DEBT, FINANCE AND THE IMF: THREE DECADES OF DEBT CRISES IN LATIN AMERICA

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INTRODUCTION*

The recent history of Latin American debt is a history of cycles. In the 1980s, 1990s and early 2000s (as in the 1930s), after periods of significant inflows from private commercial lenders, many countries in the region found themselves unable to service their debts. Suddenly, Latin America went from being darling to pariah in the eyes of the international financial community, and countries saddled with onerous debt burdens suffered deep economic recessions and experienced worsening levels of poverty and social welfare. However, lenders have short memories, and in 2006 the region was yet again awash with abundant inflows of private capital. Even Argentina, which defaulted on its debt in 2001 and then engaged in protracted and acrimonious dispute with its creditors, was able to borrow US $500m. in March 2006 with few impediments. Eventually, capital flows to the region will slow, again. Will history then repeat itself? Will Latin American countries again find themselves in vicious cycles of indebtedness, low growth, and escalating levels of poverty?

To shed light on these questions, it is useful to review the recent history of Latin American debt. Indeed, understanding Latin American debt is critical for understanding regional economic development. The debt crises that are the subject of this chapter began in August 1982, when Mexico announced its inability to make the payments that were coming due. Soon after, finance officials in Latin America's other largest—and most indebted—economies found themselves in similar predicaments. The Latin American debt crisis had begun. The debt crisis would prove to be a watershed event, provoking fundamental and lasting changes in Latin American countries' relationship with international financial markets, and the global economy more generally.

This chapter provides an overview of the key issues and events, and in doing so provides an important background for the country analyses that follow in Part Two. We begin with an examination of how such large debts were accumulated in the years prior to Mexico's near default, placing the borrowing and lending processes in the context of broader changes experienced in the world of international finance. Upon considering the factors that converted the massive borrowing and lending extravaganza of the 1970s into the crisis of the 1980s, we then examine the changing strategies for management of international debt in the 1980s, a period in which capital only trickled to the region as most countries struggled to escape from overwhelming debt-servicing burdens. Indeed, this was a period that defied the logic of international finance, as net flows of capital went *from* developing *to* developed countries. By the early 1990s, however, international finance returned to Latin America. After quickly contrasting the dominant forms of lending in the 1970s and 1990s, we examine the vulnerability generated by the new international financial context of development, vulnerability which led to yet more debt crises in the 1990s and early years of the 21st century. In the conclusion, we consider some of the broader implications for economic policy and development of Latin America's changing relationship with the international financial system.

Before proceeding, it is important to underscore that Latin America, which by 2006 had experienced more than 20 years of recurrent debt and financial crises, has the largest amount of external debt as any region in the developing world. In addition to its quantity (roughly US $800,000m.), a remarkable feature of this debt is that more than three-quarters of it is owed to private, commercial creditors. While indebtedness is certainly not limited to Latin American countries, in other regions of the developing world (e.g., Africa) the debt is owed principally to foreign governments or international institutions, such as the IMF or the World Bank. Thus, Latin American debt stands out on account of its longevity (the fact that many countries are still dealing with the effects of debt accumulated decades ago), its size, and the fact that the lenders are for-profit institutions whose own health depends on being repaid.

THE BORROWING AND LENDING EXTRAVAGANZA OF THE 1970S

What factors brought about the accumulation of such enormous debt in the years prior to the crisis? The standard explanation for the borrowing and lending in this period, rooted in the recycling of so-called 'petro-dollars,' goes as such: the 'oil shock' of 1973 engendered a massive transfer of money from oil consumers throughout the world to a small number of petroleum exporters; the exporting countries, now with massive trade surpluses, deposited their revenues in Western banks; financial intermediaries, which by definition take deposits from savers and lend to borrowers, proceeded to lend this money, principally to developing countries that had unprecedented import bills on account of the increase in oil prices. In a sense, then, the oil crisis produced a marriage of convenience between borrowers and creditors, creating both the demand for capital inflows, in the form of developing countries that sought to take on debt to continue to afford imported oil, and the supply of capital, in the form of deposits that banks would seek to recycle.

The petro-dollar narrative certainly contributes to understanding the accumulation of debt in the 1970s, but it cannot alone explain the events of this period. This is because the standard narrative understates the dynamics that contributed to both increased demand for loans on the part of borrowers and the supply of loans on the part of creditors. It also overlooks a set of important institutional changes that facilitated such a massive expansion of commercial debt. Indeed, a careful examination of lending from international banks to developing countries reveals that the trend began prior to 1973. The oil crisis accelerated this, but the new process of international financial mediation had already begun.

Borrowers

With regard to demand, the 1970s featured heavy borrowing by both oil importers and also oil exporters. To be sure, net petroleum importers, such as Argentina and Brazil, accumulated large debts in this period, but so too did net oil exporters, such as Mexico and Venezuela. This suggests that the demand for foreign loans was driven by more than the need to pay for oil imports. In some countries borrowing fuelled investment drives, while in other cases investment tended to support consumption. Investing or consuming, the most salient differences among developing countries in the 1970s were not their profiles as oil importers or exporters, but simply the size and structure of the manufacturing sector: middle-income industrializing countries had an insatiable demand for inflows of foreign capital, and borrowing from banks appeared to be an easy and attractive way to access abundant quantities with few conditions attached.

Indeed, to the extent that countries could attract capital inflows via international bank loans, they could circumvent many of the restrictions on both the amounts and use of loans that were imposed by multilateral lenders such as the IMF and the World Bank. Private bank loans also allowed countries to avoid the tensions that had accompanied the expansion of multinational enterprises after 1945, such as tensions over

*Some of the data used in this article come from the following sources: Cohen, B. J. *In Whose Interest? International Banking and American Foreign Policy*. Yale, CT, Yale University Press, 1986; Devlin, R. *Debt and Crisis in Latin America: The Supply Side of the Story*. Princeton, NJ, Princeton University Press, 1989; Stallings, B. *Banker to the Third World: U.S. Portfolio Investment in Latin America, 1900–1986*. Berkeley, CA, University of California Press, 1987.

investment strategies and the repatriation of profits. As an indicator of how much Latin American countries came to demand this form of capital inflow, consider the expanding contribution of commercial bank lending to net financial inflows to Latin America, from a mere 1.6% in 1961–65, to 8.1% in 1966–70, 42.4% in 1971–75, and amounting to 58.3% in 1976–80.

Creditors

A second limitation of the petro-dollar narrative regards the supply of capital. Net international bank lending in this period far exceeded the amount of money deposited in banks by the OPEC countries. Clearly, there was another source of capital, beyond petro-dollars. Key to the growing supply of funds was the expanding pool of dollars—largely a function of persistent US trade deficits in the post-Second World War era—that were deposited in international banks since the early 1960s. The net size of the 'eurocurrency market', which includes US dollars deposited in banks outside the USA, expanded almost 15-fold in 1965–75, and then more then doubled again between 1975 and 1980. It was this generalized increase in global liquidity, reflected by the expansion of eurocurrency markets, in conjunction with the petro-dollars that produced such abundant supply of money to be lent in the 1970s.

Importantly, 'offshore' banks operating in eurocurrency markets were largely unregulated. Unlike their national counterparts, for example, offshore banks were not obliged to hold specified amounts of cash relative to their outstanding loans. And because they were unburdened by requirements to diversify their portfolios, they could continue lending to the same set of countries. Indeed, by the early 1980s some of the larger US banks had lent as much as 200% of their capital to a handful of Latin America's largest debtors.

Mobilizing Resources and Minimizing Risk

Even given developing countries' increased demand for loans and the banks' increased supply of capital, we still need to understand why international banks were both able and willing to engage in such risky behaviour. After all, they could have found more conservative destinations for their money than Third World debt. Yet international banks devised a set of mechanisms that allowed them to mobilize massive sums of capital for international lending and to minimize (though not eliminate) the risk of doing so.

One factor that facilitated lending was a significant growth of overseas bank branches within developing countries during the 1960s and 1970s, which increased contacts and assisted in establishing customer bases among local authorities and companies. In 1960 only eight US banks had overseas branches; by 1980 this figure had increased to 139 banks (although not all of these were in the developing world).

Banks also minimized their risk by lending on adjustable interest rates, with borrowers' payment obligations linked to the London Inter-Bank Offer Rate (LIBOR). Adjustable (or floating) rates placed the burden of risk largely on the borrower, especially during a period, such as the mid-1970s, when real interest rates were low (and, at times, even negative). Were real interest rates to increase, as indeed they did, so too would countries' debt-servicing obligations. (As a note, the fact that Latin American countries accepted the banks' insistence on floating rates illustrates both the asymmetrical bargaining strength between lenders and borrowers and the extent of these countries' demand for commercial bank loans.)

A crucial mechanism on the part of the large 'money centre' banks for minimizing risk was through the creation of loan 'syndicates'. These were large lending networks, including as many as 50 banks participating in the same loan. The pyramidal shape of the 'tombstones' announcing the loans in the financial press, for example, illustrated this nicely: the main organizing bank at the top, followed by other well-known banks at the second level, then lesser-known banks, and, finally, a plethora of smaller banks. Syndicated loans increased the amount of banks involved, as they provided a means for smaller banks that lacked their own international lending departments to participate in the lending boom, and thus increased the amount of money available to be lent. However, perhaps more importantly, syndicates also constituted a mechanism for larger banks to spread the risk of international banking.

With these mechanisms in place, the 1970s witnessed a revolution in international financial intermediation. International banking was not new in this period, not by any stretch of the imagination, but these changes allowed it to assume a more important role in the operations of more banks. For the 10 largest US banks, for example, earnings from international operations (not just in developing countries) as a percentage of total earnings more than tripled, from 17.5% in 1970 to 54.7% in 1982.

To summarize, the 1970s did indeed witness a marriage of convenience between borrowers and lenders, but the events of the decade were much more complex than suggested by the standard narrative of recycling petro-dollars. Increased demand for loans, increased supply of capital available to be lent, and a set of mechanisms that facilitated the expansion of new forms of international financial intermediation produced a borrowing and lending extravaganza.

DEBT CRISES IN THE 1980s

A confluence of events turned the borrowing and lending extravaganza of the 1970s into the debt crisis of the 1980s. First, real interest rates rose dramatically in the early 1980s, as central banks in developed countries attempted to combat inflation. The LIBOR, the relevant rate for international loans, which had been negative, in real terms, in 1974–77, turned positive in 1978 and reached 6% by 1981. Since Latin American countries had borrowed on floating rates, the increase in the LIBOR produced serious financial shocks, as highly indebted countries faced increasingly large debt-servicing obligations. At the same time as the increase in interest rates, a decline in commodity prices reduced developing countries' export revenues. Subsequently, total debt service as a share of exports increased throughout Latin America and the Caribbean, from 26.8% in 1977 to 46.9% in 1982. In some countries the increase was even more spectacular (e.g. Venezuela's debt-servicing to export ratio almost quadrupled).

Many Latin American governments were also unable to repay their foreign debts on account of increased capital flight. Significant amounts of money were reinvested by nationals in real estate and financial instruments outside Latin America. Although this problem was particularly acute in countries such as Argentina, Mexico, and Venezuela, where comparatively open capital accounts made the private export of capital relatively simple, the phenomenon was widespread throughout the region. Among the many effects of capital flight, the most relevant fact to the present discussion is that the constant conversion of local currency into dollars to move abroad placed a drain on a country's foreign reserves. Finally, a new sense of fear and skittishness on the part of creditors reduced the ability of developing countries to borrow fresh money to make payments on loans coming due. As debt-servicing obligations increased, Latin American countries began to appear less creditworthy, and as a consequence bankers became reluctant to extend additional loans.

The confluence of these four factors left many developing countries in crisis. While a spike in real interest rates increased developing countries' debt-servicing obligations, declining commodity prices, capital flight, and bankers' gradual turn away from the region reduced debtor countries' ability to meet the increased obligations through either export revenues, foreign reserves, or new financing.

Mexico as Trigger and Template

In August 1982 the Mexican finance minister, Jesús Silva Herzog, travelled to the US capital, Washington, DC, to explain his country's inability to make its upcoming payment. Silva Herzog met with officials from the US Federal Reserve, the US Treasury and the IMF. The Mexican crisis triggered a panic. It was obvious that Mexico was not unique, either in terms of level of indebtedness to commercial banks or in its (in)capacity to pay. It was merely the first country to acknowledge the gravity of the situation. Moreover, many came to fear a chain reaction, with default in Mexico followed by default in the other large Latin American debtors, particularly Argentina, Brazil, and Venezuela (these four countries accounted for nearly 80% of Latin America's total external debt). Furthermore, fear of additional default exacerbated the third and fourth conditions noted above, accelerating capital flight and further reducing banks' eagerness to lend fresh money.

From the perspective of the creditors and creditor governments, the situation was alarming for the simple reason that the largest banks' high levels of exposure left them exceptionally vulnerable to default. Were the USA's largest banks to go bankrupt, which many feared was possible given the amount they had lent through their unregulated 'offshore' branches, the US economy, if not the entire international financial system, was at risk. In response, the US Treasury and Federal Reserve, working with central banks from Organisation for Economic Co-operation and Development member countries, quickly put together an emergency rescue package of nearly US $5,000m. so that Mexico was able to make the payments that were coming due and thus avert default. The rescue package was obviously not a solution. The USA and others were simply lending money to Mexico that was to be used to repay the banks. It was designed as a bridging loan to avert default and calm the markets until a strategy for dealing with international debt could be developed.

The Return of the IMF

After August 1982 the IMF would become a major player, arranging emergency financing packages with both Mexico and Mexico's creditors. To Mexico, the Fund guaranteed fresh inflows of capital in exchange for wrenching domestic adjustment—sharp reductions in public spending and reductions in imports. However, the IMF would not release the money until Mexico's private creditors also agreed to loan fresh funds, a strategy that came to be labelled 'involuntary lending'. Hence, a new template was established: debtors would enter into agreement with the IMF to implement domestic austerity measures and the IMF would provide emergency financing conditional on the involuntary lending of private creditors.

It is important to note how the 1982 crisis ushered in a new era for the IMF. The Fund had played only a marginal role in the process of international financial intermediation for most of the period leading up to the Latin American debt crisis, when commercial bank loans became the dominant source of foreign capital. Those countries that could borrow from international banks, such as middle-income countries in Latin America, could bypass standard conditionality imposed by the IMF. After 1982, with commercial banks now resolutely uninterested in extending additional money, the Fund came to play a more pivotal and central role. Countries would no longer be able to escape IMF conditionality, not just to gain access to IMF funding, but also to secure private bank loans. The IMF's new position in the centre of the emerging debt-management arrangements would give it unprecedented leverage over developing countries' ability to tap into international credit markets.

The Mexico crisis was also a turning point in terms of the IMF's relationship with creditors, for this was the first time that, in negotiating an agreement with a debtor country, the IMF had stipulated the size of the new contribution from private lenders. Certainly, the banks were reluctant to make new loans, as many regarded this as 'throwing good money after bad'. Moreover, each bank, wishing to contribute as little new money as possible but receive interest payments on outstanding loans, had an incentive to 'free ride' on the actions of the others. The creditors' collective action problem was compounded by the sheer number of banks involved and their very different levels of exposure. For example, many of the smaller banks that were brought into international lending through syndicates typically had lent less money relative to their whole lending portfolio and, unlike the heavily exposed 'money centre' banks, could feasibly write off these loans and simply cut their losses. The IMF helped the creditors achieve the necessary co-ordination. Because the Fund quickly established close relations with the debtors, it gained information that it could share with the banks. Furthermore, under the IMF's tutelage, the major lenders formed steering committees to negotiate collectively with debtor countries and prevent any of the smaller creditors from declaring default.

CHANGING STRATEGIES FOR MANAGING LATIN AMERICAN DEBT

There can be no denying that the emergency financing strategy of the early 1980s was designed with the highest priority given to averting default. The strategy, quite simply, was to reschedule loans that were immediately due, mobilize the bare minimum of new resources to enable orderly debt servicing, and reduce 'absorption' in the borrowing countries via fiscal and monetary retrenchment. The underlying expectation was that reduced economic activity would dampen demands for imports and subsequently free resources to service foreign debt, and that once the threat of default passed, capital flows would return to the region.

To the extent that the debt crisis was a crisis facing overexposed banks, the response in the early 1980s worked. The crisis was solved: countries did not default and the banks continued to receive interest payments. However, within two years it was clear that the debt crisis was far from over. Most debtor countries plunged into recession without recovery. Once the initial fears of international financial collapse were gone, it quickly became evident that most countries were still in no position to meet their debt-servicing obligations. In fact, after oil prices collapsed in the mid-1980s many countries, such as Mexico and Venezuela, appeared to be in even worse conditions.

The Baker Plan

In 1985 the US Secretary of the Treasury, James Baker, announced a new approach to the debt crisis in Latin America. The Baker Plan proposed US $20,000m. in new lending by the commercial banks, another $9,000m. in additional lending by both the IMF and the World Bank, and the introduction of structural-adjustment policies on the part of participating countries. This third aspect was of critical importance, for in contrast to freeing resources by reducing absorption, the Baker Plan aimed to generate new resources, and thus repayment capacity, through so-called 'growth-oriented adjustment'. Thus, the sorts of policies prescribed in the mid-1980s—a package of 'neoliberal' measures such as trade liberalization, deregulation of foreign investment, and privatization—were different from, and more extensive than, the straightforward austerity measures advocated in the early years of the debt crisis.

The principle limitation of the Baker Plan was that the private banks still had little interest in lending new money. The banks were receiving interest, and after the scare of 1982–83 most preferred to reduce their exposure to the region. In fact, virtually all of the money lent by private banks in this period was done so grudgingly. This involuntary lending was part of the IMF-supervised rescheduling operations. However, if the banks would not lend more money, and if the USA and IMF would only mobilize small amounts of occasional involuntary lending to refinance upcoming interest payments, the result was that countries were typically paying out more in the form of interest payments than they were receiving in the form of loans and investment. From 1985–87, for example, accumulated net resource transfers to international financial markets from Latin America's four largest borrowers (Argentina, Brazil, Mexico, and Venezuela) amounted to nearly US $40,000m., notwithstanding the calls for new money contemplated by the Baker Plan. Although the hope of the Baker Plan was that structural reforms would lead to growth and thus make debtor countries more attractive to the banks, there was reluctance to lend to highly indebted countries that appeared to have little prospects of growth in the immediate future. Latin American countries' large accumulated debts—their 'debt overhang'—led to their experiencing net negative resource transfers (NNRT), which impeded investment and growth.

One lesson of the Baker Plan, thus, was that an effective strategy for debt management would have to deal with the problems of debt overhang and NNRT. Growth-oriented adjustment, whatever the merits of the policies being prescribed, could not offer a solution to the debt crisis, for the simple reason that crushing debt burdens and the net outflow of capital inhibited investment. The critical challenge was in working out how to reduce the problem of debt overhang, although neither the USA nor the IMF was prepared to compel private banks to cancel or reduce debts. At the banks' insistence—and the banks did insist—creditor participation in any programmes of debt reduction would have to be voluntary.

The Brady Plan

A new strategy for managing international debt emerged in 1989, once again proposed and named after the incumbent Secretary of the Treasury, Nicholas Brady. In some regards, the Brady Plan was similar to the Baker Plan. In both schemes the structural-adjustment conditionality attached to participation amounted to adoption of neoliberal economic policies, and both relied on the voluntary participation of creditors. However, the Brady Plan (actually the brainchild of the Japanese finance minister) marked a fundamental change in debt management in that it included a mechanism to reduce debt overhang. The Plan called for creditors either to lend new money, reduce the amount of outstanding debt, or to reduce the interest on outstanding debt. Importantly, the second and third options would be executed by converting loans into bonds. To entice otherwise reluctant creditors to participate voluntarily, money from the IMF, the World Bank, and the Japanese Government were used to purchase US Treasury bonds that served as collateral for the converted debt. In the years after 1990, virtually all Latin American countries reached new agreements with their creditors under the framework of the Brady Plan. Throughout the region, bank loans from the 1970s were converted into bonds, so-called Brady Bonds.

The Brady Plan would have critical effects on Latin American economies. In the first regard, by offering a potential solution to the problem of NNRT, the Brady Plan provided strong incentives for developing countries to undertake the deep structural reforms that the IMF, the World Bank, and the US Treasury had been advocating since the mid-1980s. This is a key point worth underscoring: countries could only qualify for the benefits promised by the Brady Plan if they agreed to undertake significant neoliberal economic-policy changes. During the early 1990s most Latin American countries underwent fundamental changes in their strategies of economic development and, while the conditions attached to the Brady Plan were not wholly responsible for these changes, it was clear that such changes were the price to be paid for potentially escaping from the suffocating burden of debt overhang.

The Brady Plan also contributed to the reintroduction of voluntary capital inflows to Latin America. One reason for this was that the policy changes implemented by participating countries created new opportunities for foreign investment. The privatization of state enterprises, removal of restrictions on foreign investment and liberalization of domestic financial markets all made Latin American countries very attractive sites for foreign investors. A second way that the Brady Plan contributed to the new inflow of capital was that bonds, unlike bank loans, have deep secondary markets. Latin American debt, thus, became attractive and entered into the portfolios of entirely new sets of investors who buy and sell international bonds. And as the debtors regained creditworthiness, they could issue new bonds as well. Both of these new investment opportunities dovetailed with a larger change that was occurring at the same time—the growth of new institutional investors in the developed world (such as managers of mutual funds and pensions) who eagerly sought higher-risk investments to increase their returns and diversify their portfolios. Thus, in the early 1990s capital flows resumed to Latin America. In fact, by 1995 the level of capital flows exceeded that of 1980. Finance, which had flooded into the region in the 1970s and left, en masse, in the 1980s, had returned. Although the Brady Plan 'resolved' the debt crisis of the 1980s, the renewed eagerness of creditors to lend to Latin American countries meant that indebtedness would remain an important and explosive issue.

NEW FINANCIAL FLOWS, NEW VULNERABILITY

Importantly, the 1990s marked not just a return of capital flows, but the emergence of a new form of capital flows. If the 1970s was the era of the bank loan, the 1990s was the era of the portfolio investment, such as purchase of government bonds or equity. From 1977–82, roughly three-quarters of the net capital flows to Latin America and the Caribbean were in the form of commercial bank loans. From 1990–96, however, portfolio investments amounted to approximately two-thirds of net capital flows to the region.

The return of finance and, in particular, prominence of portfolio investments, created a new international financial context for development. One of the key features was the prevalence of short-term and highly mobile capital flows. Bonds tend to be issued with relatively short maturities, significantly shorter then bank loans. The effect of this is that a change in investor sentiment—if either the outlook in the borrowing country or region looks worse or the outlook in an alternative destination looks better—can lead to rapid withdrawal of the stock of outstanding bonds. Likewise, equity investments can leave overnight. Indeed, for many institutional investors the ability to make rapid withdrawals and rebalance portfolios is essential, for it allows them to compete for high returns while always being able to meet customers' demands to adjust or liquidate their accounts. It is this spectacular mobility and volatility that earned the new form of capital flows the label 'hot money'.

Latin America's dependence on volatile capital flows made the region's economies more vulnerable in the 1990s. To be sure, if one looks throughout the developing world, then by comparative standards, Latin American countries have historically been highly integrated into international financial markets. This condition was amplified in the 1990s, owing both to the economic policy changes that included augmented financial opening and to the significant increases in capital mobility and financial integration on a global scale. Although increased integration facilitated the expansion of new capital flows, it also increased countries' vulnerability to external shocks. Massive inflows tend to cause currencies to appreciate, which leads to trade deficits, which increase dependence on continued inflows in order to finance the trade deficits. However, money that enters the country can also leave it, generally just as fast; and when the direction of flows reverse, a simple phenomenon given the high degree of mobility of 'hot money', crisis ensues.

In a stylized fashion, this scenario of 'hot money' entering and then leaving, for whatever reason, aptly summarizes the financial crises experienced by Mexico in 1994–95, Brazil in 1998–99, and Argentina in 2001–02 (as well as the financial crises of the late 1990s in East Asia, Russia and Turkey). The country chapters deal with the Latin American cases in detail. For the present purposes it is worth underscoring that the massive inflows of capital that these countries received in the aftermath of the arrangements made under the framework of the Brady Plan, while important for fuelling economic recovery, clearly did not reduce these countries' vulnerability. They each suffered major crises, with wrenching adjustment and social dislocation, in the 'post-debt crisis' financial environment.

To a certain extent, the international responses to the more recent round of debt crises (now called 'financial crises') were similar to what transpired in the 1980s. The international financial community, led by the USA and IMF, mobilized resources to avert massive default (significantly more energetically and enthusiastically in the cases of Mexico and Brazil than Argentina), and in exchange for this international support the debtors underwent periods of extensive economic adjustment. In both periods, external lending increased vulnerability to crisis, external lending was followed by crisis, and debtors bore the burden of adjustment.

Ultimately, responding to financial crises in the current environment presents new challenges. In the first regard, the sheer size and expense of contemporary financial crises makes the recurrent mobilization of public resources increasingly difficult. The rescue plans organized by the USA and IMF in the 1980s, although at the time unprecedented in terms of the amounts of money available, were insignificant compared with what is necessary in the face of contemporary financial crises. Moreover, the sheer number and diversity of the actors involved generates new complexities. The creditors are no longer simply banks, large and small. Rather, a key attribute of the new international financial environment is that developing country debt is held by so many different types of institutional (and individual) investors, all of which have dramatically different relationships with borrowers and depositors. While reaching agreements on rescheduling syndicated loans in the first round of debt crises was no easy feat, the difficulties in achieving agreement with, and co-ordination among, the more recent and more heterogeneous group of creditors in the new environment are much greater.

It was in response to these challenges and difficulties that the IMF's First Deputy Managing Director, Anne Krueger, proposed the creation of Sovereign Debt Restructuring Mechanism (SDRM) in 2001. The core of the proposal was to establish a centralized and simplified process for countries which lack ability to service their debts to negotiate with creditors, under the supervision of the Fund, and, crucially, for the agreement reached to become binding on all creditors. However, creditors and creditor governments (particularly, but not exclusively, the USA) reacted coolly to Krueger's proposal, concerned that any process that simplified debt restructuring would in effect sanction and encourage default. Creditors were also wary of sacrificing their legal rights to pursue litigation against debtors, and warned that an SDRM would greatly reduce investors' interest in developing country debt. This latter concern was then echoed by many representatives of developing countries. Finally, the SDRM was also assailed by both creditors and debt-relief campaigners for strengthening the Fund's role in the process of debt restructuring: private creditors raised the possibility that the Fund could impose greater levels of private debt reduction in those countries where the Fund itself had lent significant amounts of money and was heavily exposed; debt-relief campaigners feared that the Fund's role in the SDRM would instill a bias toward minimal debt relief.

Although the project for the SDRM did not come to fruition, the underlying motivations and concerns have not gone away. Indeed, regardless of what one thinks of the particularities of Krueger's proposals, the saga of Argentina and the countries' creditors engaging in three years of protracted negotiations serves as a useful reminder of the inadequacies of the current arrangements for managing sovereign debt. Indeed, even as negotiations between Argentina and creditors led to a restructuring agreement in 2005, dissenting investors were able to delay the entire process and greatly complicate conclusion of the deal—precisely something that would be impossible under a binding process such as that contemplated with the SDRM. Indeed, the persistent opposition of a small handful of renegade creditors who rejected the final restructuring terms made Argentina's subsequent interactions with the IMF much more difficult as well.

CONCLUSION: DEBT, FINANCE AND DEVELOPMENT IN THE GLOBAL ECONOMY

The 1970s witnessed a massive credit boom, as commercial banks in the developed countries lent significant amounts of money to developing countries, particularly in Latin America. As already discussed, changed international conditions in the early 1980s brought the lending and borrowing extravaganza to an abrupt halt. The ensuing debt crisis brought about a new relationship between Latin America, the international financial system and the IMF and, ultimately, a new relationship was established between Latin America and the international economy. In many ways, the shift to the neoliberal economic model in the 1980s and 1990s has its roots in the debt crisis and the subsequent strategies for managing international debt. In the 1990s, and again in the early 21st century, capital returned to the region, in abundant fashion, but the new forms of capital flows are marked by high levels of volatility. In important ways, the different chapters of the story of Latin American debt since the 1970s are similar, in that euphoric lenders provided money to enthusiastic borrowers, with neither side appropriately considering the risks involved, only for changed international conditions to turn inflows into outflows and generate debt and financial crises. Latin America regained access to voluntary capital markets in the 1990s, but vulnerability and susceptibility to crisis remained intensely problematic features of this relationship. As long as countries need to borrow and so long as investors are anxious to lend, not just debt but debt crises will remain critical aspects of the global political economy. Devising a mechanism to address debt crises in an orderly and equitable manner is a major challenge for the 21st century.

At a more general level, the new form of capital inflows has serious and potentially perverse effects on policy-making in Latin America. To attract the interest of institutional investors and retain mobile capital, countries face pressures to raise interest rates, reduce spending, and increase taxes (particularly consumption taxes). Thus, while the purported benefit of capital inflows is to increase investment and growth, countries often need to implement austere monetary and fiscal policies that dampen investment and growth so as to attract the capital. This dilemma is heightened during periods of capital outflow, as the volatility of capital flows tends to encourage pro-cyclical policies: policy-makers fear stimulating the economy, either through monetary or fiscal policy, out of concern that such measures will cause further capital outflows. Moreover, the fact that money can enter and leave so rapidly can provoke significant movement in the exchange rate, movements that might dampen trade and investment. Thus, countries typically gather large amounts of foreign reserves as a mechanism to protect against and minimize exchange-rate volatility. However, the opportunity costs of hoarding foreign reserves must be considered: money set aside to ward off exchange-rate volatility is money not being used for infrastructure, education, health care and poverty reduction.

Put together, these effects generate serious concerns as to whether the new international financial context creates an environment conducive for growth and development. Latin American countries were among the highest-growing countries in the developing world in the 1960s and 1970s, but fell behind thereafter. Average growth rates in both the 'lost decade' of the 1980s and the post-Brady Plan 'emerging market' era of the 1990s were significantly lower then elsewhere in the developing world—notwithstanding the massive inflows of capital in the latter period. However, extended periods of low growth is not a luxury the region can afford, given the high levels of poverty and indigence. Furthermore, the region's massive inequalities with regard to the distribution of income and wealth are only exacerbated during periods of crisis. The fear, then, is that, in addition to compounding vulnerability to debt crises, the new form of integration into international financial markets creates a low-level equilibrium of low growth, high unemployment and persistent poverty and inequality.

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