into default on their foreign obligations and turmoil swept world money markets causing bank panics and leading to the imposition of strict controls on international capital movements. The steep drop in foreign investment flows to Latin America caused a collapse in Latin American bond quotations on the New York and London stock exchanges which to all intents and purposes implied that no more money would be likely to be provided to Latin American governments. Diverse bankers' committees renegotiated outstanding debts in Brazil, Chile, Bolivia and other defaulting nations but obtained only minimal concessions, the major exception being Argentina which continued to cover most of its debt service in gold.

The power of creditors over lenders naturally tended to diminish during these years and it would not be until World War II that new negotiations would lead to final resolution of the Mexican and Latin American debt quandary. In 1942 the ever optimistic and energetic banker, Thomas Lamont, renewed negotiations between the International Committee of Bankers and the Mexican government which led to a final settlement: the

[18] In the 1922 agreement Lamont was able to obtain the support of approximately 98% of all Mexican bondholders in the United States and Europe, surely a remarkable achievement. Bazant (1981),

accumulated interest backlog on the public external debt was cancelled and the capital reduced by a value of approximately 80%. If we consider that the Mexican bonds were quoted at barely 20% of face value on the New York exchange, the new debt accord to have been simply a recognition of economic reality. In fact, however, it was not the realism of bankers or bondholders which carried the day but rather the pressure of the United States government which was carrying out a broad range of negotiations with the Mexican authorities in order to be able to have their support for the prosecution of the war. [19]

In 1946 an additional agreement with the bondholders of the Mexican National Railways also led to a similar discount on debt, cancelling accumulated interest and reducing capital by 80%, terms which turned out to be more favorable than those accorded to any other Latin American nation.[20] In summary, market conditions, historical events and political pressures undermined the collective strategies of creditors and eventually allowed the debtors to obtain favorable conditions on the debt renegotiations during the war as the United States government laid down the conditions for the restructuring of the world order of the postwar era.

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p.216.

[19] The negotiations between Mexico and the United States were related to trade, energy, military and political issues and were carried on directly by ambassadors Castillo Najera and Sumner Welles as well as Cordel Hull and Franklin D. Roosevelt. A brief analysis can be found in Marichal (1989) chap. 8.

[20] Ibid.

Resolving the debt crisis of the 1980s: why the bankers triumphed

During almost two decades after the end of World War II the majority of Latin American governments negotiated few foreign loans. It was only in the early 1960s that there came a substantial increase in external credits, mainly for infrastructure programs and financial stabilization provided by the multilateral financial agencies: the International Monetary Fund, the World Bank and the Interamerican Development Bank. The nature of these new external debts were quite different from those of the past since the multilateral agencies increasingly established conditions which tied the loans to the implementation of economic policy in fixed directions.

But it was not only from an economic point of view that foreign loans had changed. The legal terms established by these new bank loans were much more binding than the old bond issues of the nineteenth and early twentieth centuries. In the latter governments had signed commercial contracts for the issue of bonds which established the promise of the respective government to mortgage certain tax revenues for the payment of interest and eventually capital according to a preestablished and relatively long timetable. The new loans of the 1960s signed with the multilateral financial agencies also established such conditions but in addition bound specific economic, monetary and financial policies of the debtor government to a new international financial regime. If conditions were not met according to contracts and supplementary accords, the debtor country would be subject to collective punishments by the agencies and by the creditor countries which could range from subtle to extreme.

An additional incentive to avoid default was established by the creation of an *international lender of last resort* which was the International Monetary Fund (IMF) insofar as it provided funds when severe imbalances arose in balance of payments accounts of member countries. This mechanism proved effective in the 1960s because of the relatively low level of debt and modest balance of payments problems in Latin America. However, as international financial markets changed and capital flows increased in the 1970s the effectiveness of the Fund diminished, although this would not become apparent until the outbreak of a new debt crisis in 1982.

During the 1970s the amount of capital available for loans on international financial markets increased phenomenally as a result of the twin phenomena of the recycling of petrodollars and the prolonged European economic recession. International bankers therefore began to funnel capital to Latin American on an unprecedented scale. The nature of the loans, however, were relatively new for as Albert Fishlow suggests:

> "This new capital market was quite different from the old. Loans were shorter-term and variable in their interest-rates; syndicates of commercial banks held the loans in their portfolios rather than channeling them to ultimate holders; and specific enterprises, usually public, rather than governments themselves were the borrowers, masking the extent to which they were sovereign balance of payments commitments."[21]

Apart from the abundance of capital in world capital markets, two additional factors contributed to intensify the loan frenzy, particularly between 1975 and 1980. One was the tremendous competition generated among international banks to maintain or increase their market shares in the lucrative Third World debt transactions.[22] The other was the competition among Latin American state-owned companies and banks for additional funds, and later among large private banks and firms. By 1980 the number of loan transactions had reached a climax but there was no adequate way of knowing exactly how much money was involved, how many players and how this might affect the finances of the debtor countries. There was clearly an information problem which neither the IMF nor the World Bank had resolved.

After the United States Treasury headed by Paul Volker increased interest rates in the early 1980s, the majority of Latin

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[21] Fishlow (1990), p.24.

American debtors had to find additional loans to bridge the costs provoked by the increase in interest payments. However, these costs went beyond the relatively limited budgetary possibilities of Latin American governments: financial globalization and indebtedness had surpassed both expectations and fiscal realities. The first country to fall was Mexico which declared a temporary suspension of payments in August, 1982. Its total external debt at this point was U$S 87 billion, of which almost $60 billion was public sector debt, $19 billion was private sector debt and $8.5 billion was commercial bank debt.

The impact of the Mexican crisis on international finance was dramatic and at the IMF/World Bank meetings in September of 1982 there was talk of a possible panic on world markets. The result was to spur a series of key financial agencies into action to produce a rescue package which would serve to deter a possible debacle. By November the key actors had reached agreement on an 8 billion dollar package (approximately the sum Mexico needed to service its debt in 1982): the IMF would provide 4.500 million dollars from its extended drawing facilities to help guarantee debt service payments on the Mexican debt; the Bank of International Settlements (BIS) would extend 1,850 million dollars in credits; the Commodity Credit Corporation and the Stabilization Fund of the United States Treasury would each provide 1,000

[22] The classic on this subject is Devlin (1987).

million dollars in additional credits.[23]

Subsequently, negotiations began to restructure part of the external debt and in the spring of 1983 two groups of commercial banks provided another 7 billion dollars in credits, which were intended basically to repay the rescue package of November and guarantee some interest payments in 1983. [24] In months and years following there were a large number of additional negotiations, some of them with the Bankers' Steering Committee which was headed by William Rhodes of Citibank and represented the 530 international banks that had interests in Mexican debt.

Less well-known perhaps is the fact that a second Mexican debt crisis erupted in mid 1986 as a result of the collapse of oil prices. Again the Mexican finance ministry had to advise its bankers that the debt service would have to be suspended and once again a multinational financial package was organized to avoid a moratorium. This package included a $1.7 billion dollar IMF loan, a $2.3 billion World Bank loan, a commercial loan of $1.6 billion, a Club of Paris restructuring agreement of $1.5 billion and a $1 billion dollar credit from the government of Japan. [25]

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[23] Data from Gurriá (1993) and Secretaría de Hacienda (1988), Final Appendix. Also see the important discussion by Harold James (1995) on the "Mexican Extended Fund Facility" approved in December 1982 by the IMF.

[24] In March commercial banks provided $5 billion to Mexico and in June the Club of Paris advanced another $2 billion in the way of commercial credits. Ibid.

Finally, following new restructuring agreements with the international commercial banks, a series of proposals made by successive secretaries of the United States, Treasury James Baker and Nicolas Baker, served as the basis for a more long-term resolution of the Mexican debt crisis in the year 1988. The basic accord was based on the exchange of the old bonds for new so-called *Brady* bonds, which were Mexican debt long-term debt instruments but with a US Treasury guarantee. The net result was a limited discount of the total capital owed to banks and a drop in debt service payments. [26]

In summary the debt negotiations following the outbreak of the debt crisis in 1982 were more complex than those previously experienced in Mexico history. The urgency to act for all the multiple parties involved was also greater and eventually implied an large number of short-term rescue packages and more long-term restructuring accords. It is clear that the collective power of commercial banks was much greater in these negotiations than in previous historical debt crises, but it is also clear that additional actors also contributed to this increased power of the lenders: namely the participation of multilateral financial agencies and of the governments of the leading industrial nations, in particular the United States.

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[25] Ibid.

[26] A very interesting journalistic account of the 1987/88 negotiations between the US negotiating team led by Angel Gurría and the US commercial bankers and later US government officials is found in Fernández Sotelo (1994).

An important question that is not yet resolved is who was the international lender of last resort in this and subsequent Mexican debt crises. It should also be observed that when the 1982 crisis broke an international lender of last resort mechanism had to be put into force: in this case the International Monetary Fund took the lead but in extremely close coordination with the U.S. Treasury. That this operation had the blessing of European central bankers and governments is made evident by the more passive but important participation of the BIS. On the other hand, in 1986 the IMF and World Bank took the lead without the direct participation of the US Treasury, helping forge a rather amorphous financial alliance that avoided a new (although clearly less severe) financial crisis. Finally, in 1988- at the time of final the restructuring of the Mexican public debt- the key actors were the collective of private international banks and the US treasury which provided the guarantees for the Brady debt restructuring plan.

Insofar as similar if somewhat different mechanisms were used to pull other Latin American debtors out of similar situations in the 1980s, it may argued that a new financial instrument had emerged as Altimir and Devlin suggest in a recent study on debt moratorium in the 1980s. They observe

> "The emergence of an international mechanism of lender of last resort (IMLLO) which served to avoid many suspensions of payments and formal moratoria, allowing creditors to avoid the destabilizing losses that usually accompany systemic financial crises." [27]

The Mexican debt crisis of 1994/96: Who was the lender of last resort?

Quite recently William Cline, prestigious economist of the Institute for International Economics in Washington, D.C. published a book titulled International Debt Reexamined. In this extremely detailed work Cline announced the end to the debt crisis in Latin America.[28] However and rather unfortunately at the moment that the author had prepared the publication of this study, the Mexican financial crisis broke out and he was forced to postpone the distribution of the book until he could add an additional chapter in which it was argued that despite its severity the Mexican crash did not affect the essential conclusions about the demise of the great Latin American debt crisis that had begun in

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[27] This mechanism is constituted (according to the authors) by an informal alliance of the governments of the G-7 group of countries, some of the big international commercial banks and the principal multilateral lenders, especially the IMF. The decentralized axis of the group is found in the governments of the G-7 nations, and the leadership role in the rescue operation is generally delegated to that nation which has the strongest political and commercial ties to the country or region in crisis. Altimir y Devlin, Moratoria de la deuda en América Latina, p.13-14, who cite Philip Wellons, Passing the Buck: Banks, Governments and Third World Debt, Boston, Harvard Business School Press, 1987.

the 1980s.

In many ways William Cline was right, for the Mexican financial debacle of 1994/1996 is in fact something new. It did not originate in the inability to service the old debt that had been originally issued in the late 1970s, for those obligations had been restructured in 1988 under the so-called Brady Plan. But curiously enough, between 1990 and 1994 Mexico was able to accumulate a new, additional debt of large proportions and of much shorter term. The bulk of the debt was initially that taken by large Mexican companies which sold stock and bonds abroad (Telmex and Cemex were the leaders) as well as the largest of the recently privatized banks (Banamex, Serfin, Bancomer). However in the years 1992-1994 a large number of smaller companies and banks also entered the fray and took loans abroad given the low interest rates in the industrialized countries, particularly in the United States and Japan. At the same time a bubble built up in the Mexican stock exchange which attracted much money given the stability of the exchange rate (carefully nurtured by the government).

Although the private external debts increased at extremely rates in the years 1990-1994, it was the extraordinary jump in the public external obligations in 1993/1994 that made the problem insoluble. The origins of the increased indebtedness were two-

[28] Cline (1995).

fold. On the one hand virtually all the state-owned banks (Nacional Financiera, Banobras, Banco Nacional de Comercio Exterior, Banrural) took enormous amounts of dollar, yen and mark-denominated debt abroad to benefit from the low interest rates. Furthermore, from March 1994, the central bank (Banco de México) convinced the Ministry of Finance that it could prove wise to issue new financial instruments known as *Tesobonos* (short-term debt indexed to the dollar) in order to anticipate and counter a possible flight of capital during an electoral year (1994) fraught with risks.

The issue of the *Tesobonos* was perhaps the biggest mistake of finance minister Pedro Aspe and indeed can be considered the most serious error committed by any finance minister in the history of Latin America. The main public debt instruments of the Mexican government in 1993 were still CETES, which were payable in pesos. However, as political instability increased in late 1993 and early 1994 and capital outflows began (steadily and in large volumes from March, 1994) Aspe decided to authorize the issue of increasingly large numbers of the *Tesobonos* allowing holders of CETEs to sell their securities and hedge against the devaluation risk that was emerging but without taking the money out of Mexico.

A large volume of *Tesobonos* were also sold abroad allowing for a dollar inflow to compensate partially for the capital outflow which surpassed $8 billion in the weeks following the assassination of presidential candidate Luis Donaldo Colosio. Other government currency reserves were also used to stem the flow, caused by the capital flight conducted not only (or mainly) foreign investors but by wealthy Mexican investors who were covering themselves by putting their money in New York and other financial centers.

The problems only got worse and the Salinas administration did not defuse the pressure but allowed all the political and economic pressure to build up steam simultaneously until the change in presidential administration in early December. At this point, Miguel Mancera, head of the Banco de México, committed the cardinal sin which a central banker should not. He began sending messages to privileged players in the market that he was going to devalue. The Banco de México bought back some 2 billion dollars in *Tesobonos* in the first two weeks of December, and the largest financial companies (compañías de bolsa) followed suit. The result was that dollar reserves declined and the pressure for a devaluation built up.[29] On December 20, 1994 the new Finance minister, José Serra Puche, and the director of the Mexican central bank, Miguel Mancera, resolved to move to a more flexible exchange rate, allowing for a 15% devaluation. However they had made an enormous blunder and the Mexican bankers moved in for the kill on the following day: on december 21 and in the space of five

[29] See information in a careful study published in La Jornada, February 7, 1995, based on analysis of stock exchange and public debt transactions registered.

hours they bought some $8 billion dollars, virtually wiping out the last reserves of the central bank. Subsequently there was no alternative but to allow for a complete devaluation which provoked a free fall for the peso.

The results of the devaluation were a financial crisis followed by an economic depression which has been the worst in Mexican history since the Great Depression. The errors of the financiers (public and private) have proven more costly than ever, as more than one million people lost their jobs in 1995, a large number of banks entered into technical bankruptcy (being saved only by government intervention) and the national gross product dropped eight per cent in one year.

The financial catastrophe was so ominous that before the lenders began to mobilize, the United States Treasury headed by Robert Rubin organized an extraordinary emergency financial package in February 1995 which initially involved a guarantee of almost $40 billion dollars for Mexico, the largest sum ever to be provided to one individual country. The total actually disbursed during the years 1995 and 1996 by the US Treasury (using the Monetary Stabilization Fund) was $12.5 billion dollars, plus slightly over $17 billion disbursed by the International Monetary Fund, plus some $4 billion from the World Bank and the Interamerican Development Bank and lesser sums from commercial banks.

Paradoxically it should be noted the so-called financial bailout of Mexico was not carried out by the actual lenders of the monies that had generated the crisis which threatened a suspension of payments. What occurred was that the potential danger of a Mexican moratorium was perceived by the financial and political elite in the United States to be so serious that emergency measures were considered indispensable to impede a breakdown of world financial markets. It was deemed necessary to demonstrate to the increasingly volatile global financial markets that there was an international lender of last resort mechanism which would operate with force to detain the crisis and impede its transfer to other countries.

The initial objective of the rescue package therefore was not to help the lenders who had advanced money to private or public entities in Mexico. It was something quite different, being the result of an immense increase in international capital flows on a short term basis which contributed to global volatility and which had surpassed all expectations. The regulation of these flows was not contemplated or possible, but by organizing the huge financial package for Mexico, the United States Treasury and the International Monetary Fund were rather more simply telling investors and bankers worldwide that stability was the *desideratum*.

But what happened with the lenders who actually advanced the money that built up the huge volume of short-term external debt in 1990-1994? The majority of lenders who bought *Tesobonos* did not lose money for they got their funds back in dollars; in fact, Mexican investors who bought huge quantities of these instruments with pesos in the weeks before the devaluation made enormous profits afterwards as the peso value of these peculiar securities doubled. In effect, the US/IMF financial rescue package allowed for a huge transfer of funds to Mexico and guaranteed that these lenders got their money as the Mexican government paid off each of the successive amortizations on time during 1995.

On the other hand, foreign investors who invested in the stocks of Mexican companies lost large amounts of money because of the fall in quotations. Finally, the foreign banks that provided enormous advances to Mexican banks did not lose much money because the government assumed (or guaranteed) most of these debts. It was the Mexican taxpayers who were expected and indeed will be forced to pick up this expensive bill.

In summary, the recent Mexican financial collapse is indeed a new type of debt crisis and it would be a mistake to think that there are very close parallels with that of the 1980s. On the contrary, the present situation is the result of more recent developments in global financial markets which have gained extraordinary strength in the last decade. However, if one compares the mechanisms used to attempt to deal with both crises- that of 1982 and 1995- in its initial stages then it is clear that there are some significant parallels, especially with respect to the international mechanism of lender of last resort. The actors involved in November 1982 are basically the same as those involved in February 1995 except for the fact that they had to multiply their commitments in the latter crisis by a large factor. This helps explain the recent IMF decision to double the fund of special drawing rights which can be made available for dealing with new financial crises.

The brief comparison of four Mexican debt crises carried out in this paper would seem to suggest that a historical approach offers considerable insights for an understanding of the complexities of these financial events but at the same time it also indicates that it is important to take into account and anticipate the extraordinary changes that are occurring in contemporary financial world markets. They are in many ways unprecedented and can lead to even graver debt crises than those of the past if not dealt with well before the danger is imminent.

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Addenda: In the final version of this paper we will present the charts of the different lenders' groups, organizations and institutional alliances in the four debt crises.

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