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THE FINANCES OF HEGEMONY IN LATIN AMERICA: DEBT NEGOTIATIONS AND THE ROLE OF THE UNITED STATES GOVERNMENT, 1945-2005[i]

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In Latin America, it is common currency that the contemporary era of financial instability began basically as a result of the loan boom of the 1970s and the subsequent debt crisis that exploded in the early 1980s. The bankruptcy of most of the governments of the region opened a prolonged period of negotiations between politicians, technocrats and international bankers that were to continue for a decade. The Latin American debt crises of the 1980s threatened not only the financial survival of governments of the subcontinent but also menaced international banks and financial markets with a possible debacle. This was, in fact, a first and perilous chapter in the history of contemporary global finance that has been marked by successive financial crises.

The debt crash of the 1980s led to the most severe economic downturn in the region since the depression of the 1930s. This was accompanied and followed by a profound and radical process of political and economic restructuring that included not just debt renegotiation but privatization of hundreds of state enterprises, trade liberalization and other *neoliberal* reforms. The reforms contributed to push Latin American states and economies into a more intense process of globalization in the early 1990s which, however, was again soon followed by the multiplication of financial crises between 1995 and 2002. As it now stands, Latin America has a larger foreign debt than ever and has not been able to get out of the debt quandary. If this situation continues it will confront continuing obstacles to economic and social development and will, in all probability, experience renewed and intense financial crises in the early decades of this twenty-first century.

The possible solutions to the debt dilemma continue to be debated in many forums, political, financial and academic. Indeed, the contemporary literature on Latin American finance is now enormous, whether it be daily news reports, research papers, political evaluations or books on the recent trends of external debt. This outpouring is further amplified by the explosive growth of studies on financial globalization as the process of integration of the world economy advances rapidly. But it is important to note that while the degree of financial globalization may be unprecedented, it has complex historical roots. Furthermore, as this paper will argue, the huge debts taken by Latin American states have a very large political ingredient and therefore their analysis is critical to debates on the directions of global political economy.

Economists tend traditionally to limit their studies of debt to review of financial trends or to construction of analytical models with some kind of predictive potential. But the fact of the matter is that since debt is a key instrument of overall growth strategies of Latin American countries, political analysis is also essential to gauge the possible financial options, past, present and future. Since the bulk of Latin American foreign debts have been contracted by Latin American states, these are eminently political debts, which have mortgaged public finance for their service. But, paradoxically, public external debts are not simply *national* debts. The character of external *bonds*- payable in foreign currencies, negotiated by foreign banks and bought and sold by foreign investors- makes them a kind of financial instrument (and commodity) subject to international financial regulation and practice. However, this also implies that when renegotiations of Latin American external bonds take place, the governments of the most important investor groups, in particular the United States, attempt to exercise their power over such negotiations. A somewhat different kind of foreign debts are the *bank loans* provided directly by international multilateral agencies such as the International Monetary Fund, the World Bank or the Interamerican Development Bank. While it may be considered that these loans are international public loans, the question of sovereignty is again crucial. Despite the fact that multilateral agencies are owned by many states, in practice a few governments (with greater voting power) - in particular the United States- have a disproportionate influence over these agencies. Hence their lending strategies are not designed independently of the United States government but rather are carefully supervised by Washington.

In summary, the politics of external debts is complex and cannot be limited to an economic analysis. In this chapter we attempt to analyze the increasing role of the United States government in debt strategies in Latin America, particularly over the last quarter century by looking at the region as a whole but focusing our attention particularly on the cases of Mexico and Argentina. Such a focus implies severe limitations, although it may be hoped that the analysis can contribute to stimulate complementary studies on the recent history of the international debt negotiations of other countries of Latin America, as well.

In this regard, it is the object of this paper to contribute to this purpose by suggesting the importance of carrying on more research on what Louis Pauly calls "the actual political foundations of the capital markets now so prominent a feature of the international economy."[ii] In the case of Latin America, the work of researchers such as Cheryl Payer and Paul Drake, as well as many classic articles in NACLA have constituted pioneering literature. More recently, Oscar Ugarteche and Eric Toussaint have published important contributions.[iii] But much more work is needed to provide a solid groundwork for future proposals with regard to the *political* analysis and understanding of global financial dynamics and the possibilities of reform of international financial relations.

A sub theme of this paper, which is interwoven in the text, is the difficulty of popular movements in Latin America in confronting financial power structures and strategies. Identifying the nature of the financial strategies of the hegemonic power in the contemporary age has been particularly difficult for a variety of reasons. In the first place, this is so because market and corporate forces are more dispersed and less visible in the political debate than the State. In the second place, financial strategies imply a complex mix of fiscal, monetary, banking and debt instruments and policies which are managed by both public and (increasingly powerful) private actors. The complexities of the financial sphere lead most concerned citizens to focus their attention preferentially on other issues that may prove easier to grasp. For instance, it is easier to grasp and denounce the significance of sheer military power or the insidious threats of intelligence operations rather than the consequences of monetary or financial hegemony. As a result, popular movements have proved slow in the Third World (and elsewhere) in formulating programmatic critiques and strategies for rethinking a new and more equitable international financial order.

In summary, it is our contention that although many studies on Latin American external debt devote preferential attention to the economics of the phenomenon, to the evolution of financial markets and expectations of bankers and investors, a complementary and necessary approach is to look at the politics of debt studies. There are two sides to debt politics: one is basically domestic and requires the analysis of the individual financial and development strategies of each government that takes much foreign debt; the second is the international politics of debt, and particularly the influence of the governments and other key actors of the creditor nations in many key debt negotiations. In this chapter I focus attention on the latter problem and, more particularly, on the role of the United States in successive debt negotiations and resolutions between 1946 and 2005. I will briefly compare the debt resolutions which took place at the end of the 2nd World War, the debt renegotiations of the 1980s, and the responses to the financial (or debt) crises in Mexico and Argentina in recent years. In both cases, the United States government played a major role but a much more *direct* one in Mexico than in Argentina. However, in order to delve into the international politics of Latin American debt of recent times, it is worthwhile first commenting briefly on the concept of *hegemonic states* in international finance during the last hundred and fifty years.

<u>The role of hegemonic states in international finance: historical perspectives</u>

According to standard economic textbooks, the governments of the most powerful nations did not generally intervene in international financial markets in the 19th or early 20th centuries. Much of this literature presupposes that one hegemonic financial power, Great Britain held sway until 1914, although research has increasingly demonstrated that the degree of competition in global finance was intense with France from the mid nineteenth century and Germany from the 1880s. In any case, if we review the literature on the international projection of British finance and politics it is possible to observe the prominence of arguments put forth by conservative historians as such Robinson and Gallagher or D.C.M. Platt who maintained that even when there financial conflicts which led to political intervention, the real motives of the bankers and politicians of Great Britain were essentially “strategic”. For instance, these writers maintain that after the bankruptcy of the Egyptian government in 1876, the takeover of the Suez Canal and the establishment of a neocolonial administration in Cairo in 1880 were simply instruments of Whitehall to guarantee continued access to British India, the jewel of the empire. Christopher Platt even went so far as to argue that during the nineteenth century the large number of interventions by the British Navy in Latin American ports to pressure for payments of debt (owed to bondholders or merchant groups) were not a sign of financial imperialism; Platt cited some 40 such military incidents or interventions.[iv] More recently, authors such as Charles Lipson, who have focused on this issue, are somewhat more nuanced, but emphasize the *policy of restraint* by the British authorities in their expansion worldwide in the nineteenth century, at least in the financial sphere. [v] Such arguments are clearly full of holes, but constitute the orthodox contention in favor of a benign view of the role of imperial powers in what we may term the age of birth of global finance.

An additional element to keep in mind is that no international financial organizations (*a la* IMF) existed in the 19th and early 20th centuries. In that age of free capital markets, there were few rules that governed international financial transactions outside of the terms of loan contracts themselves, which stated- as they still do today- that conflicts between debtors and creditors would be resolved in the courts of the country of creditors. But such strictures were not necessarily compelling. Hence, from the late 19th century, the main strategy promoted by bankers and their political allies was to attempt to stabilize international finance through increasingly widespread adoption of the gold standard. As Barry Eichengreen - the foremost financial historian on the subject- has argued, the imposition of the gold standard was possible at the time because politics and finance were, in many senses, decoupled (*delinked*) by the lack of power of social and political movements to impose fiscal and financial objectives upon governments.

> "The pressure twentieth century government experienced to subordinate currency stability to other objectives was a feature of the nineteenth century world. The credibility of the government's commitment to convertibility was enhanced by the fact that workers who suffered most from hard times were ill positioned to make their objections felt. In most countries, the right was still limited to men of property…"[vi]

On the other hand, during the interwar period (1918-1939), Eichengreen maintains that practically all states tended to raise trade, monetary and financial barriers, reducing the intensity of international transactions. The gold standard lost ground and was finally discarded by the economic cataclysm of the Great Depression.

After World War II, a new international financial architecture was put in place which attempted to conciliate national economic interests with international financial supervision: the creation of the IMF was the most important example of the latter. Furthermore, many other multilateral and national financial innovations began to be put in place, including the establishment of multilateral development banks- with headquarters in the United States, the creation of state banks (export/import banks, development banks)- in Europe and Latin America, in particular- and a much more active financial role of all governments in many kinds of national development programs. . Coordination among central banks began to be standard as well as the promotion of an increasing number of official and unofficial of financial/political instruments for coordination among creditor states and banks: for example, the Club of Paris (established in 1956) and the G-7 (1970s).

In the postwar world, the role of the United States was clearly hegemonic in the financial sphere, a fact reflected in the key role of the dollar as international currency reserve. In terms of international financial transactions, the role of the United States government was fundamental, for example in the finances of it military forces on a world wide scale, transferring a huge and sustanined volume of funds to bases in Western Europe, Japan, Korea, the Phillipines and various points in the Caribbean, for decades. Complementary was the Marshall Plan which implied the transfer of some 12 billion dollars to Europe after 1947. In addition, it may be noted that loans provided by multilateral financial agencies were in dollars, although in the case of IMF, more flexible monetary instruments were increasingly used in the case transaction based on Special Drawing Rights. Later in the 1960s and 1970s, the hegemony (at times almost monopoly) of the dollar began to cede as many more international debts were contracted in pounds sterling, marks, francs and yens, and as the circle of major financial powers broadened. As a result, the coordination of policies on a world scale became necessary, as witnessed by the creation of the G-7 and similar bodies. Moreover, powerful private banks from the G-7 countries all began operating much more actively on a global scale, and multinational companies also began increasing their financial investments and transactions abroad.

As a result of the multiplication of international financial actors , a *political analysis* of the financial architecture and dynamics in this period becomes more complicated. In this regard, it is worthwhile keeping in mind that for several decades, there was no real questioning of the postwar *Bretton Woods consensus* on the need to maintain low domestic, interest rates, convertibility to the dollar (at a fixed parity of $35 dollars to the ounce of gold), and bank stability, all of which were tied, in a varying degree, to protectionism for trade and industry. Yet by the 1960s, with increased trade competition among the United States, Japan and Europe, accompanied by the expansion of multinational enterprises and later multinational banks, the development of the eurodollar markets and a rising complexity of international transactions on leading capital and money markets, this consensus began to break down. The huge deficits of the United States government during the Vietnam War were also major factors which led to the breakdown of the Bretton Woods architecture, and attacks on pegged exchanged rates began to be common.

The result was that in 1973 the postwar monetary agreements came tumbling down, and a new period of increasing financial instability, rising interest rates and rapidly expanding international capital flows presaged the age of financial globalization. Some authors have designated this period as that of *Bretton Woods II*, although others would argue that it was not until the 1980s that the *brave new world* of global finance would really come into its own, provoking an enormous increase in financial instability, particularly in the indebted countries of the Third World.

In any case, it is the argument of this paper that the Latin America lending booms of the 1970s constituted a fundamental antecedent of modern financial globalization and reflected the enormously pernicious consequences of adopting debt policy as the preeminent priority of government development finance strategies. We will discuss some aspects of the adoption of these policies but – for reasons of space – will focus on the changing responses of the United States government to international financial instability in Latin America, with emphasis on debt renegotiations.

The Latin American debt negotiations at the end of World War II

The Second World War and the postwar era led to an intense process of politization of international finance, under the hegemony of the United States government. Hence it is worthwhile to begin by reviewing the Latin American debt negotiations that took place in the 1940s insofar as they reveal historical antecedents of the *political* nature of many foreign debts. Most Latin American governments had suspended payments on their foreign debts in the years 1931-1933 as a result of the Great Depression. A wide array of debt renegotiations took place during the 1930s, but generally speaking the restructurings did not produce a resumption of debt service. As a result, the Latin American defaults generally continued until the end of the World War. At that time, authorities in Washington resolved to adopt a much more activist role in the negotiations between Latin American debtor states and mainly European private creditors. The European investors, in fact, had no option but to accept the preeminent role of the United

States government and its banker allies in the successive restructuring of Latin American debts between the end of the Second World War and 1950.

The first major debt negotiations were those conducted with Mexico during the years 1942-1946. The bankers and private creditors were forced at this time to accept the advice of the United States government which tied these debt renegotiations to other important accords signed between the US and Mexico which had developed as a result of World War II. At the end of the war, the US government virtually obliged creditors to accept a huge discount on their outstanding bonds, and the Mexican foreign debt was thus reduced by 80%. There followed the Brazil debt negotiations in 1945 which allowed for a reduction of 50% on the value of that nation's external obligations and in 1948 with Chile, also with a partial reduction in external debt stock and service.[vii]

Quite different was the case of Argentina which was at loggerheads with the United States government. Juan Domingo Peron had huge cash reserves which had accumulated in the Bank of England during the war against Argentine exports. In 1947 Peron nationalized the foreign owned railways, the telephone companies and paid off the entire debt in gold at 100% of its nominal value. This was a major populist coup but a Pyrrhic victory as it wiped out a good deal of Argentine reserves, which had been, until then, the richest government in Latin America.

After these negotiations, following the end of World War II, and for almost 20 years, Latin America did not receive much foreign finance in the way of loans.

From 1955 the IMF offered several bridge loans to different Latin American governments when confronted with balance of payments problems, and from the early 1960s development loans began to flow from the World Bank and the recently established InterAmerican Development Bank. But very little came to the region in the way of private bank loans (except US commercial bank loans to companies in Mexico in the 1960s). [viii] There were also very few issues of Latin American government bonds abroad until late the 1960s.

The reason for the weak demand in Latin America for external finance during more than a quarter of a century can be attributed to the fact that import substitution industrialization (ISI) was basically domestically -financed and reasonably successful despite emerging problems generated by inflation-driven growth policies which had begun to be adopted from the 1950s.

This situation changed in the 1970s as a huge new loan boom gained strength throughout Latin America. The loan boom of the 1970s has been attributed to various causes, the most important being the recycling of petrodollars, as bankers sought new investment outlets as result of the drop in international demand for credits caused by economic recession in Europe and to a lesser extent the USA. It should also be noted that in most other regions of the world demand for external finance was either limited or not feasible: in Japan and Korea, for example, domestic banks financed industrialization; in the nations of the socialist bloc, the USSR, Eastern Europe and China, domestic state-controlled finance was the agency of industrial development; in Sub-Saharan Africa, the volume of external financial flows was reduced, although there was a rising current of official credits. In summary, during the 1970s, there was much pressure by bankers and other private financial actors to invest the rapidly accumulating petrodollars preferably with state guarantees on repayment. As a result, it was not illogical that the bulk of the loans went to Latin American governments, state enterprises and banks which demanded financial support for their fast expansion plans in the 1970s and in other cases to cover deficits and arms expenditures by local military governments.

The Latin American loan boom of the 1970s: finance and politics

No region in the world absorbed such large debts as Latin America in the decade of the 1970s, a fact which- we insist- merits more comparative reflection and discussion. The remarkable feature was that virtually all Latin America governments and public enterprises sought the easy money at what were argued to be low interest rates. The *supply side* explanation of the lending boom was emphasized in particular by Robert Devlin who argued that the excess sums of petrodollars in western banks stimulated a ferocious competition to obtain clients who would take loans. On the other hand, the *lemming-type* behavior of all Latin American governments in seeking loans has yet to be adequately explained in theoretical terms, although both the supply and demand sides of the equation were clearly important. In any case, any such explanation requires a political component (or more precisely a *political economy* component) to be able to account why different types of regimes in Latin America all became engulfed in the financial frenzy.

In the case of Argentina the expansion of the foreign debt took place basically during the bloody military dictatorship of 1976-1983, although it had begun on a small scale before. In 1975 the Argentine foreign debt stood at 7,900 million dollars ($7.9 billion) but rose to 45,000 million dollars ($45 billion) by 1983. A review of the bond issues of those years indicates that a large part was guaranteed by state companies such as YPF, the state-owned water, electrical and telephone companies. Great sums were expended in hydroelectric projects, highways and an unknown amount in military expenditures. Private corporations also took debt abroad, although these debts were mostly absorbed by the state by means of exchange rate insurance schemes in the years 1982-1983.

[INSERT CHART ARGENTINE DEBT]

The funds that flowed into Argentina from abroad spurred a tremendous speculative boom in local financial and real estate markets that paradoxically allowed for a huge exit of local capital. Capital flight was predicated on the inflow of foreign currency as a result of the rising government indebtedness. The finance minister of the dictatorship, José Alfredo Martínez de la Hoz, gave his blessing to this peculiar and perverse financial casino. The result was that huge fortunes were accumulated by members of the private sector (including entrepreneurs, rentiers, technocrats and generals) while the state became increasingly weighted down with foreign debts.

The economic strategies adopted by Martinez de Hoz- whose tenure became known as the era of “la plata dulce”- were well known by the IMF and the US government which provided full support to the military dictatorship and its high-level servants. In this regard, mainstream political and economic analysts have generally argued that there was virtually no connection between international finance and geostrategic priorities of the United States government. However, it is notable that the international banks should have funneled such huge sums of money precisely to the military dictatorships and authoritarian governments which reigned in Latin America in the 1970s. This point was raised in the classic special numbers by NACLA published in late 1973 called "New Chile" which demonstrated how multilateral lending agencies had decreased loans to the Allende government. It has also been remarkably well illustrated by Eric Toussaint in recent articles on the CADTM website which demonstrate how loans took off after the military coups in Chile and Argentina.

In the case of Mexico, the reasons for increasing foreign indebtedness were linked to the need of the state political party, the PRI (Partido Revolucionario Institutcional), to reinforce populist strategies which could guarantee the immense party bureaucracy and its allies a continued political monopoly (not a democracy). One of the key instruments was the financing of state companies which provided jobs, bureaucratic plums and thousands of contracts. In the 1970s, two public enterprises, Petróleos Mexicanos (PEMEX), the profitable state petroleum monopoly, and Comisión Federal de Electricidad (CFE), the state electrical consortium, took the greatest number of loans. The foreign debt of PEMEX had stood at barely $ 367 million in 1970 but by 1981 had surpassed $ 11 billion, representing 27% of total long-term Mexican public debt. Promoting electrical expansion was also a major government priority under the administrations of presidents Luis Echeverría (1970-1976) and José López Portillo (1976-1982), which led the external obligations of the public electricity corporation, CFE, to rise from $ 990 in 1970 to over $8.2 billion by end of 1981.

The 1970s thus marked a major change in international financial operations. This was no longer the age of *bond finance* of the 19th and early 20th centuries. [ix] Now it was *bank finance* which dominated. All the major U.S., European and Japanese banks were recycling petrodollars to Latin America and not surprisingly in this decade Latin America stood out as the leading region of all developing nations in the world in terms of reception of loan flows from abroad.

INSERT CHART MEXICO DEBT

<u>The debt crises of the 1980s: the increasing role of the United States government in financial negotiations</u>

The loan boom came to a close in 1982 with the outbreak of the debt crisis, provoking panic on world markets. This grim prospect spurred a series of international financial agencies into action to produce a rescue package which could serve to deter a possible debacle. This also involved the United States government, but not, initially, as the most prominent actor.

Mexico which had declared itself virtually bankrupt in late August, 1982 was the talk of the town among the hundreds of bankers and high-level technocrats who met in the IMF/World Bank meetings at the end of September, and there was much fear of the fallout this situation would create for world financial markets. By

November, the key actors – Mexican technocrats and international bankers and U.S. Treasury Department officials- had reached agreement on an 8 billion dollar package (approximately the sum Mexico needed to service its debt in 1982 and early 1983): 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; and the Commodity Credit Corporation and the Stablization Fund of the United States Treasury would each provide 1,000 million dollars in additional short-term funds. [x]

Subsequently, negotiations began to *restructure* part of the external debt. In the spring of 1983 two groups of commercial banks provided an additional $ 7 billion in credits to Mexico in order to stretch out the November rescue package and to guarantee interest payments for the rest of 1983. [xi] There followed an intense sequence of negotiations during several years which allowed for a series of renegotiations, although no definite solution. Despite the initial intervention of the multilaterals, it was the private international banks who took the drivers' seat and first renegotiated, rescheduled and then securitized and/or sold their stakes in Latin American loans. Walter Rhodes of the Citibank was the paradigm of the debt renegotiator, heading a great many of the banker teams that negotiated with the Latin American governments in the 1980s. In the case of Mexico he headed the Bankers' Steering Committee, which represented the 530 international banks that had interests in Mexican debt.

Writing in 1989, Charles Lipson argued ingenuously that: “In the case of debt renegotiations (of the 1980s) and security issues, the delinkage has been almost complete. Even though dozens of countries, including virtually all of Africa and Latin America, have required substantial debt restructuring, only rarely have security issue intruded on the formulation of US debt policy. “ According to this view, the United States government did not participate very openly in most of the other debt negotiations until 1987, although its presence was felt. But even Lipson, recognizes that “Given Mexico’s strategic and diplomatic significance, the US government has been willing to do far more in debt restructuring and temporary financing than with other major debtors.”[xii]

In 1988, with the establishment of the Brady Plan- beginning first with Mexico- it became evident that the U.S. Treasury was taking an *increased* role in the resolution of the debt crisis in order to stabilize world financial markets and assure the banks that they would recover most of their money. 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. [xiii]

The Mexican debt restructurings reflected the success of the alliance of the IMF, the U.S. Treasury, and the international private banks in guaranteeing continued debt service payments and at the same time impelling a dramatic restructuring of the Mexican public sector, including privatization of state enterprsies and liberalization of foreign trade. This set of neoliberal policies which were, in part, the offspring of the debt crisis and which were applied in many developing nations came to be known as the *Washington Consensus*.[xiv] Once neoliberalism was generally adopted by most Latin American political and financial elites, it became possible to carry out new programs of financial engineering- like the Brady Plan- which it was expected - could help reconciliate debtor countries and their numerous international creditors.

The initial stages of what would become the Brady plan had been negotiated by the Mexican president Miguel de la Madrid (1982-1988), but the new debt program was actually put in place by his successor, Carlos Salinas de Gortari (1988-1994). The Brady plan thus became operative for Mexican debt in 1989, serving as the basic model for subsequent financial arrangements in most other Latin American nations.[xv] Furthermore, the Brady plan was key in launching the age of *equity finance* in the Third World.[xvi] Much of the money that began to pour into Mexico in early 1990 was from pension and mutual funds now interested in so-called “emerging markets”, but a fair amount was also of Mexican plutocrats who had stashed away billions of dollars in the United States or in off-shore banking accounts. A major attraction for the return of these funds to Mexico was the privatization of numerous state-owned Industrial and banking firms.

Financial crises of the 1990s: bailouts and the perverse connection of Mexico-Washington elites

According to the International Monetary Fund, between 1990 and 1993 Mexico received $91 billion, or "roughly one fifth of all net inflows to developing countries."[xvii] Of this sum, portfolio inflows amounted to $ 61 billion while foreign direct investment was only $ 16.6 billion. The bubble in the Mexican stock exchange continued to attract money from the United States as a result of stability of the pegged exchange rate, carefully nurtured by the Mexican Central Bank and the Finance Ministry. But that apparent stability was not based on solid economic fundamentals, for by the early 1990s Mexico had accumulated a cumulative commercial deficit of over $ 100 billion as a result of adoption of the General Agreement on Trade and Tariffs (GATT) in 1984 and subsequent negotiation of the North American Free Trade Agreement, ratified in November, 1993. Commercial deficits were mainly covered by the inflow of portfolio (hot) capital flows. But the money could as easily leaves as it had entered. This instability would soon contribute to the most severe financial crisis in recent Mexican history.

The history of events in 1994 in Mexico provides an excellent case study of how politics can accentuate the course of financial developments. But not all political events have the same impact. For instance, some observers argued that the launching of the rebellion of the Zapatistas in Chiapas on January 1, 1994 had a major impact on Mexican financial markets but, in fact, *this was not the case*. It was rather the March assasination of presidential candidate Luis Donaldo Colosio, which provoked panic among wealthy Mexican and foreign investors, who took over $ 10 bilion out of the country in a few weeks. [See Graph 1]. This was the moment for a devalution to have been implemented but the president Carlos Salinas, and finance minister Pedro Aspe did not want a blemish on their administration and held out till the end, in a kind of financial Russian roulette, which finally devolved into the devaluation of December, 1994 and the subsequent collapse of the Mexican economy in 1995, with one million thrown of their jobs, thousands of firms driven into bankruptcy, and eventually almost the entire banking system also pushed into technical bankruptcy.

The result of the financial bankruptcy of the Mexican government in December of 1995 led not only to a general economic crisis but also threatened with a more general threat to international financial markets, particularly because of the large amount of Mexican debt that had been issued on the emerging markets. Bankers and investors everywhere were terror/stricken with the prospect of capital flight from Latin America back to Europe, Japan and the United States. As a result, the head of the U.S. Treasury, Robert Rubin (by profession a banker who had been heavily engaged in global finance), convinced the United States president, William Clinton that a Mexican rescue program was urgently needed. It is now a historical cliché that the February 1995 rescue plan, which initially involved a guarantee of almost $40 billion dollars for Mexico, was the first of the great bailouts of the late 1990s and represented one the largest loan operations 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.[xviii]

By organizing such a huge financial package for Mexico, the United States Treasury- in the person of Robert Rubin- and the International Monetary Fund- in the person of Michel Camdessus- were rather dramatically informing investors and bankers worldwide that they should not pull entirely out of Mexico since stability was preferable to a prolonged *international* financial crisis. Camdessus labelled the Mexican cataclysm as the first of the 21st financial crises, and he was certainly not mistaken, as many others soon followed.

The objective of the rescue package, however, was not simply to help the government confront the financial crisis unleashed by the devaluation. The immediate object was quite simply to bailout the foreign and national investors who had bought a huge volume of *tesobonos* (Mexican government short-term public debt) in 1994, indexed to dollars. The affluent lenders (each *tesobono cost U$S 100,000*) did not lose money after devaluation, for they almost immediately got their funds back in dollars. In fact, many wealthy Mexican investors made enormous profits for they had bought huge quantities *tesobono*s with pesos in the weeks before the devaluation but afterwards got double their money back as the value of these peculiar securities doubled.[1] In effect, the US Treasury/IMF financial rescue package allowed for a huge transfer of funds to Mexico which allowed these lenders to get their money. The financial authorities of the Mexican government paid off each of the successive

[1] Only wealthy Mexicans could participate in this financial gambling since each Tesobono cost U$S 100,000.

monthly amortization of the dollar-indexed *tesobono*s on schedule during the year 1995. Evidently, if the government of Ernest Zedillo had had the courage, it could have found a much less costly solution by calling for a restructuring of this huge very short-term debt with an offer to repay in five or ten years instead of the incredibly brief amortization schedule of less than one year. But neither Zedillo nor Rubin were in a mood to provoke any irritation in the investment community. The bills for the bailout were passed on the Mexican taxpayers and the state oil company, Pemex. These policies clearly were the most incompetent adopted in the modern financial history of Mexican history. And, paradoxically, the men most directly responsible for generating the creating the conditions which led to the huge debacle at the close of 1994, Miguel Mancera, director of the Banco de Mexico and the finance minister of Mexico, Pedro Aspe, got off scot free.

The costs of repayment to creditors was huge. During 1995 and 1996 Mexico repaid over $14 billion to the U.S Treasury to liquidate the emergency loans of early 1995, winning the applause of the Clinton administration for having fulfilled its financial obligations ahead of schedule. Repayment of the huge sum of $ 17 billion to the IMF was also covered by the Mexican governments in the 1996/98 period, using the bulk of petroleum revenues for this purpose.

If one compares the mechanisms used to attempt to deal with debt crisis of 1982 with the financial collapse of 1995- then it is clear that there are some significant parallels with regard to the responses adopted, especially with respect to the international mechanism of lender of last resort. The actors involved in organizing the financial rescue plans for Mexico in November 1982 were basically the same as those involved in February 1995 and included the U.S. Treasury, the IMF, the World Bank and representatives of private international banks, all of them participating actively because of the importance of Mexico in the international financial and political arena. However, the United States government, in particular, had to make much larger commitments in the crisis of 1995. The IMF also had to increase its emergency support by a large factor, which helps explain the IMF decision to double the fund of special drawing rights which could be made available for dealing with financial crises in the future.[xix] And these crises were soon in coming.

In fact, the IMF virtually exhausted its resources when it organized similar bailouts to confront the subsequent financial crises of the late 1990s in Indonesia, Korean, Russia, Brazil, Turkey. What is of particular interest for our analysis of the Mexican crash, is the extraordinary role assumed by the United States government, in particular the heads of the Department of Treasury in providing a what they considered to be a necessary rescue mechanism for Mexican finance. Indeed, what this financial collapse (as well as other emerging makets crises of the late 1990s) demonstrates is that as financial markets have become more complex and integrated in recent decades, the role of governments has been crucial. In this regard, it would appear that despite the rhetoric of official reports of the IMF, it is clear that the United States government in alliance with the IMF played an increasingly decisive role in the *regulation* of financial markets, although the orthodox view is that the role of the IMF should act essentially as lender of last resort, in times of huge emergencies. In other words, it is argued that governments should not interfere with financial markets and speculation when they are on the up. On the other hand, when they are on the down, then it is clear that they- and more particularly the United States Treasury- were obliged to rush to the rescue. The metaphor – typical of the 1990s- was clearly that of the fireman rather than the policeman. The financial rescue operation organized in Mexico in February 1995 by then Secretary of the Treasury, Robert Rubin is a prime case in point.

Turn of the century: the Argentine financial crash and the wavering financial game of Washington

The Argentine financial debacle of 2001-2002 demonstrated the limits of the game of global financial roulette which had been played to the hilt in the 1990s. It also revealed increasing contradictions in the strategies of the United States with respect to management of Latin American foreign debts. The IMF had initially offered huge financial guarantees to administration of president Fernando de la Rúa in 2001 when confronted with a potential default. However, the IMF subsequently reneged when Stanford economist, Anne Krueger was named sub director of the powerful multilateral agency. She called a halt to future lending to Argentina, arguing that the moral hazard was unacceptable. As a result, the IMF soon forced the Argentine government to default, but paradoxically with its own, unspoken blessing. This unprecedented decision was taken in consultation with the Treasury Department and the White House. For the first time, the IMF had decided to stop playing the fireman but in so doing, it obliged the Argentine authorities to adopt a new game plan. The largest default in history began and its resolution was unexpected.

It is now recognized- even by the IMF- that lack of adequate supervision in the 1990s by the multilateral agencies was heavily responsible for the financial debacle in Argentina. By allowing for an incredible increase in Argentine indebtedness in times of global and domestic financial uncertainty, the tragedy was made inevitable. It may be recalled that even in the midst of the Mexican crisis of 1995, the Argentine government- under the administration of Carlos Menem- devoted itself to financing growing deficits with rising foreign debts. International investors took loan after loan confiding that they would get their money back because of the stability of the fixed exchange regime (with a dollar currency board) that had been adopted in Buenos Aires in the early 1990s. But the foreign debt had begun increasing at the rate of almost almost $ 10 billion per year from late 1992, continuing until 2001 and the subsequent meltdown. From $59 billion in 1990, the total debt rose to almost $160 billion by 2002.

(INSERT Chart…).

After the fall of the De la Rúa government at the end of 2001, an interim presidential administration- headed by the Peronist party leader, Eduardo Duhalde, attempted to confront the crisis by suspending convertibility and debt service on foreign bonds. Debt service payments continued to the IMF and other multilateral agencies. Nonetheless, resolution of the default remained in suspense until after the national elections in the spring of 2003 which brought to power another, more leftist Peronist politician, Nestor Kirchener. The new president adopted an incredibly hard-line with the foreign bondholders, maintaining the default on half of the foreign debt until early 2005, when an offer for conversion of the bonds at reduced value was offered to and accepted by the majority of international investor groups.

The negotiations of the Argentine debt have been incredibly complex and have spurned a new polemical literature in the press, in financial journals and the publications of specialized financial agencies and in recent books, a good number published in Buenos Aires. [xx] While it would appear that in the Argentine debt negotiations, the IMF and the United States government are affirming that markets should resolve the financial debacle, it is clear that it was the strategy and actions of the Argentine government which resolved the default and obliged the markets to accept its proposals. In this case, a Latin American state gained stength in the negotiations by making a firm offer and by not backing down. The results proved successful and represented a major lsetback to bankers, investors and speculators.

The Argentine case is a major turning point in Latin American financial history and points to the possibility that other governments in the Third World may also follow in its step and demand more equitable treatment from bankers, investors and financial markets. Thus, inevitably- as new crises emerge- the governments of the leading industrial powers may find that they can no longer simply impose their views and financial policies, but will gradually be obliged to accept the need for some substantial changes in the regulation of world finance and in the policies of the multilateral agencies. In this regard, it is clear that there are now strong doubts as to whether there would be any intention of reinforcing the IMF as international lender of last resort. Hence, without a strong fireman, it is clear that policing by the G-7 of the foreign debt of Third World countries will become more difficult. The need for more equitable political and financial negotiations in global debt finance will inevitably became a major issue in the future. The difference with the neoliberal doctrines would thus appear to be fundamental, but the implications have yet to be widely discussed.

<u>The slowly emerging popular response to the international debt game</u>

Additional actors that have begun to play an important role in debt finance negotiations are political activists, and increasingly on a world scale in many counter-globalization mass meetings and protests. In addition, there is a growing increase of protests among some taxpayer groups in Third World countries against financial exploitation, although not yet on a large scale. There are very few analyses of the popular responses to the debt crises, whether in the 1980s or in more recent times. The academic literature on the subject is scarce. Information is derived basically from the press and activist organization on popular protests. Most protests against external debts- common throughout Latin America in the last two and a half decades- were of relatively short duration and had limited degrees of political effectiveness. As has been noted by most specialists, the popular opposition to the debt negotiations of the 1980s failed, although in the cases of debt renegotiations of Nicaragua and Bolivia, popular pressure did eventually influence the somewhat outcome of negotiations, which were somewhat better than expected.[xxi] On the other hand, the proposals in the mid 1980s for cartels of nations to reduce debt exposure and debt service payments did not succeed. Economists and political scientists have written quite a large number of research papers to explain why the creditors in the 1980s were in a much stronger position than in the 1980s, focusing on the success of bank cartels, supported by the international multilaterals and by the G-7, in successive negotiations.

It should be noted, nonetheless, that in the last few years, particularly in South America, popular repudiation of debts has had at least two important recent impacts. The first was the establishment by the Peruvian Congress of an investigative committee of the foreign debt in 2003, the reports of which demonstrate the corruption and lack of legitimacy of many loans taken in the 1990s. Oscar Ugarteche was coordinator of the committee and his reports merit full attention as never before in the history of Latin American parliaments have such investigations taken place. [xxii] The second concrete indicator of popular mobilizations against the old debt policies, has been the widespread popular support to the firm negotiating strategies of President Kirchener of Argentina, who managed the largest sovereign default in world history with notable ability. The negotiations with bondholders reached a successful conclusion for the Argentine government, and therefore speak tomes in terms of future debt negotiations by indebted Third World nations.

But beyond the specifics of financial renegotiations, it is also worthwhile to some new ways in which public opinion has been responding to financial instability and the perverse effects of financial globalization. A review of the numerous activist sites on global finance – and most particularly the Comité pour la Anulation de la Dette du Tiers Monde (CADTM)- based in Brussels and directed by Eric Toussaint-demonstrates how among new generations (particularly in forums like those of Porto Alegre and Mumbai) there is a growing rejection of orthodox finance and of the strategies of the majority of international financial banks and agencies. The growing stream of articles and books by Toussaint and his colleagues, as well as by members of the international ATTAC committee (which focus on the Tobin tax as a possible instrument of democratic reform of the financial system) now constitute an important critical literature on the subject. Frequently, the tone of these texts can be quite radical, but this is a response to the radical/right positions of the traditional spokesmen of the Washington Consensus.

In addition, it is impossible to neglect other more reformist groups that have pushed for debt reduction, being led initially by the Catholic promoters of the Jubilee debt reduction campaign in the year 2000. At that time, the G7 countries promised reductions on debt to many of the poorest countries in the world, but in practice did not provide much relief. On the other hand, from early 2005, the jubilee campaign regained steam as certain leading politicians in Europe- in particular the British prime minister,Tony Blair- began touting the need for reduction of African debt. In the early summer of 2005, at a G-7 meeting in Scotland, agreement was formally reached to reduce debts by official and multilateral agencies by a sum close to forty billion dollars, the largest debt relief that had ever been contemplated. Despite leftwing criticism of this program, these measures represent a significant advance in the regulation of global finance which can help to reduce the suffering of highly indebted countries.

More orthodox, and also at loggerheads with the leftist proposals of abolition of foreign debts, a considerable number of academics in Washington think tanks also recognize the political problematic of global finance. They propose limited reforms, but it is clear that in recent years there has been an increasing awareness of the need to introduce real political and social concerns and reduce technocratic behavior in the realm of multilateral finance. A key spokesperson of the trend is Nancy Birdsall, president of the Center for Global Development in Washington, who has repeatedly put the accent on the need for some political reform of multilateral institutions. She takes note of the popular critiques in the Third World to the skewed political architecture of international financial organizations, which are, in principle, public entities and thus accountable to taxpayers. She says:

> "Those activists see the Financial Stability Forum, the Bank for International Settlements, the International Monetary Fund, and the World Trade Organization as undemocratic. They see the overall system as controlled by corporate and financial insiders, not by the world's median income voter; by the United States Treasury and Wall Street not middle-income consumers; by Ministers of Finance and Governors of Central Banks not Ministers of Health, Labor, and Social Affairs.[xxiii] They are suspicious of the Bretton Woods institutions, where country votes reflect economic power, compared to the more democratic United Nations, where in the General Assembly at least, every country has a single vote.[xxiv] Independent of the merits or demerits of these various views, they all contain a core truth, namely that the global economic and financial system overall is not particularly representative of the poor of the world...[xxv]

In the final analysis, Birdsall does not call for radical reform, but simply points to the fact that the Interamerican Development Bank is considered more responsive to its Lat American participating government members, in contrast to the more bureaucratic and rigid World Bank. She therefore points to a key governance issue, but sets an agenda for limited political reform of the international financial architecture.

The vaguely reformist discourse of the mainstream and center of left think tanks are clearly at odds with many activists and popular movements around the world. The drama of world poverty, of increasingly uneven income distribution within most societies, the growing power of global companies and the decreasing capacity of states to maintain equitable social, educational and health policies, all point to the need for a much more profound transformation of the dynamics of international finance, in particular as it relates to new options for a more just social order. The relevance of the radical critiques of the debt burden in the case of Latin America is obvious. Extremely slow growth has accompanied the last quarter century of constant increase of total debt stock and enormous debt service payments. The international financial and investor community are clearly not well-disposed to any further debt reductions as those obtained in the Argentine case. They will fight tooth and nail to assure, for example, that Brazil and Mexico continued with their huge debt payments. Nonetheless, a simple survey of the overall debt burden in Latin America suggests that restructuring is indispensable to allow for greater economic growth. However, given the tremendous instability being generated by the current trends of global finance and, in particular, the United States government (with its huge debts), the prospects for further reform appear remote. It is, in fact, possible that only a world financial crisis (a gruesome possibility which does not now not seem so unlikely) can force radical change, as did the Great Depression of the 1930s.

[i] This essay was presented at a meeting organized by the Social Science Researl Council in Cuernavaca in March, 2005. Currently under consideration for publication; please do not cite without permission of the author.

[ii] Louis W. Pauly Who Elected the Bankers: Surveillance and Control in the World Economy, Cornell University Press, 1997, p.8. Pauly also calls attention to the burgeoning literature on politics and international finance that is of great use for our purpose.

[iii] Eric Toussaint, Deuda externa en el Tercer Mundo: las finanzas contra los pueblos, Caracas, Nueva Sociedad, 1998; Oscar Ugarteche, El falso dilema: América Latina en la economía global, Lima, Fundación Friedrich Ebert, 1996; Adios Estado, Bievenido Mercado, Lima, Fundación Friedrich Ebert, , 2004.

[iv] D.C.M. Platt, Finance, Trade and Politics in British Foreign Policy, 1815-1914, Oxford, 1968, passim.

[v] Charles Lipson, "International Debt and National Security: Britain and America, in Barry Eichengreen and Peter Lindert, eds. The International Debt Crisis in Historical Perspective, MIT, 1991, chapter 7.

[vi] Barry Eichengreen, Globalizing Capital: A History of the International Monetary System, Princeton University Press, 1996, p. 31.

[vii] For summary details on all the debt negotiations of Latin American countries in the 1930s and 1940s see Carlos Marichal, A Century of Debt Crises in Latin America, Princeton, 1989, chapter 8.

[viii] For details on the U.S. comercial bank loans to Mexico in the 1960s see an important bu little cited study by E. Sánchez Aguilar, "The International Activities of U.S. Commercial Banks. A Case Study: Mexico," Ph.D thesis, Harvard University, 1973.

[ix] The concepts are from Barry Eichengreen and Albert Fislow, "Contending with Capital Flows: What is Different about the 1990s?, in ……….. pp.23-68.

[x] Data from José Angel Gurriá, La política de la deuda externa, Mexico, Fondo de Cultura Económica, 1993, and Secretaría de Hacienda Deuda externa pública mexicana, Mexico, Fondo de Cultura Económica. (1988), final Appendix.

[xi] Ibid. 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.

[xii] Charles Lipson, "International debt..." p.212.

[xiii] The most detailed analysis of the origins and implementation of the Brady bonds can be found in William Cline, International Debt Reexamined, Washington D.C., 1995. A journalistic account of the 1987/88 negotiations between the Mexican negotiating team led by Angel Gurría and the U.S. commercial bankers and government officials is found in Fernández Sotelo, "El último rescate", Tesis en ciencias y técnicas de la información, Universidad Iberomericana, 1994.

[xiv] An interesting critique of the Washington Consensus is found in Paul Krugman, "Dutch Tulips and Emerging Markets", Foreign Affairs (July-August, 1995), 74,4, pp.28-44.

[xv] Again, William Cline, International Debt Reexamined is the basic source here.

[xvi] Again the concept is taken from Eichengreen and Fishlow, "Contending with Capital Flows, pp.47-60.

[xvii] International Monetary Fund, International Capital Markets, August, 1995, p.53.

[xviii] A detailed analysis of the rescue package is in Carlos Marichal, "La devaluación y la nueva crisis de la deuda externa mexicana: reflexiones y reomendaciones", Este País, (Mexico) June 1995, no.51.

[xx] Among the more detailed recent analyses is that of Eugenio Andrea Bruno, El default y la restructuración de la deuda, Buenos Aires, Nueva Mayoría, 2004. But also see the extensive recent literature published in Buenos Aires, including, Marcelo Bonelli, Un país en deuda: la Argentina y su imposible relación con el FMI, Buenos Aires, Planeta;Carlos Juliá et al, La memoria de la deuda, Buenos Aires, Ed. Biblios, 2002. Douglas R. Elespe, et al, Default y reestructuración de la deuda externa, Buenos Aires, Número especial de La Ley, noviembre, 2003. Salvador María Lozada, La deuda externa y el desguace del Estado nacional,Cuyo, Ediciones jurídicas, 2002. Tiziana Vicario, "Argentina y el FMI: una visión integrada de los factores internos y externos de la crisis", en Revista Ciclos en la historia, la economia ya la sociedad (Buenos Aires), año xiv, no. 27, 1er sem de 2004, pp49-80. Norberto Galazo, De la Banca Baring al FMI: historia de la deuda externa argentina, Buenos Aires, Editorial Colihue, 2003. Ricardo Héctor Arriazu, Lecciones de la crisis argentina: bases programáticas para un esquema de desarrollo sustentable, Buenos Aires, Editorial El Ateneo, 2003. Michael Mussa, Argentina y el FMI: del triunfo a la tragedia, Buenos Aires, Planeta, 2002

[xxi] See Hans Huber Abendroth, et al, La deuda externa de Bolivia: 125 años de renegociaciones y ¿cuántos más? La Paz, CEDLA, 2001. Oscar Ugarteche has announced a new book on the debt of Andean nations which is about to be published. On the CADTM web site, Eric Toussaint has various artciles on the Nicarguan debts.

[xxii] Oscar Ugarteche, Adios Estado, Bievenido Mercado, Lima, Fundación Friedrich Ebert, , 2004.

[xxiii] Birdsall notes that Joseph Stiglitz makes this point (2002).

[xxiv] Birdsall notes: The view of the UN as more democratic (and more friendly to developing countries) is surprising given that its most fundamental decisions are controlled in the Security Council, where six countries have a veto. On security issues, the traditional cleavage has been between east and west, however, not between the "north" i.e. the industrialized countries, and the "south", i.e. the developing countries, and as a result on some issues, some countries of the north have often been unable to push through decisions they favored.

[xxv] Nancy Birdsall, President, Center for Global Development "Why It Matters Who Runs the IMF and the World Bank", Center for Global Development, Working Paper #22, Washington 2004.