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Economic Interdependence and the Sovereignty of Debtor Nations: A Comparison of Mexican and Argentine Reactions to International Monetary Fund Stabilization

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Elizabeth Smith Stukeley

Abstract

Part I of this Note examines the concept of sovereignty and the role of the International Monetary Fund (Fund) as an instrument of supranational or joint sovereignty. Part II traces the development of economic dependence in Mexico and Argentina, examines the history of both public and private lending to these nations, and suggests that their current indebtedness is an extension of a chronic need for imported capital. Part III discusses the growth of international bank lending to developing countries in the 1970's, and Part IV examines the Fund's role in the renegotiation of sovereign debt. Part V addresses the relationship between modern economic interdependence and sovereignty. The Note concludes that the relationship between commercial bank creditors and their sovereign debtors is one that has grown beyond the legal mechanisms that coordinate international economic relations.

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INTRODUCTION

Accepted definitions of national sovereignty distinguish between economic interdependence of nations and activities that impair the autonomy of sovereign states.¹ Economic interdependence is permitted and even encouraged by the state, while an infringement of sovereignty occurs involuntarily.² However, when used to measure the effect of enormous international loans on the sovereignty of debtor nations, this distinction between voluntary and involuntary actions becomes more difficult to discern.

Part I of this Note examines the concept of sovereignty and the role of the International Monetary Fund³ (Fund) as an

1. See, e.g., H. MORGENTHAU, *POLITICS AMONG NATIONS: THE STRUGGLE FOR POWER AND PEACE* 320-21 (rev. 5th ed. 1978). In modern times, national sovereignty means that a nation has "exclusiveness of jurisdiction in certain domains." P. JESSUP, *A MODERN LAW OF NATIONS* 41 (1968). For example, one authority has stated that "[s]overeignty is not actual independence in political, military, economic, or technological matters. The actual interdependence of nations in those matters . . . does not normally affect their supreme lawgiving . . . authority within their own territories" H. MORGENTHAU, *supra*, at 320-21. Economic interdependence is not an invasion of national sovereignty because the nations assume this interdependence voluntarily. *Id.*

2. H. MORGENTHAU, *supra* note 1, at 320-21.

3. The International Monetary Fund (Fund) was established by the Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 60 Stat. 1401, T.I.A.S. No. 1501, 2 U.N.T.S. 39 [hereinafter cited as Fund Agreement]. Its sister organization, the International Bank for Reconstruction and Development (World Bank), was created by the Articles of Agreement of the International Bank for Reconstruction and Development, Dec. 27, 1945, 60 Stat. 1440, T.I.A.S. No. 1502, 2 U.N.T.S. 134 [hereinafter cited as World Bank Agreement]. The Fund is a multilateral organization designed to monitor its members' balance-of-payments and foreign exchange rates. See Fund Agreement, *supra*, art. I, §§ (1), (v), (vi); Gold, *Strengthening the Soft International Law of Exchange Arrangements*, 77 AM. J. INT'L L. 443, 444 (1983). The Fund was designed to address the short-term monetary problems of its membership, while the World Bank was to administer to the members' long-term development needs. Compare Interpretation of the Articles of Agreement, IMF Doc. No. 71-2 (Sept. 26, 1946) reprinted in *SELECTED DECISIONS OF THE EXECUTIVE DIRECTORS* 19 (1970) (interpreting Fund Agreement, *supra*, art. VI, § 1(a)) with World Bank Agreement, *supra*, art. I, § (iii). For general background on the Fund, see E. MASON & R. ASHER, *THE WORLD BANK SINCE BRETTON WOODS* (1973); Allen, *The Recent Shift in*

instrument of supranational or joint sovereignty. Part II traces the development of economic dependence in Mexico and Argentina, examines the history of both public and private lending⁴ to these nations, and suggests that their current indebtedness is an extension of a chronic need for imported capital. Part III discusses the growth of international bank lending to developing countries in the 1970's, and Part IV examines the Fund's role in the renegotiation of sovereign debt. Part V addresses the relationship between modern economic interdependence and sovereignty. The Note concludes that the relationship between commercial bank creditors and their sovereign debtors is one that has grown beyond the legal mechanisms that coordinate international economic relations.

The Note focuses on two of the largest sovereign debtors, Mexico and Argentina,⁵ because they have reacted to pressure

United States Policies Toward the International Monetary Fund and the World Bank, 16 VAND. J. TRANSNAT'L L. 1, 7 (1983).

The Fund Amendment, *supra*, has been amended twice. See Amendment of Articles of Agreement of the International Monetary Fund, May 31, 1968, 20 U.S.T. 2775, T.I.A.S. No. 6748, 726 U.N.T.S. 266 [hereinafter cited as First Fund Amendment]; Second Amendment of the Articles of Agreement of the International Monetary Fund, Apr. 30, 1976, 29 U.S.T. 2203, T.I.A.S. No. 8937 [hereinafter cited as Second Fund Amendment].

4. There are two ways that a nation may finance a deficit on its current account of international balance-of-payments. See INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK 24 (1982) [hereinafter cited as WORLD ECONOMIC OUTLOOK]. A sovereign borrower may finance its deficit by borrowing from the international currency reserves of the Fund and other international organizations such as the World Bank. See Allen, *supra* note 3, at 7. Nations may also borrow from private financial institutions. WORLD ECONOMIC OUTLOOK, *supra*, at 24. Recently, developing nations have borrowed from a syndicate of banks. See R.M. PECCHIOLI, THE INTERNATIONALISATION OF BANKING, THE POLICY ISSUES 22 (Org. Econ. Cooperation & Dev. ed. 1983) [hereinafter cited as POLICY ISSUES]. High volume borrowers like Mexico and Argentina have drawn from both of these sources. See *infra* notes 90-201 and accompanying text.

5. Riding, *Latin Debt: Postponing the Burden*, N.Y. Times, Sept. 23, 1984, at F1, col. 1. As of September 1984, Mexico owed U.S.\$96 billion to international organizations and commercial banks. *Id.* Argentina owed U.S.\$45 billion. *Id.*

The exposure of United States commercial banks to possible default by Latin American governments is significant. As of June 30, 1980, the exposure of the nine largest United States banks was 200% of their capital. Reisner, *Default by Foreign Sovereign Debtors: An Introductory Perspective*, 1982 U. ILL. L. REV. 1, 3. By February, 1984 Argentina alone owed the nine largest commercial bank creditors a total of 153% of their capital. *The Battle of Wills Over Argentina's Debt*, Bus. Week, Feb. 6, 1984, at 63. The banks' Mexican exposure increased from 32% of capital in June of 1980 to 50% of capital in June of 1982. Volcker, *How Serious Is U.S. Bank Exposure?*, Challenge, May-June, 1983, 11, 17.

from the Fund and commercial banks in strikingly different ways.⁶ Mexico, the first Latin American nation to nearly default on large debt payments, adopted a Fund austerity plan shortly after the Mexican economy collapsed in August of 1982.⁷ Argentina, by contrast, resisted pressure from the Fund and the commercial banks until September 27, 1984, when Argentine President, Raúl Alfonsín, began negotiations with international banks.⁸ Unlike the Mexican people in 1982, who supported President de la Madrid Hurtado's decision to negotiate a stabilization plan with the Fund, the Argentine people vigorously resisted Alfonsín's efforts to concede to international pressure.⁹

6. See *infra* notes 90-201 and accompanying text.

7. Riding, *Latin Debt: Postponing the Burden*, N.Y. Times, Sept. 23, 1984, at F9, col. 1; see *infra* notes 138-45 and accompanying text. The difference in Mexico's and Argentina's reaction to the Fund plan arose from traditional social and economic differences in the two nations. Mexico always has been a poor country with a large peasant population, while Argentina traditionally has been prosperous and middle class in character. See *infra* notes 112-14 and accompanying text. For Mexico, stabilization or "austerity" measures merely are a return to normal. *The Cheery Bit of Latin America*, Economist, Apr. 7-13, 1984, at 30. In Argentina, by contrast, cutbacks in government spending represent a departure from the nation's customary lifestyle. *Flag Day For Argentina*, Economist, Apr. 2-8, 1984, at 12.

Mexico and Argentina also have contrasting political climates. In Mexico, the Partido Revolucionario Institucional (PRI) has dominated the political scene for the last 55 years, see *infra* notes 105-45 and accompanying text, while in Argentina the government now is in the hands of an opposition party after decades of alternating between the control of the Peronist party and the Argentine military. See *infra* notes 159-201. The majority of Argentine resistance to the Fund's conditionality has come from the strong Peronist labor unions. See, e.g., Di Tella, *The Economic Policies of Argentina's Labour-Based Government (1973-6)*, in *INFLATION AND STABILISATION IN LATIN AMERICA* 181 (1979) (discussing the significant impact of labor unions on economic and political developments in Argentina during the 1970's); Chavez, *For Argentina Austerity is a Bitter Pill*, N.Y. Times, Sept. 23, 1984, at F8, col. 1 (work stoppage called by Peronist labor unions in September 1984 as a protest against Fund stabilization measures affected 80% of Argentina's industrial production).

Mexican labor unions, in contrast, have traditionally worked in tandem with the ruling political party, and have not openly opposed the Fund-induced wage cuts. Similar cuts in Argentina sparked general strikes in 1982 and 1984. *Why It Is So Quiet*, Economist, Sept. 8-14, 1984, at 34; *The Financial Crisis That Won't Go Away*, Bus. Week, Dec. 27, 1982, at 24. In Mexico, the labor union called off a scheduled November 1982 strike over wages, and the workers agreed to drop their demand for a 50% wage increase. *The Ripples From Mexico Are Crossing the Rio Grande*, Economist, Nov. 20-26, 1982, at 67.

8. Bennett, *Argentina and Banks Begin Talks*, N.Y. Times, Sept. 27, 1984, at D2, col. 2; see *infra* notes 193-201 and accompanying text.

9. See, e.g., Chavez, *Argentine President Rallies Support*, N.Y. Times, Apr. 27, 1985, at A3, col. 2 (labor unions call for general strike on May 23 to protest declining

The contrast between the Mexican and Argentine reactions to Fund stabilization measures highlights the question of sovereignty. In the words of one authority, "[s]overeignty is the supreme legal authority of the nation to give and enforce the law within a certain territory" ¹⁰ Sovereignty is lost "when it is placed under the authority of another nation, so that it is the latter that exercises supreme authority to give and enforce the laws within the former's territory." ¹¹

Traditionally, a distinction is made between an interference with sovereignty and the economic interdependence of nations. The distinction is that countries voluntarily assume interdependence in economic matters, whereas an interference with sovereignty occurs involuntarily. ¹² Economic interdependence may make it more difficult, or even impossible, for countries to pursue their own domestic policies, but it does not invade national rights because it does not diminish the governments' authority. ¹³

The question remains, however, whether there is a point at which interdependence, through the mechanism of a Fund stability program, may become a violation of a nation's sovereign rights. Are commercial banks in the United States the prime movers behind the Fund's stability measures? Are these banks, in effect, controlling significant parts of Latin American economies? Would a debtor nation's claim of interference with its sovereignty provide the basis for a repudiation of their foreign liability? These questions are likely to reappear with the next oil crisis, the next rise in interest rates, or the next recession.

I. SOVEREIGNTY AND MODERN INTERNATIONAL LAW

Sovereignty is one of the concepts that gave rise to and supports the notion of an international legal order. ¹⁴ The fol-

wages); *A New Crunch for Third World Debt*, Bus. Week, May 28, 1984, at 29 (majority in Argentine Senate pressured government to end negotiations with the Fund).

10. H. MORGENTHAU, *supra* note 1, at 321; see also P. JESSUP, *supra* note 1, at 41.

11. H. MORGENTHAU, *supra* note 1, at 321.

12. See *id.* at 320-21. Thus, "[a] nation can take upon itself any quantity of legal restraints and still remain sovereign, provided those legal restraints do not affect its quality as the supreme lawgiving and law-enforcing authority." *Id.* at 320.

13. *Id.*

14. 1 J. VERZIJL, *INTERNATIONAL LAW IN HISTORICAL PERSPECTIVE* 256 (1968).

lowing discussion of the term "sovereignty" will explain the legal origins of international organizations like the International Monetary Fund and will examine the sources and limitations of their authority.

A. *The Development of Sovereignty*

In pre-Renaissance Europe,¹⁵ a state's sovereign power was "an absolute, uncontrolled state will,"¹⁶ restrained only by Divine power.¹⁷ As political and social conditions changed, however, Renaissance and post-Renaissance jurists gradually eroded the absolute view of national sovereignty by developing the concept of a "law of nations."¹⁸ One of the bases of the law of nations was positivism, the belief that a nation is bound only by the rules of international law to which it has consented to be bound.¹⁹ Positivism dominated the analysis of international relations until the late nineteenth century.²⁰

Positivism is a problematic concept. One of its weaknesses is that it implies the existence of a law independent of a nation's consent.²¹ Another problem with positivism is that it contradicts an idea that is necessary for its existence.²² Positiv-

The concept of state sovereignty has been "[o]ne of the major *crucis* in the theory and practice of the law of nations" *Id.*

15. *Id.* at 258.

16. P. JESSUP, *supra* note 1, at 40.

17. I J. VERZIJL, *supra* note 14, at 258. For example, the French jurist Jean Bodin (1530-96) concluded that "[a]lthough the King of France was supreme in power, even he was not '*legibus solutus*,' but subordinated to the commands of God and His moral order." *Id.*

18. P. CORBETT, *LAW AND SOCIETY IN THE RELATIONS OF STATES* 20 (1951). The proponents of a "law of nations" rejected the earlier theological view of a Divine will as the only controlling power, and adopted instead a humanist approach to the relations between sovereign states. *Id.*

The writings of Aquinas, Vitoria, Vasquez, Gentili, Suarez, Grotius, and others developed the idea of a law among nations by drawing a distinction between just and unjust war. *Id.* They sought to persuade leaders "not to go to war except for grave reasons defined in advance and, if war nevertheless came, to wage it in accordance with fixed rules." *Id.* These writers supported their arguments for a law between nations with citations to Roman and Canon Law and the works of ancient philosophers. *Id.* "To call the system *jus* . . . was to assert its place in a great genealogy of thought, and at the same time to claim for it some of the special authority attaching to the Digest, Code and Novels of Justinian." *Id.*

19. *Id.* at 23.

20. *Id.* at 68.

21. *Id.* at 73.

22. *Id.*

ism's reliance on the notion of consent postulates that all states are equal.²³ However, this equality is eliminated

if the whole legal system linking State A with another State derives its validity from the latter's own will [T]hen A alone is sovereign in the group and all other members are subject to A's law. There can thus be only one sovereign at a time, namely, the State from whose point of view the system is being considered.²⁴

By the early twentieth century, dissatisfaction with positivism on a theoretical level was compounded by the desire to limit the growing destructiveness of war through international mediation.²⁵ Thus, the main thrust of twentieth century legal analysis of sovereignty has been toward replacing positivism with a concept of sovereignty that can coexist with the notion of a dominant international authority.²⁶ During the 1930's and 1940's, scholars achieved this end by substituting the implied "law" of positivism with the hypothesis that there is an international community, the international community has a common will, and "the will of the international community must be obeyed."²⁷ In rejecting positivism, these scholars argued that a nation's consent only means that it joins other consenting nations in creating a communal will.²⁸ It is this joint will that is the source of modern international legal authority.²⁹

B. *The United Nations as an Instrument of Joint Sovereignty*

The United Nations is a direct expression of this acceptance of a jointly sovereign will.³⁰ On June 26, 1945, the United Nations Conference on International Organization

23. *Id.*

24. *Id.*

25. See, e.g., Jessup, *International Law in the Post-War World*, 36 AM. SOC. INT'L L. PROC. 46-47 (1942).

26. P. CORBETT, *supra* note 18, at 70-71.

27. *Id.* at 73 (citing H. LAUTERPACHT, *THE FUNCTION OF LAW IN THE INTERNATIONAL COMMUNITY* 421 (1933)).

28. *Id.* at 74-75.

29. See *id.*

30. See I G. SCHWARZENBERGER, *INTERNATIONAL LAW* 121 (3d ed. 1957). International law has limited sovereignty in a number of ways. *Id.* "Rules of international customary law, general principles of law recognised by civilised nations, and above all, treaties imposed farreaching limitations on the sovereignty of states. In a system of interrelated legal principles, sovereignty is necessarily a relative concept." *Id.*

adopted the Charter of the United Nations and established an international organization known as the United Nations.³¹ The preamble of the United Nations' Charter clearly states that the document is an expression of a communal will.³² The Charter represents the signatories' deliberate subjugation of their sovereign rights to an international legal body.³³ However, the signatories do not completely assign all of their rights to the international organization. In article 2, paragraph 1, the Charter states that the United Nations "is based on the principle of the sovereign equality of all its Members"³⁴ and article 2, paragraph 7 identifies a sphere of "domestic jurisdiction" that remains with the member state.³⁵

The formation of the United Nations created three possible areas for the operation of international law.³⁶ The first governs matters that nations have specifically subjected to rules established by international organizations.³⁷ The second area concerns sovereign rights reserved by member nations under article 2, paragraph 7 of the Charter.³⁸ This area of domestic jurisdiction or "reserved domain" is an area that international law "does not . . . regulate because it wishes to leave to the sovereign States an independent sphere of activity not bound by its prescriptions."³⁹ The third area where international law may operate is where a matter is international in

31. U.N. CHARTER.

32. *Id.* preamble. The preamble of the United Nations Charter states:

We the peoples of the United Nations determined to save succeeding generations from the scourge of war . . . to establish conditions under which justice and respect for the obligations arising from treaties and . . . international law can be maintained . . . and for these ends . . . to employ international machinery for the promotion of the economic and social advancement of all peoples, have resolved to combine our efforts to accomplish these aims.

Id.

33. See P. CORBETT, *supra* note 18, at 74-75.

34. U.N. CHARTER art. 2, para. 1.

35. *Id.* art. 2, para. 7. Specifically, this provision states that "[n]othing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the *domestic jurisdiction* of any state or shall require the Members to submit such matters to settlement under the present Charter . . ." *Id.* (emphasis added).

36. I J. VERZIJL, *supra* note 14, at 274.

37. *Id.* One authority described this area as "the group of matters which the law of nations governs by means of positive rules." *Id.*

38. *Id.*; see *supra* note 35 (text of article 2, paragraph 7).

39. I J. VERZIJL, *supra* note 14, at 274.

scope, but has escaped the regulation of an international organization.⁴⁰

The boundaries between these three areas are flexible, and react to changes in the social and economic conditions that the United Nations' Charter and its members oversee.⁴¹ The recent growth of international debt⁴² is one of the developments that tests this fluidity in international law. Originally monitored by the Fund,⁴³ an organization associated with the United Nations, international debt has outgrown the original "rules" of the international body designed to keep it in check.

C. *The International Monetary Fund as an Instrument of Joint Sovereignty*

1. The Formation of the International Monetary Fund

Article 1 paragraph 3 of the United Nations Charter states that one of the purposes of that organization is "[t]o achieve international cooperation in solving international problems of an economic . . . character."⁴⁴ This goal is a reflection of aims set forth at the Bretton Woods Conference of 1944. The Bretton Woods Conference of 1944 initiated international cooperation in economic and financial affairs by calling for the creation of the International Monetary Fund and the Bank for International Reconstruction and Development (World Bank).⁴⁵ Before Bretton Woods, nations considered "the unqualified

40. *Id.* This third area where international law may operate is not a subset of rights reserved by the nations that join an international regulatory institution. *Id.* Instead, this area is for matters which should be subject to international regulation, but which international organizations have not yet been able to control. *Id.*

41. *See id.*

42. Address by Paul A. Volcker, House of Representatives Committee on Banking, Finance and Urban Affairs, Table II (Feb. 2, 1983). In 1975, the total volume of bank claims on developing nations was U.S.\$62.7 billion. *Id.* By June of 1982, this figure had reached U.S.\$268.3 billion, *id.*, and over half of these claims arose from loans to Argentina, Brazil, and Mexico. *Id.*

43. *See infra* notes 44-86 and accompanying text.

44. U.N. CHARTER art. 1, para. 3.

45. In July, 1944, after three years of preparation, representatives of 44 nations met at Bretton Woods, New Hampshire, to complete the formation of the Fund and the World Bank. E. MASON & R. ASHER, *supra* note 3, at 1. The Fund and the World Bank were created "[t]o promote international monetary co-operation," Fund Agreement, *supra* note 3, art. I, § (i), and "[t]o assist in the reconstruction and development of territories of members by facilitating the investment of capital." World Bank Agreement, *supra* note 3, art. I, § (i).

right to determine the value of one's own currency . . . [as] an essential feature of sovereignty."⁴⁶ The Bretton Woods Agreements⁴⁷ were established partly because of the economic instability that this perception engendered in the years between the World Wars.⁴⁸ During the 1920's and 1930's, many nations' discriminatory currency arrangements, random valuations of their currencies, and restrictive trade practices inhibited international trade⁴⁹ and contributed to the outbreak of the Second World War.⁵⁰ The Fund was designed to overcome the destructive practices of the period between the wars by encouraging international trade through restrictions on the exchange practices of the Fund's membership.⁵¹

The nations that comprise the Fund agree to relinquish control over the valuation of their currencies in the following ways. Member nations must agree to establish a par value system for their currencies,⁵² and cannot restrict payments and transfers of foreign currency unless the Fund authorizes the restrictions.⁵³ Finally, the Fund does not allow members to use public policy arguments to justify their failure to honor another government's exchange controls.⁵⁴

46. J. GOLD, *THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS*, 2 (1965). Both institutions were officially established on December 27, 1945. See Fund Agreement, *supra* note 3; World Bank Agreement, *supra* note 3.

47. See *supra* note 45.

48. J. GOLD, *supra* note 46, at 2. One commentator has observed that [l]ooking backward, one of the astounding features of international relations before the Articles took effect is . . . that the value that a state could attribute to its currency . . . was within its sole discretion. . . . The lesson of experience has been that rates of exchange are matters of international concern and . . . had better be made the subject of international regulation. This has been done in a set of elaborate provisions in the Articles and in the policies of the Fund based on those provisions.

Id.

49. See *id.* at 14-15.

50. A. VAN DORMAEL, *BRETTON WOODS: BIRTH OF A MONETARY SYSTEM* 3 (1977). The economic and social disturbances of the 1920's and 1930's "accelerated the drift to self-sufficiency, isolation and impoverishment, until finally the 'have-nots' resorted to armed aggression on the plea of economic self-defense." *Id.*

51. See Fund Agreement, *supra* note 3, art. I; J. GOLD, *supra* note 46, at 14-15.

52. Fund Agreement, *supra* note 3, art. IV; see J. GOLD, *supra* note 46, at 3.

53. Fund Agreement, *supra* note 3, art. IV, § 5(b); see J. GOLD, *supra* note 46, at 7.

54. See Fund Agreement, *supra* note 3, art. V, § (5); J. GOLD, *supra* note 46, at 23-24.

2. Borrowing from the Fund: "Conditionality"

When a member nation draws on the Fund's resources⁵⁵ it does so by using its own currency to "purchase" the currency of another nation from the Fund.⁵⁶ At the same time, the purchaser agrees to "repurchase" its currency from the Fund at a later date.⁵⁷ This agreement is analogous to a loan from the Fund, although a nation is not technically indebted to the Fund unless it borrows over 100% of its quota.⁵⁸ Once the member borrows above this level, the Fund has the authority to condition any further access to the Fund's resources on the member's adoption of measures designed to stabilize its economy.⁵⁹ A borrowing member thus gains additional access to the Fund's resources only when the member, with the assistance of the Fund, develops a program of domestic policies designed to stabilize the borrower's currency and balance-of-payments.⁶⁰ These policies are known as conditionality.⁶¹

The legal basis of conditionality is the Fund's mandate to use "adequate safeguards" to ensure the proper use of its resources.⁶² The Fund always has attached conditions to the use of its resources, such as controlling inflation and decreasing

55. The Fund's resources traditionally come from the subscription quotas of the Fund's members. J. JACKSON, *INTERNATIONAL ECONOMIC RELATIONS* 870-76 (1977). Since the Fund adopted the First Amendment to the Articles in 1968, First Fund Amendment, *supra* note 3, member nations pay three-quarters of this quota in their own currency and the remaining quarter or "tranche" in a reserve asset entitled "Special Drawing Rights" (SDR's). *Id.* art. XXI; J. JACKSON, *supra*, at 876. The first amendment authorized the Fund to use SDRs to replace gold as the primary asset of the international monetary system. *See id.* art. XXV; J. JACKSON, *supra*, at 876. The Fund bases the value of SDR's on the short-term rates received for several currencies traded in euro-currency markets in the United States, Japan, West Germany, France, and the United Kingdom. J. JACKSON, *supra*, at 876.

56. *See* Fund Agreement, *supra* note 3, art. V; Comment, *The Renegotiation of Official International Debt: Whose Club Is It?*, 17 U. CAL. DAVIS 853, 869 (1984).

57. *See* Second Fund Amendment, *supra* note 3, art. V, § 3(b)-(c); Comment, *supra* note 56, at 869.

58. *See* Second Fund Amendment, *supra* note 3, art. V § 3(b)(iii); Comment, *supra* note 56, at 869.

59. *See* Second Fund Amendment, *supra* note 3, art. V § 3(f); Comment, *supra* note 56, at 869.

60. *See* Second Fund Amendment, *supra* note 3, art. V § 3(a); Comment, *supra* note 56, at 869.

61. Comment, *supra* note 56, at 869.

62. Fund Agreement, *supra* note 3, art. I(v); J. WILLIAMSON, *THE LENDING POLICIES OF THE INTERNATIONAL MONETARY FUND*, 9, 11 (Inst. for Int'l Econ. Monograph No. 1, 1982).

imports, but the terms of these conditions have varied considerably since the Fund's inception.⁶³ In the early years, the Fund granted access to the higher credit tranches⁶⁴ with only minimal conditionality.⁶⁵ By 1953, however, the organization had adopted a stronger position on the use of its resources⁶⁶ by limiting the level of conditionality to the size of the member's loan.⁶⁷ If the member's purchase was small, the Fund would attach only minimal conditions.⁶⁸ If the amount was large, the Fund would require the borrower to adopt more stringent policies.⁶⁹

Low conditionality requires that the member nation prove that it has a deficit, and state that the government is taking steps to adjust its balance-of-payments.⁷⁰ The Fund usually does not challenge such an assertion.⁷¹ Stringent, or high conditionality requires that the member design a specific program to reduce its deficit.⁷² The Fund reserves the right to approve or reject the plan prior to granting access to the Fund's resources.⁷³ For the borrower, the Fund's sanction is essential because it acts as a "seal-of-approval" and enables the borrower to negotiate more loans on the private credit markets.⁷⁴

Conditionality is important for a number of reasons. First, it is an example of the deliberate delegation of certain aspects of national sovereignty to an international body.⁷⁵ Second, it

63. J. GOLD, *CONDITIONALITY 1-13* (1979) (detailed description of the evolution of conditionality by the former General Counsel of the Fund).

64. *See supra* note 56.

65. J. WILLIAMSON, *supra* note 62, at 11.

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.* at 11-12.

73. Second Fund Amendment, *supra* note 3, art. V, § 3(b).

74. J. GOLD, *supra* note 63, at 14. This effect has been described as follows:

The Fund's endorsement, and the member's observance, of a program have become, increasingly, conditions for the entry into loan contracts by other lenders or for making resources available under contracts. If a policy of the Fund on the use of its resources does not call for the adoption of a program by a member, the Fund's action in providing resources is less likely to induce other parties to provide additional financing.

Id.

75. *See supra* text accompanying notes 44-54.

is the Fund's means of ensuring that members use Fund resources in ways that fulfill the Fund's original purpose.⁷⁶ Finally, the Fund's ability to impose conditions on its loans, not the loans themselves, are what make the Fund essential to the resolution of a debt crisis.⁷⁷ Although the commercial banks' exposure to the default of sovereign debtors like Mexico and Argentina is extremely high, because they do not have the international legal authority to impose conditions on their sovereign borrowers, they must use the Fund's conditionality as a conduit for their own renegotiation terms.⁷⁸

3. Conditionality and Economic Interdependence

By becoming members of the Fund and submitting to a program designed to restrict some of its economic and financial choices, a nation voluntarily relinquishes some of its sovereign authority.⁷⁹ In doing so, the nation adds conditionality to a list of economic activities that link one nation with another and make them economically interdependent. Economic interdependence, in the sense of normal trade relations between sovereign nations, may make it more difficult, or even impossible for nations to follow their own domestic policies, but it does not invade national sovereignty because the nation consented to the interdependence.⁸⁰

Recently, however, the economic dependence created by Fund conditionality has entered a new dimension. The consent necessary to prevent an invasion of a reserved sovereign right⁸¹ to determine economic policy binds the debtor nation and the Fund.⁸² In the last several years, private commercial banks, not the Fund, have become the debtor's primary creditors.⁸³ A debtor nation's consent to the terms of a private loan

76. Gold, *Use of the International Monetary Fund's Resources: "Conditionality" and "Unconditionality" As Legal Categories*, 6 J. INT'L L. ECON. 1, 24 (1971).

77. *It's High Noon for IMF Funding: Congress Stalls, Threatening Loans to Troubled Developing Countries*, Bus. Week, Oct. 3, 1983, at 40 (interview with Anthony M. Solomon, president of the New York Federal Reserve).

78. See *infra* notes 274-95 and accompanying text.

79. See *supra* text accompanying notes 44-54.

80. H. MORGENTHAU, *supra* note 1, at 320-21.

81. See *supra* notes 38-39 and accompanying text.

82. See Fund Agreement, *supra* note 3, art. VIII.

83. See *infra* notes 204-73 and accompanying text.

agreement should not be confused with consent to the subjugation of sovereign rights to a communal will.

Some indebted nations have tried to evade their international obligations by arguing that Fund stabilization measures are an invasion of their national sovereignty. In 1980, for example, Jamaican Prime Minister Michael Manley used this argument to reject a Fund austerity plan.⁸⁴ More recently, the general secretary of Argentina's powerful labor confederation claimed that his government's management of the national debt "surrendered totally and absolutely" the patrimony of the nation.⁸⁵ Usually, criticism of this nature is loosely directed at the Fund, the controlling political party, and the United States Government.⁸⁶

These attempts to evade international debt obligations misuse the term "sovereignty" because their complaints are directed toward the Fund and thus fall within the type of economic interdependence to which member nations have consented. The real problem raised by the increasing role of the commercial banks in recent renegotiations of sovereign debt is that it has removed the stabilization process from the category of activities that member nations delegated to the Fund.⁸⁷ Escalating foreign debt and increased participation of private commercial bank lenders has created a new phenomenon that is beyond the control of the Fund, and thus beyond the existing mechanism of joint sovereignty. The problem of sover-

84. Garvan, Bernall & Hughes, *The IMF and the Third World: The Case of Jamaica, 1974-80*, 2 *DEV. DIALOGUE* 113, 121-22 (1980). Despite Jamaica's need for major refinancing, in January 1977 the Manley government rejected a recently negotiated Fund program that would have required that Jamaica devalue its currency, freeze wages, and balance the budget. *Id.* at 121. The Prime Minister told the nation:

[W]e are now facing a situation in which some of the people who could lend us money will apparently do so only on the condition that they should be able to tell us how to conduct our affairs. . . . [T]his government . . . will not accept anybody anywhere . . . telling us what to do in our country. We are the masters in our house and in our house there shall be no other master but ourselves. Above all, we are not for sale.

Id. at 122.

85. *Argentina Fires a Shot in The Debtor's Revolt*, *Bus. Week*, Oct. 17, 1983, at 47.

86. See, e.g., Abdalla, *The Inadequacy and Loss of Legitimacy of the International Monetary Fund*, 2 *DEV. DIALOGUE* 25, 37-38 (1980) (the Fund's policies should not apply to developing members because developing nations, as a class, were under-represented at the Bretton Woods Conference).

87. See *supra* notes 30-35 and accompanying text.

eign debt is not, as some political leaders have argued,⁸⁸ an improper subject for cooperative international regulation, but is instead an international problem that falls within the third area of international law:⁸⁹ where there is at present no consensual international arrangement.

II. MEXICO AND ARGENTINA: A TRADITION OF ECONOMIC DEPENDENCE

The current Mexican and Argentine liquidity crisis is an outgrowth of traditional Latin American dependence on the economic conditions in the United States and Europe. Under the theory of economic dependence,⁹⁰ an economically dependent nation is one whose growth and development is conditioned on the strength of another nation's economy.⁹¹ The dominant country is economically self-sustaining, while the dependent country's economic prosperity is linked to that of its trading partners.⁹² According to this theory, economic dependence is a self-perpetuating condition; only the exporting and importing sectors of the dependent nation participate in and benefit from contact with the international economy.⁹³ The influx of foreign capital from imports is returned to the interna-

88. For example, in June and July of 1980, several developing nations met in Tanzania for the North-South conference on "The International Monetary System and the New International Monetary Order." *The International Monetary System and the New International Monetary Order*, 2 DEV. DIALOGUE (1980). During this conference, Tanzanian President Nyere characterized the Fund's conditions as "political interference." Address by President Nyere, New Year Message 1980, *reprinted in* 2 DEV. DIALOGUE 7, 9 (1980). Nyere labeled the Fund itself "a device by which powerful economic forces in some rich nations increase their power over the poor nations of the world." *Id.* at 8.

89. *See supra* note 40 and accompanying text.

90. The theory of economic dependence was developed by Latin American economists in the late 1950's and 1960's. *See, e.g.*, F. CARDOSO & E. FALETTO, *DEPENDENCY AND DEVELOPMENT IN LATIN AMERICA* vii (M. Urquidi trans. 1979) (classic statement of the dependency theory); Prebisch, *Economic Development or Monetary Stability: The False Dilemma*, VI ECON. BULL. FOR LATIN AMERICA 1 (Mar. 1961). The dependency theory is partly Marxist in origin, F. CARDOSO & E. FALETTO, *supra*, at vii, but recent commentators employ the economic model of dependency without adopting its ideological aspects. *See, e.g.*, T. SKIDMORE & P. SMITH, *MODERN LATIN AMERICA* (1984).

91. T. SKIDMORE & P. SMITH, *supra* note 90, at 9.

92. *Id.* at 10.

93. *Id.* Dependency, "[b]y its intrinsic character . . . generated inequities, allocating benefits to sectors participating in the world market and denying them to other groups." *Id.*

tional marketplace because the local economy does not provide enough goods for either business or domestic demand.⁹⁴ In a dependent economy, therefore, there is no domestic investment in the nonexport businesses needed to develop economic independence.⁹⁵ Economic dependence on the industrialized nations leads to inherent limitations on the state's own industrial growth.⁹⁶ The resistance of some Latin American nations, particularly Argentina, to the Fund's conditional-ity results from a desire to protect the steps they have made toward economic autonomy.

Industrialization brought Mexico and Argentina into the international markets for the first time since the former colonies won independence from Spain in the early nineteenth century.⁹⁷ The growth of industry in Europe and the United States developed a market for the raw materials and agricultural products of the region, and the exports of Mexico, Argentina, and other Latin American nations attracted foreign investment in areas that supported the export trade.⁹⁸

Between 1880 and 1930, the governing elites of both Mexico and Argentina encouraged foreign investment and the export trade.⁹⁹ Leading politicians and businessmen encouraged this development for a number of reasons. The prominent groups endorsed the liberal, laissez-faire economic theories of the day, and opposed the protectionist measures necessary to shield local businesses from lower priced imports from Europe and the United States.¹⁰⁰ The Mexican and Argentine Governments also encouraged their economies to become dependent on the export-import pattern because it kept prices low for consumers.¹⁰¹ In addition, any government interference in or promotion of local businesses might have been interpreted as a

94. *Id.*

95. *Id.* Profits from exports would "provide precious little capital for diversifying the local economy, thus creating a situation that some observers would have labeled 'growth without development.'" *Id.*

96. *Id.*

97. *See id.* at 47.

98. *Id.* at 55-56. Railroad, shipping, and financial services were developed and controlled by foreign investors. *Id.* at 74, 231.

99. *Id.*; *see infra* notes 105-15, 146-52 and accompanying text.

100. T. SKIDMORE & P. SMITH, *supra* note 90, at 55-56. Latin American liberals thought "deviation from liberal principles in economics must mean authoritarian government, and it was therefore held in low regard." *Id.* at 56.

101. *Id.*

sign that the government was catering to private business at the public's expense.¹⁰²

Since World War II, many Latin American nations have tried to achieve economic independence from the economies of their industrialized trading partners by substituting local products for imports and by increasing the government's participation in their economies.¹⁰³ Despite some success in industrialization and domestic investment, both Mexico and Argentina seem only to have changed the form of their economic dependence.¹⁰⁴

A. Mexico's Economic History: Growth of an Export Economy

General Porfirio Díaz, who served as Mexico's President from 1876 to 1911, welcomed foreign investment in the Mexican economy.¹⁰⁵ For Díaz, the involvement of foreign investors was an opportunity to enhance the country's economic power, rather than a threat to Mexico's independence.¹⁰⁶ Like the Argentine leaders of the same era, Díaz espoused laissez-faire policies that he enforced by centralizing power in a federal government.¹⁰⁷ Díaz actively encouraged foreign investment by granting private companies lucrative concessions in areas such as railroad construction and oil exploration and by refusing to impose tariffs on imports.¹⁰⁸ By the time Díaz left

102. *Id.* Opponents of government support of national industry usually "charged . . . that a small group of selfish investors were seeking to profit at the expense of the public." *Id.*

103. See R. VERNON, *SOVEREIGNTY AT BAY: THE MULTINATIONAL SPREAD OF U.S. ENTERPRISES* 99 (1971).

104. For a pre-1982 discussion of this concept, see Solomon, *Developing Nations and Commercial Banks: The New Dependency*, 12 J. INT'L L. & ECON. 325, 359-60 (1978).

105. R. VERNON, *supra* note 103, at 194. "The Diaz policy was to play the interests of British, French, and United States capital against each other." F. CARDOSO & E. FALETTO, *supra* note 90, at 105.

106. R. VERNON, *supra* note 103, at 194-95.

107. T. SKIDMORE & P. SMITH, *supra* note 90, at 230.

108. *Id.* The mining industry is an example of the extent of foreign investment in Mexico during the Porfirian era. Mining produced nearly three-fifths of Mexico's exports by the turn of the century, and was primarily controlled by United States companies. C. CUMBERLAND, *MEXICO: THE STRUGGLE FOR MODERNITY* 228 (1968); Oliver, *The Historical Perspective: A Vital Force in United States-Latin American Relations; Neglected Here, Distorted There*, 12 CAL. W. INT'L L. J. 423, 426 (1982). Another example is the oil industry. Around 1900, the Mexican Government granted British and United States oil companies real property interests in Mexico's subsurface oil and gas fields. *Id.* This transaction violated the Mexican Constitution, which stated that sub-

office in 1911, Mexico had become a haven for foreign investors.¹⁰⁹ According to one estimate, foreign investment in Mexico was as high as two billion pesos.¹¹⁰ Fifty percent of this figure came from investors in the United States.¹¹¹

This high level of foreign involvement in the Mexican economy caused several problems. For example, foreign capital investments preempted the development of a system of investment by the Mexicans themselves.¹¹² The export-oriented nature of the economy also inhibited the growth of an entrepreneurial class, a situation that was reenforced by the poverty, low literacy level, and rural character of the Mexican population.¹¹³ As a result, there was no class of consumers to provide either the capital for industrial development or to provide a market for domestically produced goods.¹¹⁴

The Mexican Civil War erupted in 1911, and relations between Mexico and foreign investors deteriorated.¹¹⁵ Like other Latin American nations, Mexico resented the United States' interventionist approach to the region during the late nineteenth and early twentieth centuries.¹¹⁶ Mexico expressed its antipathy toward foreigners in a number of ways. For example, the drafters of the Constitution of 1917 wrote into that

surface property belonged to the public and could not be alienated by the state. *Id.* at 425-26.

109. See C. CUMBERLAND, *supra* note 108, at 232. Between 1895 and 1910, the Mexican treasury registered a surplus. *Id.* By 1911, tax revenues in Mexico were over 100 million pesos, up from 15 million in 1876, and Mexican bonds sold at a premium on international bond markets. *Id.*

110. *Id.*

111. *Id.*

112. See T. SKIDMORE & P. SMITH, *supra* note 90, at 231-32.

113. *Id.* at 231.

114. See T. SKIDMORE & P. SMITH, *supra* note 90, at 232.

115. C. CUMBERLAND, *supra* note 108, at 250.

116. *Id.*; see Oliver, *supra* note 108, at 430. In 1904, President Roosevelt announced a foreign policy position known as the Roosevelt Corollary to the Monroe Doctrine. 1904 FOR. REL. OF U.S. XLI. The Corollary sought to prohibit European interference in the affairs of the Americas and to authorize the United States intervention to protect its interest. *Id.* "If a nation shows that it knows how to act with . . . decency in social and political matters, if it keeps order and pays its obligations, it need fear no interference from the United States." *Id.* Two particular events reinforced Mexico's resentment of the United States' activity in the region. In 1913, rumors indicated that the United States' Ambassador was connected with the assassination of President Madero. See F. CARDOSO & E. FALETTA, *supra* note 90, at 108. In 1914, United States troops occupied Veracruz at the direction of President Wilson. *Id.*

document two articles designed to restrict the activities of foreigners, and in the late 1920's the government formally expelled all non-Mexican priests.¹¹⁷ In 1938, following years of bitter controversy, the Mexican Government expropriated the properties held by the United States and British oil companies since the Porfirian Presidency.¹¹⁸

The Second World War was a turning point in Mexico's attempt to break away from the influence of United States and European investors. The absence of competition from United States and European manufacturers during the 1940's stimulated fledgling Mexican industries.¹¹⁹ Between 1946 and 1952, President Alemán continued this development by adopting a plan to expand Mexico's infrastructure and create a domestic market for Mexican goods.¹²⁰ During this period, the government spurred the growth of a domestic market and eased balance-of-payments by raising tariffs on imports.¹²¹ The Alemán plan contributed to the 9.2% growth of Mexican manufacturing between 1948 and 1951, but in 1952, inflation overtook these gains and the economy's expansion slowed.¹²²

Between 1952 and 1976, Mexico adhered to a par value system designed to curb inflation.¹²³ Initially, this hard money policy succeeded in sustaining Mexico's prosperity by linking the value of the peso to the price of the United States dollar.¹²⁴ For a time, this policy controlled inflation and increased Mexico's attractiveness to foreign investors.¹²⁵ By the early 1970's,

117. C. CUMBERLAND, *supra* note 108, at 250.

118. *Id.*

119. T. SKIDMORE & P. SMITH, *supra* note 90, at 243-44.

120. *See id.* The high price of exports in the years following World War II sustained the growth of domestic investment and a market for domestic products. F. CARDOSO & E. FALETTO, *supra* note 90, at 150-51.

121. T. SKIDMORE & P. SMITH, *supra* note 90, at 244.

122. *Id.*

123. *Id.*; *see infra* text accompanying note 124.

124. *Id.* Traditionally, Mexico's "[e]conomic activity is . . . linked to the US business cycle, principally through fluctuations in demand for Mexican exports, but also through price levels reflected in import prices . . . on the Mexican traded goods sector." FitzGerald, *Stabilisation Policy in Mexico: The Fiscal Deficit and Macroeconomic Equilibrium 1960-77*, in *INFLATION AND STABILISATION IN LATIN AMERICA* 23, 28 (1979) (footnote omitted).

125. T. SKIDMORE & P. SMITH, *supra* note 90, at 244. During the 1970's, Mexico enacted legislation restricting foreign investment in new projects in Mexico to 49%. *The Ripples From Mexico Are Crossing the Rio Grande*, *Economist*, Nov. 20-26, 1982, at 67-68.

however, the Mexican economy was in serious trouble.¹²⁶ Over 50% of the national budget went into state supported companies and agencies.¹²⁷ This massive subsidization,¹²⁸ coupled with an increase in inflation, encouraged Mexicans to convert pesos to dollars, or to invest outside the Mexican economy.¹²⁹ Mexico's inflation rose to 20% between 1973 and 1974, and by 1976 this rate had increased by another 50%.¹³⁰

During this period Mexicans continued to convert pesos to dollars, draining Mexico's foreign reserves.¹³¹ Despite the discovery of huge oil deposits in Mexico in late 1977, inflation remained high.¹³² Mexico continued to borrow heavily from foreign lenders to meet its financial obligations.¹³³ Declining world oil prices in the early 1980's significantly altered government budget projections, resulting in steep increases in the Mexican Government's borrowing in the international credit markets.¹³⁴

By the end of 1981, Mexico's foreign debt exceeded U.S.\$57 billion.¹³⁵ Despite the government's attempts to stabi-

126. FitzGerald, *supra* note 124, at 28, 40. The growth of the Mexican economy slowed in the mid-1960's. Exports declined as a percentage of the Mexican Gross Domestic Product (GDP) and imports remained constant. *Id.* This development had two results. First, the government's current account balance moved from a U.S.\$380 million deficit in 1965 to a U.S.\$1076 million deficit in 1970. *Id.* at 29. Second, as the deficit increased, the government increased borrowing from official creditors and short-term foreign bank loans to private companies. *Id.* at 28.

127. T. SKIDMORE & P. SMITH, *supra* note 90, at 248. The government's public expenditures during the 1960's represented a long-term investment for the state. FitzGerald, *supra* note 124, at 30-31. "Overall, the current and capital expenditure of the Sector Publico Federal rose from 15 percent of gross domestic product in 1960 to 22 percent in 1968 and 29 percent in 1976, without a parallel increase in income." *Id.* at 31.

128. T. SKIDMORE & P. SMITH, *supra* note 90, at 249. By 1970, the government had a controlling interest in nine of the top 10 Mexican companies. *Id.* at 248-49. The government's investment in the Mexican economy rose from 1.7% of GDP in 1960 and 1964 to 3.2% of GDP in 1973 to 1976. FitzGerald, *supra* note 124, at 32.

129. FitzGerald, *supra* note 124, at 28.

130. T. SKIDMORE & P. SMITH, *supra* note 90, at 249, 253.

131. *Id.* at 250-52.

132. *Id.* at 253. The country's earnings from oil production increased from U.S.\$500 million in 1976 to over U.S.\$13 billion in 1981. *Id.* at 252-53.

133. *Id.* Although Mexico's oil exports totaled U.S.\$14 billion in 1981, Mexico's current account deficit was U.S.\$13 billion during the same year. Volcker, *How Serious is U.S. Bank Exposure?*, Challenge, May-June, 1983, 11, 13.

134. Frazier, *Mexico's Boom Dampened by Oil Glut*, Wall St. J., Aug. 13, 1981, at 23, col. 2.

135. T. SKIDMORE & P. SMITH, *supra* note 90, at 253.

lize the value of the peso, the Mexican economy continued to deteriorate throughout the year. In February, when the nation's annual inflation rate stood at 60%, President Lopez Portillo nationalized Mexico's banks and devalued the peso by almost 100%.¹³⁶ By the end of the year, Mexico's foreign debt was U.S.\$80 billion, or 15% of the gross national product.¹³⁷

In August, 1982 the Mexican Government suspended payments on its foreign debt and negotiated bridge loans¹³⁸ with the Fund to cover the nation's immediate obligations.¹³⁹ In exchange for this assistance, the Mexican Government agreed to impose certain restrictions on the economy.¹⁴⁰ Under the Fund plan, the Mexican Government would reduce its heavy subsidization of the business sector, and adopt measures to increase exports, decrease the nation's reliance on imports, and reduce inflation.¹⁴¹

The newly elected de la Madrid administration quickly ratified the austerity program negotiated by the previous government.¹⁴² By 1984, Mexico's inflation rate had fallen from its 1982 high of 100% to 60%.¹⁴³ In February of 1985, however, the Mexican Government announced that it was taking "emergency measures" to contain the economic damage it sustained as a result of an expected rise in interest rates on its foreign debt and a drop in the price of oil.¹⁴⁴ These measures included a U.S.\$465 million reduction in government expenditures and the sale of 236 state-run companies.¹⁴⁵

136. *Id.* at 254-55.

137. *Id.*

138. Bridge loans are short-term loans intended to tide the debtor over until payments from the Fund and the commercial banks actually begin. Farnsworth, *Argentina Seen Near Bank Pact, IMF Package Hinges on Deal*, N.Y. Times, Dec. 27, 1984, at D10, col. 2. The United States' Government provided a bridge loan for Mexico in 1982 and for Argentina in 1984. *Id.*

139. *Mexico, IMF Initial \$4.5 Billion Loan Tied to Austerity*, Wall St. J., Nov. 11, 1982, at 2, col. 3.

140. Riding, *Latin Debt: Postponing the Burden*, N.Y. Times, Sept. 23, 1984, at F9, col. 1.

141. *Id.*

142. Farnsworth, *IMF Loan to Mexico*, N.Y. Times, Dec. 24, 1982, at D4, col.3; *Mexico, IMF Initial \$4.5 Billion Loan Tied to Austerity*, Wall St. J., Nov. 11, 1982 at 2, col. 3.

143. Meislin, *Mexico Tightens Austerity*, N.Y. Times, Feb. 11, 1985, at D4, col. 4.

144. *Id.*

145. *Id.*

B. *Argentina's Economic History*

Argentina experienced a dramatic increase in trade with Europe and the United States in the late nineteenth century.¹⁴⁶ This trade attracted foreign investment, but did not develop a significant local industry or create a market for domestically produced goods.¹⁴⁷ As in Mexico, the development of an economy dependent on the exchange of Argentine agriculture products for foreign goods and capital laid the foundation for the debt problem of the 1980's and for the Argentines' resistance to the Fund's conditionality.¹⁴⁸

Argentina, like Mexico, achieved prosperity in the late nineteenth and early twentieth centuries by providing Europe with products it needed to fuel industrialization.¹⁴⁹ European investors, not Argentines, financed and managed the businesses that supported Argentina's rapidly expanding international trade.¹⁵⁰ Between 1880 and 1914, Britain financed nearly the entire Argentine export economy: railroads, docks, shipping, utilities, meatpacking houses, insurance companies, and banks.¹⁵¹ The Argentine economy grew at a phenomenal rate during this period, with the gross domestic product increasing by a minimum of 5% annually.¹⁵²

Between 1914 and 1946, fluctuations in international trade directly affected the Argentine economy, illustrating the nation's dependence on the export-import system.¹⁵³ The peso value of exports, for example, doubled between 1915 and 1920 because World War I increased demand for Argentine wheat and beef,¹⁵⁴ but dropped during the early 1920's.¹⁵⁵ By 1930, the peso had returned to its 1920 value, but five years later the world-wide depression had forced the peso back to its 1915 price.¹⁵⁶ By the end of the 1930's, the peso had doubled

146. T. SKIDMORE & P. SMITH, *supra* note 90, at 74-75.

147. *Id.* at 75.

148. *See infra* notes 193-96 and accompanying text.

149. T. SKIDMORE & P. SMITH, *supra* note 90, at 74.

150. *Id.*

151. *Id.*

152. *Id.* at 75.

153. *Id.* at 75-76.

154. *Id.* at 75.

155. *Id.*

156. *Id.*

in value.¹⁵⁷ These swings in the value of the Argentine currency expanded and contracted the nation's money supply, thereby stifling local investment.¹⁵⁸

During the 1940's, Juan Perón rose to the presidency in part because of his opposition to foreign influence in Argentina.¹⁵⁹ In particular, Perón vehemently opposed joining the Fund because he viewed the international organization as a threat to Argentina's autonomy.¹⁶⁰ Perón designed his own anti-inflationary plans to curb Argentina's post-war inflation.¹⁶¹ These policies were initially successful,¹⁶² but in 1955 a group of military officers ousted Perón and immediately reversed Perón's position on international economic cooperation by joining the Fund.¹⁶³ After a succession of military and civilian governments, Perón returned to power in 1973.¹⁶⁴ Shortly thereafter, Perón died in office and his wife Isabel succeeded him.¹⁶⁵ A military junta removed Isabel from office in 1976, partly because of the nation's poor economic condition.¹⁶⁶

The military government appointed a new Economic Minister, José Martínez de Hoz, who designed an economic plan known as the National Reorganization Process (NRP).¹⁶⁷ De Hoz intended to decrease inflation by cutting tariffs and al-

157. *Id.*

158. *See id.* at 76.

159. *Id.* at 91-92.

160. *Id.* at 97.

161. *Id.* at 91-94. One economist described Perón's foreign trade policy as the "most comprehensive attempt yet made in Latin America to bring exports under the control of the State." C. FURTADO, *ECONOMIC DEVELOPMENT OF LATIN AMERICA* 158 (1970).

162. T. SKIDMORE & P. SMITH, *supra* note 90, at 92.

163. *Id.* at 94, 97. The following year Argentina asked the Fund to renegotiate the terms of its loans. Comment, *supra* note 56, at 862.

164. Di Tella, *supra* note 7, at 182.

165. *Id.*

166. *Id.* Isabel Perón's administration departed from the moderate position of the previous government. *Id.* Juan Perón's second administration, in general, followed an economic program designed to distribute income in Argentina. *Id.* Isabel's reformation of these programs sparked a violent reaction from labor unions. *Id.* In 1975, union members demanded a 100% wage increase. T. SKIDMORE & P. SMITH, *supra* note 90, at 106. The government gave in to the unions' demands, and as a result, inflation increased to 335%. *Id.* This rapid increase in prices caused a reduction in money supply. DiTella, *supra* note 7, at 184.

167. Martin, *Argentines, Fearing Sudden Devaluation, Continue to Transfer Funds Out of Pesos*, Wall St. J., Feb. 17, 1981, at 35, col. 1.

lowing cheap imports to enter the Argentine market.¹⁶⁸ Theoretically, these measures would foster competition, lower prices for consumers and force Argentine producers to make their operations more efficient.¹⁶⁹ Inefficient companies that merely drained the economy would be eliminated by this process.¹⁷⁰ The NRP also planned to eliminate the currency speculation that was draining capital from the Argentine economy.¹⁷¹ The government intended to prevent this outflow of capital by announcing all currency devaluations one year in advance.¹⁷²

De Hoz's NRP program was unsuccessful. The military regime insisted that certain industries remain protected from De Hoz's cuts in government subsidization, thereby eliminating one of the key elements of the NRP.¹⁷³ In addition, increased competition from inexpensive exports caused a rash of corporate bankruptcies, which in turn led to the collapse of at least sixty financial institutions.¹⁷⁴ This chain of events had a significant impact on the government's effort to curb spending. The Argentine Government spent \$6 billion reimbursing the bankrupt institutions' investors.¹⁷⁵

Another unsuccessful element of the NRP was its provision for currency devaluation. De Hoz deliberately allowed the rate of devaluation to lag behind the rate of inflation, thereby giving imports an effective discount.¹⁷⁶ At the same time, this practice harmed the nation's ranchers, farmers, and manufacturers who could not earn enough from exporting their goods

168. *Id.*; *Salvaging an Economy After Seven Years of Chaos*, Bus. Week, Feb. 6, 1984, at 67. De Hoz' program was a radical departure from the economic policies of previous administrations: "After years of protectionism, Martinez de Hoz reduced tariffs sharply overnight, unleashing a flood of low-cost imports and submerging the country's cosseted import-substitution industries." *Id.* The NRP's exchange policy simultaneously harmed exporters by creating a 40% overvaluation of the peso. *Id.*

169. Martin, *Argentines, Fearing Sudden Devaluation, Continue To Transfer Funds Out of Pesos*, Wall St. J., Feb. 17, 1981, at 35, col. 1.

170. *See id.*

171. *Id.* col. 2.

172. *Id.*

173. *See Flag Day For Argentina*, Economist, Apr. 2-8, 1984, at 11.

174. Martin, *Argentina Announces Program to Bail Out Firms Caught in a Severe Credit Squeeze*, Wall St. J., Apr. 27, 1981, at 38, col. 2.

175. *Id.*

176. Martin, *Argentines, Fearing Sudden Devaluation, Continue to Transfer Funds Out of Pesos*, Wall St. J., Feb. 17, 1981, at 35, col. 2.

to cover the cost of production.¹⁷⁷ It also affected the balance-of-payments deficit by diminishing tax revenues and encouraging Argentines to invest outside the country.¹⁷⁸

Unemployment, hyperinflation, and soaring national debt characterized the Argentine economy of the early 1980's. In 1982 factories operated at 50% of capacity¹⁷⁹ and in 1981 and 1982 unemployment figures stood at an eight year high.¹⁸⁰ Total output of goods and services dropped 4.5% between 1980 and 1981,¹⁸¹ and gross domestic product declined by 8% in the first half of 1982.¹⁸² The cost of living increased by 87.6% between 1979 and 1980,¹⁸³ and increased by another 83.6% in the following year.¹⁸⁴

In a vain attempt to curb Argentina's excessive inflation rate, the government devalued the peso three times in 1981.¹⁸⁵ Ironically, the government lost the most from the devaluations. Although the government closed the currency exchanges for several days before announcing the devaluations,¹⁸⁶ by the time the devaluations went into effect, most businesses and individuals already had converted their holdings into stronger currencies.¹⁸⁷ The government's devaluation policy catalyzed a run on the nation's foreign currency reserves, leaving the government with a large number of pesos.¹⁸⁸ After doing so, the government devalued the currency,

177. *Id.* col. 1; Martin, *Argentines Rush to Buy Dollars After Peso is Cut*, Wall St. J., Feb. 13, 1981, at 20, col. 1.

178. Martin, *Argentines Rush To Buy Dollars After Peso is Cut*, Wall St. J., Feb. 13, 1981, at 20, col. 1. Before the government's 10% devaluation of the peso on February 2, 1981, the outflow of capital from Argentina was U.S.\$50 million per day. *Id.* The week after the evaluation, this figure rose to U.S.\$280 million per day. *Id.*

179. *Back From The Brink?*, Economist, Nov. 20-26, 1982, at 69.

180. Wall St. J., Dec. 28, 1981, at 69.

181. *Id.*

182. *Id.*

183. *Argentines Rush to Buy Dollars After Peso is Cut*, Wall St. J., Feb. 13, 1981, at 20, col. 1.

184. Wall St. J., Feb. 9, 1981, at 20, col. 2.

185. Martin, *Argentina Devalues Its Currency by 30%*, Wall St. J., June 2, 1981, at 34, col. 4; *Argentines Rush To Sell Dollars After Peso is Cut*, Wall St. J., Apr. 3, 1981, at 25, col. 3; *Argentines Rush To Buy Dollars After Peso is Cut*, Wall St. J., Feb. 13, 1981, at 20, col. 1.

186. Martin, *Argentina Devalues Its Currency by 30%*, Wall St. J., June 2, 1981, at 34, col. 4; *Argentines Rush to Sell Dollars after Peso is Cut*, Wall St. J., Apr. 3, 1981, at 25, col. 3.

187. Martin, *Coping With Chaos*, Wall St. J., June 29, 1981, at 1, col. 1.

188. *Id.*

thereby diminishing its own cash reserves.¹⁸⁹

In response to this drain on foreign currency reserves, the government increased rates on savings accounts.¹⁹⁰ The increase in interest rates, however, also increased borrowing rates for businesses, thus making it even more difficult for the struggling business community to finance even its routine operations.¹⁹¹ This rise in borrowing rates placed all but the strongest companies in financially precarious positions because Argentine businesses survive hyperinflation only by rolling over short-term loans.¹⁹²

President Alfonsín replaced the military junta in 1983.¹⁹³ The first democratically elected, non-Peronist president in years, Alfonsín did not have the political backing to impose stringent Fund conditions on the Argentine economy.¹⁹⁴ Alfonsín and Grinspun refused to "bow to the strictures of the IMF"¹⁹⁵ so that they could build public support for the necessary economic cuts and simultaneously hold out for more favorable terms from the commercial banks.¹⁹⁶ In June of 1984, a meeting of several Latin American debtors, including Argentina, started a rumor that these nations were forming a "debtor's cartel."¹⁹⁷ This rumor was reinforced by the strong public opposition to the adoption of Fund stabilization measures,¹⁹⁸ but no formal negotiating cartel emerged. In September 1984 the Argentine Government finally agreed to negotiate a stabilization plan with the Fund.¹⁹⁹ As a condition to such a plan, the Fund required the Argentine Government to

189. *Id.*

190. Martin, *Argentina Announces Program to Bail Out Firms Caught in a Severe Credit Squeeze*, Wall St. J., Apr. 27, 1981, at 35, col. 1.

191. *Id.*

192. *Id.* col. 2.

193. Schumacher, *Peronists Suffer a Stunning Defeat in Argentine Vote*, N.Y. Times, Nov. 1, 1983, at A1, col. 6.

194. See *Alfonsin Unbowed*, Economist, June 30-July 6, 1984, at 65; *Intents and Purposes*, Economist, June 16-22, 1984, at 73; see also *Argentina's New Hope*, Bus. Week, Feb. 6, 1984, at 63.

195. *Alfonsin Unbowed*, Economist, June 30-July 6, 1984, at 65.

196. *Argentina's New Hope*, Bus. Week, Feb. 6, 1984, at 63.

197. See, e.g., *Debtor Nations Throw Down the Gauntlet—Gently*, Bus. Week, Jul. 9, 1984, at 98; *Gang of Four*, Economist, May 26-June 1, 1984, at 88, 93.

198. See *supra* note 7 (discussing Peronist labor unions' opposition to conditionality); see also *Argentina's New Hope*, Bus. Week, Feb. 6, 1984, at 61.

199. Farnsworth, *Argentina Seen Near Bank Pact*, N.Y. Times, Dec. 28, 1984, at D10, col. 2.

reach an agreement with its 320 creditor banks on a U.S.\$20 billion refinancing package.²⁰⁰ The government reached an agreement with the Fund in late December of 1984,²⁰¹ but by February, 1985, when inflation was at an annual rate of over 1,300%,²⁰² some observers feared that Argentina would not meet the economic adjustment goals set forth in the Fund Agreement.²⁰³

III. BANK LENDING TO DEVELOPING COUNTRIES IN THE 1970's

Several economic and political factors contributed to Mexico's and Argentina's massive accumulation of foreign debt during the 1970's and led to the uneasy balance between two opposing powers: the banks and their sovereign debtors in Latin America.

A. *The Growth of International Bank Lending in the 1970's*

In 1973 and 1974, the Organization of Petroleum Exporting Countries²⁰⁴ (OPEC) imposed an oil embargo on the United States and Europe, drastically lowering the volume and raising the price of petroleum exports to these countries.²⁰⁵ The embargo stimulated a dramatic increase in international bank lending in a number of ways. Oil rich OPEC nations flooded United States banks with deposits, giving the banks the opportunity to invest large sums of money.²⁰⁶ The recession in the industrialized world in 1974 and 1975 caused banks to look elsewhere to invest.²⁰⁷ The banks eventually invested a

200. *Id.*

201. *Id.*

202. Kreisler, *2 Top Argentina Officials Resign: Played Key Role in Debt Accord*, N.Y. Times, Feb. 19, 1985, at D9, col. 1.

203. Riding, *Argentina Denies Policy Shift*, N.Y. Times, Feb. 21, 1985, at D14, col. 5.

204. The Organization of Petroleum Exporting Countries (OPEC) was formed in September 1960 to allow oil producing nations to realize a larger share of crude oil profits. F. WYANT, *THE UNITED STATES, OPEC, AND MULTINATIONAL OIL* 66-68 (1977). The original members of OPEC were Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela. *Id.* at 68.

205. Volcker, *How Serious is U.S. Bank Exposure?*, Challenge, May-June, 1983, at 12.

206. *See id.*

207. *Id.* at 12-13. At this time the banks also were confronting changing conditions in traditional lending patterns. In the 1970's the banks' best creditors, large

significant amount of these funds in loans to developing nations.²⁰⁸

Developing countries like Mexico and Argentina were attractive investments for several reasons. First, in times of rising oil prices and increasing awareness of the United States' dependence on oil imported from the OPEC cartel, loans to oil producing nations seemed an attractive investment.²⁰⁹ Second, Latin American nations were growing.²¹⁰ The combined gross domestic product for the region increased at an annual rate of nearly 6% between 1960 and 1974,²¹¹ and prices for commodities produced by Latin America remained high.²¹² In addition, the banks' confidence in their loans to developing countries increased as the industry quickly responded to the developing countries' demand for more financing from the private sector.²¹³

1. Lending to Latin America: How the Banks Viewed the Risk

a. The Nature of Lending Risk

The risks of lending fall into two categories: economic and moral. "Economic hazard" is the risk that the borrower will not be able to repay its debts.²¹⁴ "Moral hazard" is the risk that the borrower will not be willing to fulfill its obligations.²¹⁵

When banks lend to domestic borrowers, the banks can easily assess the economic hazard of the loan.²¹⁶ The banks may already be familiar with trends in the borrower's industry,

corporations, were avoiding bank financing by using alternatives such as commercial paper. M. STIGUM, *THE MONEY MARKET: MYTH, REALITY AND PRACTICE* 483-85 (1978).

208. *POLICY ISSUES*, *supra* note 4, at 20.

209. *See id.* at 22.

210. Address by Paul A. Volcker, American Swiss Association, New York, at 3 (Nov. 29, 1984).

211. *INTERNATIONAL MONETARY FUND SURVEY*, at 113 (Apr. 21, 1980).

212. Address by Paul A. Volcker, American Swiss Association, New York, at 3 (Nov. 29, 1984).

213. *Id.*

214. Guttentag & Herring, *What Happens When Countries Cannot Pay Their Bank Loans? The Renegotiation Process*, 5 *J. COMP. BUS. L.* 209, 213 (1983).

215. *Id.*

216. *Id.* In developed nations, "assessment of the ability of borrowers to repay is facilitated by easy access to information and familiarity with the economy and the culture." *Id.*

and may know the borrower's reputation.²¹⁷ Domestic loans also have a more predictable moral hazard. Domestic loan agreements include restrictive covenants and penalties that the banks may enforce by invoking the power of the state.²¹⁸

When banks lend to foreign governments, both the economic and moral hazards of the loan increase.²¹⁹ The banks' access to information about the borrower's economic and financial condition is more limited and is expensive to obtain.²²⁰ In addition, during the 1970's the banks were unfamiliar with evaluating the risks of lending to foreign governments. Unaccustomed to this type of lending, bankers used inconsistent methods of examining the risks of these foreign loans.²²¹ Also, the banks' existing standards for evaluating potential creditors were designed for private domestic borrowers or local governments, and were inadequate for measuring transfer risk²²² or the stability of foreign governments.²²³

The moral hazard of lending to foreign governments is even greater.²²⁴ In contrast to the moral hazard of domestic loans, loans to countries like Mexico and Argentina cannot be enforced by the lender state.²²⁵ The creditors' government has limited power to compel other governments to repay their loans.²²⁶ In the United States, some courts will not enforce lending arrangements with foreign governments where default

217. *Id.*

218. *Id.* In the United States, the creditor may enforce such agreements under the Bankruptcy Act, 11 U.S.C. § 303 (1982).

219. Guttentag & Herring, *supra* note 214, at 213.

220. *Id.*

221. Volcker, *How Serious Is U.S. Bank Exposure?*, Challenge, May-June, 1983, at 15. Bankers "were also aware that blanket 'classifications' of a particular country . . . could have sudden devastating effects on the availability of credit, sometimes defeating the possibility of orderly adjustment and inviting a misinterpretation that the U.S. government might be making a political judgment." *Id.*

222. Transfer risk is the possibility that a country will use its sovereign power to cut back its debt service payments, interrupt them, or withhold them altogether. Guttentag & Herring, *supra* note 214, at 214. All foreign loans evaluated in currencies other than the debtors' currency are open to transfer risk. Even if the sovereign borrower uses the loan effectively, the loan is still vulnerable to transfer risk if an inefficient sector of the borrower's economy lowers the nation's net earnings of foreign exchange and forces the government to suspend the debt service payment. *Id.* at 230 n. 2.

223. *Id.* at 213.

224. *Id.*

225. *Id.*

226. *Id.* at 214.

is a public act by a foreign sovereign government²²⁷ or where enforcement of the agreement is contrary to the United States' foreign policy.²²⁸

Creditors do have one weapon against breach by a sovereign debtor: the implied power to withhold further credit from the borrower and to deny the country access to the international bank lending facilities it needs to finance trade.²²⁹ "[D]epriving a borrower of access to international banking facilities is tantamount to depriving that borrower of participation in the international financial system."²³⁰

2. How the Banks Limit Their Exposure

Banks with high levels of foreign loans have taken two steps to reduce the risk associated with lending to foreign governments. To distribute their exposure, large United States banks have formed syndicates that typically include European banks and other United States banks.²³¹ The banks also have applied the traditional short-leash lending technique as a second hedge against sovereign debt exposure.²³²

227. See, e.g., *IAM v. OPEC*, 649 F.2d 1354, 1359 (9th Cir. 1981), cert. denied, 454 U.S. 1163 (1982); *Allied Bank v. Banco Credito Agricola*, 566 F. Supp. 1440, 1443 (S.D.N.Y. 1983). The usual remedy for nonrepayment of loans, attachment of the debtor's assets, is prohibited in this situation by the Foreign Sovereign Immunities Act of 1976, 28 U.S.C. § 1602 (1982).

228. See, e.g., *Allied Bank*, 566 F. Supp. at 1444. The Second Circuit concluded in *Allied Bank* that

[a] judgment in favor of Allied in this case would . . . [put] . . . the judicial branch of the United States at odds with policies laid down by a foreign government on an issue deemed by that government to be of central importance. Such an act by this court risks embarrassment to the relations between the executive branch of the United States and the government of Costa Rica.

Id.

229. Guttentag & Herring, *supra* note 214, at 215. This implied power has been relatively successful in deterring sovereign default. With the exception of Cuba, Ghana, and North Korea, debtor nations have not repudiated their loans. *Id.* at 214. Even when new regimes ousted the governments that assumed the debt, the newcomers continued to honor these obligations. *Id.* Another deterrent to breach is the competitive nature of international banking. If a country was shut off from international banking facilities, an aggressive bank might see the void as an opportunity to lend to the boycotted country at profitable terms. *Id.* at 215.

230. *Id.* at 215.

231. *Id.*; see *infra* text accompanying notes 232-37.

232. Guttentag & Herring, *supra* note 214, at 216; see *infra* text accompanying notes 238-50.

a. Syndicate Loans

Syndicate loans, usually organized by a large bank, draw creditors from the United States regional bank market and from several nations.²³³ In addition to distributing the exposure of the large bank at the head of the syndicate, the arrangement deters default by the sovereign borrower.²³⁴ In contrast to a loan made by a single bank, a syndicate loan involves a larger number of banks and affects several markets in the United States and abroad.²³⁵ The debtor who falls behind on the repayment of a syndicate loan therefore risks alienating a significant portion of the international financial community.²³⁶ A syndicate loan also increases the number of governments that have an interest in the sovereign debtor's repayment.²³⁷

b. Benefits and Dangers of Short-Leash Refinancing

The short-leash technique is international lending's version of the restrictive covenants found in domestic loan agreements.²³⁸ In lieu of restrictive covenants, commercial banks attempt to limit their exposure by keeping short maturities on sovereign loans.²³⁹ This technique forces the sovereign borrower to renegotiate the loan frequently and may help the lenders to influence the borrowers' macroeconomic policy.²⁴⁰

233. Guttentag & Herring, *supra* note 214, at 215. See generally Clarke & Farrar, *Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers*, 1982 U. ILL. L. REV. 229 (discussing the formation of syndicates and the obligations assumed by managing and agent banks).

234. Guttentag & Herring, *supra* note 214, at 215.

235. *Id.*

236. *Id.* Access to international credit markets is important "[e]ven if a country does not expect to be in a debtor position with regard to foreign banks. The country may . . . find it essential to have balances at foreign banks in order to finance trade flows" *Id.*

237. *Id.*

238. *Id.*

239. *Id.* "[C]ountry risk for foreign lending is reduced as the length of the obligation decreases, since shorter maturities permit adjustments in exposure as balance of payments or political conditions change." *Id.* at 216.

240. *Id.* Some authorities suggest that commercial banks loans to foreign governments "are made with the implicit assumption that the borrower will manage its economy so that the nation will maintain foreign exchange levels adequate to meet the terms of repayment." *Id.* This assumption is not stated in the loan agreement because the lender would be unable to enforce the such a covenant and "the explicit statement of such conditions is likely to be viewed as an offensive intrusion on the borrower's economic sovereignty." *Id.*

The banks also use the short-leash approach to encourage debtors to stay current on their debt repayment schedule.²⁴¹ In theory, sovereign debtors will be less likely to withhold payments if they know they soon will have to confront their creditors in renegotiations.²⁴²

The commercial banks' use of shortened maturities only superficially diminishes the credit risks of lending to sovereign debtors.²⁴³ In effect, the technique has accelerated the debt problems of countries like Mexico and Argentina, and has contributed to the instability of the international banking system.²⁴⁴ The viability of the short-leash approach depends on the assumption that *every* bank can react to a repayment problem before its competition and can withdraw, leaving the burden of its exposure on other creditors.²⁴⁵ This premise creates a false sense of security in the lending banks. The short-term technique is designed to protect the interests of a single creditor.²⁴⁶ If the banks' competition also uses shortened maturities as a hedge against default, the loss-cutting advantage of the technique is diminished because it is possible that all the members of the syndicate may withdraw their funds at once.²⁴⁷

Short-term maturities also create problems for the borrower. The practice questions the certainty of the nation's sources of financing, and may encourage the debtor to adopt temporary solutions rather than long-term plans for adjust-

241. *Id.*

242. *Id.*

243. *Id.* The debt repayment schedules of a short-leash loan agreement "are related less to the capacity of the borrower to repay than to the need to influence the borrower's willingness to repay. Loan maturities tend to be shorter than those that are optimal from the standpoint of repayment capacity." *Id.* at 217.

244. *See generally id.* at 217-18.

245. *Id.*

246. *Id.*

247. *Id.* at 216-17. The problem has been explained as follows:

A current account deficit arising from any source that is accompanied by an adverse shift in expectations regarding the government's policies can thus lead to a "run", an unwillingness of holders of maturing obligations to roll them over. The larger the volume of such obligations coming due in any period, the larger the magnitude of any potential run. Thus, the more "conservative" banks are in protecting themselves individually against moral hazard by keeping maturities short, the more likely that a balance-of-payments deficit . . . will lead to a debt crisis.

Id. at 218.

ment.²⁴⁸ The constant renegotiations that result from short-term maturities also are expensive for the debtor and distract the nation's talent from the task of finding permanent solutions to their country's problems.²⁴⁹

When the level of exposure is high, and there are a large number of creditors, the commercial banks' belief that the short-leash approach protects the creditor with superior information is shortsighted.²⁵⁰ Ultimately, the technique prevents both creditors and debtors from taking a more realistic view of the risks involved.²⁵¹

3. The Impact of Inflation on Bank Lending to Latin America

The commercial banks continued to lend to Latin American nations throughout the late 1970's²⁵² despite growing foreign deficits in these countries and despite the banks' own declining capital ratios and liquidity.²⁵³ During this period, increasing world-wide inflation, and the distortions it engendered, played a key role in the exponential growth of bank lending to Latin American nations.

From the lenders' perspective, the high inflation rates of the late 1970's appeared to offset the rising level of the banks' sovereign debt exposure.²⁵⁴ Throughout the 1970's "rising world inflation, and low or even negative 'real' interest rates greatly moderated the rising debt ratios. Moreover, with credit in ample supply, most of the largest [sovereign] borrowers were able to add substantial amounts to their official reserve assets . . . tending to maintain confidence in their financial management and outlook."²⁵⁵ The commercial banks continued to lend to countries like Mexico and Argentina because the

248. *Id.* at 220.

249. *Id.*

250. *Id.* at 216-17.

251. *Id.*

252. See *supra* notes 210-13 and accompanying text.

253. Address by Paul A. Volcker, American Swiss Association, New York, at 4 (Nov. 29, 1984).

254. *Id.*

255. Volcker, *How Serious Is U.S. Bank Exposure?*, *Challenge*, May-June, 1983, 11, 12.

banks made several false assumptions.²⁵⁶ First, the banks anticipated that inflation would remain high and real interest rates would remain low.²⁵⁷ Second, the banks assumed that the borrowing governments would continue to sustain economic growth.²⁵⁸ Finally, the lenders believed that modern times were immune to financial disaster, and that the financial crises of the past “were more a relic of history than a future threat.”²⁵⁹ These miscalculations resulted in a situation in which “both interest payments and debt maturities were, in effect, being made only with the proceeds of new loans. . . . But [this condition] is sustainable only when the debt is maintained, . . . in some manageable relationship to real growth and productivity, with a liquidity or borrowing cushion against inevitable periods of recession and disturbance.”²⁶⁰

B. Mexico and Argentina Borrow from the Commercial Banks to Avoid Fund Conditionality

Despite the higher interest charges and shorter maturities of loans from commercial banks, developing countries like Mexico and Argentina were as eager to borrow from the commercial banks as the banks were to lend.²⁶¹ During the 1960's, developing countries had borrowed from the Fund under the

256. Address by Paul A. Volcker, American Swiss Association, New York, at 3 (Nov. 29, 1984).

257. *Id.*

258. *Id.* Between 1960 and 1979, the GDP of the Latin American region tripled, rising from U.S.\$149 billion in 1960 to U.S.\$430 billion in 1979 (constant 1978 dollars). INTERNATIONAL MONETARY FUND SURVEY, at 117 (Apr. 21, 1980). As a percentage of total growth in industrialized nations during this period, the region's GDP increased from six percent in 1960 to eight percent in 1979. *Id.*

259. Address by Paul A. Volcker, American Swiss Association, New York, at 3 (Nov. 29, 1984). Volcker claims that despite these problems, Latin America continued to be a sound investment. In his opinion, the losses sustained by the commercial banks on loans to such developed nations “continued to be substantially lower than on domestic lending—as they had been for many years. Foreign lending accounted for a rising share of the assets and earnings of most large international banks, both U.S. and foreign based.” Volcker, *How Serious is U.S. Bank Exposure?*, Challenge, May-June, 1983, at 11, 13. Volcker does not discuss the possibility that the banks may have been finding ways to make the loans continue to look profitable despite growing indications that the loans would not be repayed on schedule.

260. Address by Paul A. Volcker, American Swiss Association, New York, at 3-4 (Nov. 29, 1984).

261. Guttentag & Herring, *supra* note 214, at 221. By the 1970's, the Fund had become known as a lender of last resort. See J. WILLIAMSON, *supra* note 62, at 12.

Fund's conditional "stand-by" arrangements.²⁶² Although these arrangements encouraged borrowers to impose internal controls,²⁶³ the controls were politically unpopular and gave the Fund a reputation for inflexibility.²⁶⁴ When banking conditions in the United States and other industrialized nations made the private financial markets more accessible to developing countries, these countries were willing to borrow at less favorable rates in order to avoid the political cost of the Fund's conditionality.²⁶⁵

Between 1978 and 1980, a second large jump in oil prices caused the world economy to slip into recession once again, triggering a fall in commodity prices and shrinking the export markets for goods manufactured in Latin America.²⁶⁶ High interest rates increased the cost of servicing debts tied to market rates and forced debtor nations to raise their own interest rates

262. *See id.*

263. *See supra* notes 59-61 and accompanying text.

264. Stand-By Credit Arrangements, IMF Doc. 155-(52/57) para. 2 (Oct. 1, 1952) reprinted in *SELECTED DECISIONS OF THE EXECUTIVE DIRECTORS* 25 (1970); J. WILLIAMSON, *supra* note 62, at 12. As developing countries increased their purchases from the Fund during the 1960's and 1970's, the borrowers moved into higher conditionality, and the Fund became more involved in the borrowing government's administration of its currency imbalances. *See INTERNATIONAL MONETARY FUND SURVEY*, at 117 (Apr. 21, 1980). The Fund's reserves of Latin American currencies tripled between 1970 and 1973, and by 1979 this figure had doubled again. *Id.* In 1974, the Fund's gross reserves were U.S.\$18.2 billion. *Id.* This figure climbed to U.S.\$38 billion by 1979, nearly a 94% increase in borrowing from the Fund. *Id.*

In response to growing complaints about the Fund's interference in the affairs of members subject to high conditionality, in March of 1979 the Executive Board adopted a decision on "Use of Fund's General Resources and Stand-by Arrangements." *INTERNATIONAL MONETARY FUND SURVEY*, at 38 (Feb. 4, 1980).

Paragraph 4 of the decision reflects the Fund's "willingness to accommodate the views of developing members." J. GOLD, *supra* note 63, at 22. This section of the decision requires the Fund to give due regard to the domestic social and political objectives, the economic priorities and the circumstances of members, including the causes of their balance of payment problems. *Id.* The broad language of paragraph 4 reveals the Fund's sensitivity to criticism from the developing members during the late 1970's and early 1980's. The language "circumstances of the members" requires the Fund to "[accept] as beyond debate a member's economic organization [including] . . . the extent to which the economy is under government ownership or control. *Id.* at 23. "Only that attitude would be consistent with the technical mission of the Fund, the principle of universal membership and the uniform treatment of all members." *Id.* at 23-24.

265. Guttentag & Herring, *supra* note 214, at 221; *see supra* notes 55-78 and accompanying text (discussing conditionality).

266. Volcker, *How Serious Is U.S. Bank Exposure?*, *Challenge*, May-June, 1983, 11, 12.

to prevent the flight of capital.²⁶⁷ This curtailed the development of business and deprived the governments of tax revenue that such development would have provided.²⁶⁸ By the end of the decade, the Latin American region had a U.S.\$20 billion annual increase in its combined current account deficit; a five-fold increase since 1971.²⁶⁹

Despite the dual pressures of shrinking revenue and increasing interest payments on existing debt, borrowers like Mexico and Argentina did not impose effective domestic controls.²⁷⁰ The indebted governments' failure to react to the recession led to a sharp increase in domestic inflation, a corresponding increase in deficits, and continued conversion of capital into investments of a more stable value.²⁷¹ Throughout the late 1970's, these sovereign debtors avoided borrowing from the Fund and continued to rely primarily on financing from commercial banks.²⁷² This reliance increased as other sources of revenue raising, particularly, the external bond market, lost faith in the credit of developing nations.²⁷³

267. Address by Paul A. Volcker, Swiss American Association, New York, at 4 (Nov. 29, 1984).

268. *Id.* at 12.

269. INTERNATIONAL MONETARY FUND SURVEY, at 117 (Apr. 21, 1980). From 1971 to 1973, the annual increase in the region's current account deficit was U.S.\$4 billion. *Id.* By 1981, the annual increase in this figure was U.S.\$33.7 billion. INTERNATIONAL MONETARY FUND SURVEY, at 15 (Jan. 11, 1982). The region's foreign debt was nearly U.S.\$240 billion in 1981, a fourfold increase since 1977. *Id.*

270. Volcker, *How Serious is U.S. Bank Exposure?*, Challenge, May-June, 1983, 11, 12-13.

271. *Id.*

272. See Guttentag & Herring, *supra* note 214, at 221.

273. See INTERNATIONAL MONETARY FUND SURVEY, at 129 (May 10, 1982). The external bond markets, which market foreign bonds (bonds issued in a single national market) and eurobonds (bonds underwritten and sold in several markets) are popular with developing countries because they allow these countries to diversify their sources of financing. *Id.* The bond market also is attractive to developing countries because bonds provide long-term financing at fixed rates. *Id.*

Developing countries' percentage of total external bond issues increased from 3.3% in 1970 to 6.1% in 1976. *Id.* at 139. By 1978, this figure had risen to 15.5% and represented nearly 10% of the combined current accounts of the developing nations. *Id.*

The developing countries' ability to borrow on these markets has declined significantly since the late 1970's. *Id.* Investors lost interest in the bond markets for a number of reasons. First, interest rates were volatile and investors were unwilling to commit themselves to a fixed rate. *Id.* Second, local governments were entering the bond market to obtain fixed rate financing. *Id.* Bond market investors traditionally expect the issuer to have a high credit rating. *Id.* at 139-40. Those who did invest

IV. THE RESCHEDULING OF OFFICIAL AND PRIVATE DEBT

A. *The Paris Club*

Renegotiation of sovereign debt begins when an indebted nation requests a meeting of the Paris Club, the Fund's ad hoc, multilateral rescheduling group.²⁷⁴ The rescheduling of official debt negotiated by the debtor and the Paris Club is usually followed by a renegotiation of loans to commercial banks.²⁷⁵ The Paris Club agreement may state the terms of the private debt rescheduling as an express condition to the official debt agreement, and recent documents signed by the United States provide that the debtor must reschedule private loans on the same terms as those negotiated by the Fund.²⁷⁶

Commercial banks traditionally resisted the notion that the renegotiation of their loans to sovereign debtors should correspond to the terms of the Paris Club agreements.²⁷⁷ Recently, however, as sovereign borrowers like Mexico and Argentina have come to the brink of default,²⁷⁸ commercial banks have been more receptive to the Fund's renegotiation process.²⁷⁹ Although private commercial banks cannot directly impose stabilization programs on sovereign governments,²⁸⁰

during this period preferred the more predictable risk of domestic bonds to the uncertainty of heavily indebted foreign governments. *Id.* at 140.

274. Comment, *supra* note 4, at 860. The Paris Club, named for its usual meeting place, began in 1956 when Argentina asked the Fund to reschedule the repayment of its debt. *Id.* at 862. See *supra* notes 159-63 and accompanying text for a discussion of Argentina's early attitude toward the Fund.

The Paris Club meetings occur in three stages. First, the official creditors such as the Fund, the World Bank, and the Organisation For Economic Co-Operation and Development, meet separately. *Id.* This meeting, like the others, is for official creditors only. *Id.* at 863. Commercial bank creditors have no official role at the Paris Club meetings. Second, the Fund and the debtor meet to discuss stabilization measures that the nation will install as a condition to the renegotiation of its obligations. *Id.* Finally, the creditors meet to discuss the terms of the renegotiation and sign agreed minutes. *Id.* The Fund later transcribes the minutes into a binding bilateral agreement. *Id.*

275. *Id.* at 858.

276. *Id.*

277. POLICY ISSUES, *supra* note 4, at 123.

278. See *supra* notes 138-41, 190-96 and accompanying text.

279. See *supra* notes 75-77.

280. POLICY ISSUES, *supra* note 4, at 124. A second effect of this indirect approach is that it "reduce[s] the risk that availability of unconditional bank lending may dissuade the country from seeking conditional IMF assistance." *Id.*

the Fund's renegotiation process allows the private lenders to indirectly impose the conditions necessary to resuscitate the borrower's economy.²⁸¹

B. *The Fund and Commercial Banks Form a Coordinated Response to Mexico's Suspension of Debt Repayment*

Before the Mexican crisis of 1982, the Fund and the commercial banks did not have a coordinated response to sovereign default.²⁸² When Mexico suspended payments on its foreign loans in August of 1982, many of Mexico's creditors were caught by surprise.²⁸³ The Fund and the banks did not have a coordinated response to the crisis until several months after Mexico announced that it was suspending repayments.²⁸⁴ By November of 1982, the Fund's Managing Director Jacques de Larosière had ascertained that the banks' response to the Mexican situation was ineffective.²⁸⁵ De Larosière seized the initiative by calling Mexico's leading bank creditors to a meeting at the Federal Reserve in New York. By calling this meeting, de Larosière made what one banker termed an unprecedented move.²⁸⁶ De Larosière informed the bankers that he had an adjustment plan for Mexico, but would not seek the board's approval of the program unless the banks provided the necessary funds.²⁸⁷ He told the banks that the Fund needed a total commitment of U.S.\$6.5 billion, with U.S.\$5 billion in new fi-

281. *Id.*

282. See Field, Shirreff & Ollard, *The IMF and Central Banks Flex Their Muscles*, *Euromoney*, Jan. 1983, at 35, 38. In 1979, for example, when the Turkish Government needed to renegotiate U.S.\$3 billion in short-term commercial bank loans, the banks refused to extend further credit to Turkey, and left the nation's problems to the Fund. *Id.* at 38. In early 1982, several months before Mexico asked the Fund to reschedule its debt, the banks again refused to extend additional credit to Hungary when that nation fell behind on its debt service payments. *Id.*

283. *Id.*; Adam, *Is Salvation Any Nearer?*, *Euromoney*, Mar. 1983, at 22, 23-24.

284. *Id.* at 27.

285. *Id.*

286. See Field, Shirreff & Ollard, *The IMF and Central Banks Flex Their Muscles*, *Euromoney*, Jan. 1983, at 39. The meeting is significant because it indicates the importance the banks attached to the Mexican crisis. Although the banks were under no obligation to attend this meeting, as a practical matter the large United States banks had no alternative. See *The IMF Orders Banks to Keep Mexico Afloat*, *Bus. Week*, Dec. 6, 1982, at 35. As one banker noted, "[y]ou don't have to convince Chase and Bank of America to stay in this thing . . . They've no place to run." *Id.*

287. Field, Shirreff & Ollard, *The IMF and Central Banks Flex Their Muscles*, *Euromoney*, Jan. 1983, at 38.

nancing by December 15.²⁸⁸ Under the Fund's plan, the commercial banks also were to roll over U.S.\$20 million in Mexican loans.²⁸⁹

There are several reasons why the Fund responded to the Mexican crisis so aggressively. First, the banks were reacting to the crisis slowly, partly because many of the Mexican loans were syndicate loans.²⁹⁰ Approximately 1,400 banks had an interest in the restructuring of Mexico's foreign debt,²⁹¹ and some of the smaller bank creditors were not cooperating.²⁹² Second, the Fund may have been better prepared for the crisis than the banks. While officials at the Fund anticipated Mexico's repayment problems as early as mid-1981, the banks did not foresee the crisis,²⁹³ and were surprised to learn that so much of the country's obligations were short-term.²⁹⁴ More importantly, the Fund intervened because only the Fund has the legal authority to impose conditions on the deals it negotiates with sovereign borrowers.²⁹⁵

288. *Id.*

289. Farnsworth, *A Dramatic Change at the IMF*, N.Y. Times, Jan. 9, 1983, at F1, col. 2, at F10, col. 1.

290. Field, Shirreff & Ollard, *The IMF and Central Banks Flex Their Muscles*, *Euromoney*, Jan. 1983, at 35, 38.

291. *Id.*

292. *Id.*

293. *The IMF and Latin America*, *Economist*, Dec. 11-17, 1982, at 69, 76. In order to encourage members to provide the Fund with accurate information about their balance-of-payments, the Fund keeps information about its members confidential. *Id.*; see Second Fund Amendment, *supra* note 3, art. VIII.

294. *The IMF and Latin America*, *Economist*, Dec. 11-17, 1982, at 69, 72-73. The problem with short-term financing in countries like Mexico and Argentina is that "large volumes of long-term financing needs are being met through medium-term credit instruments funded by short-term deposits. This process of intermediation inherently involves refinancing or rescheduling . . . since the purpose of the loan does not match the maturity of the financing and funding instruments." POLICY ISSUES, *supra* note 4, at 35.

295. See *supra* notes 212-49 and accompanying text (discussing the banks' alternatives to conditions to international loans); see also *supra* notes 53-77 and accompanying text (discussing conditionality).

One senior United States banker's comment on the Fund's assertive role in the Mexican crisis reveals the industry's reliance on Fund conditionality to safeguard their loans: "We can't really have a situation preserved where we come in at the IMF's behest and then find out that they get out before the commercial banks can, otherwise we'd lose the element of conditionality." Field, Shirreff & Ollard, *The IMF and Central Banks Flex Their Muscles*, *Euromoney*, Jan. 1983, at 44; see also *supra* text accompanying notes 75-78.

C. The Development of Debtor and Creditor "Cartels"

1. The Debtor Group

In the nineteenth century, international economic transactions were predominantly private.²⁹⁶ Governments were limited to maintaining a gold standard that automatically regulated the currency, and negotiating straightforward commercial treaties that would enhance the nation's commercial and navigational positions.²⁹⁷ During the first half of the twentieth century, governments increased their participation in international economic and financial transactions and also expanded their role in the domestic economy.²⁹⁸ Membership in joint sovereignty organizations like the Fund and the World Bank gave member governments control over economic areas previously dominated by private interests.²⁹⁹

As developing nations like Mexico and Argentina grew increasingly dependent on the Fund as a source of financing,³⁰⁰ the Fund's membership became polarized. This polarization began in the early 1960's when the United States announced

296. G. SCHWARZENBERGER, *THE FRONTIERS OF INTERNATIONAL LAW* 210 (1962).

297. *Id.* at 210-11.

298. *Id.* An example of this change is the Drago Doctrine. This doctrine arose from two incidents in Latin America during the nineteenth and early twentieth centuries. See P. JESSUP, *supra* note 1, at 113. The first incident began in 1859, when the Mexican Government defaulted on a loan from a Swiss-French banking firm. *Id.* Three years later, when France invaded Mexico and installed Maximilian as the Emperor of Mexico, France cited Mexico's default as the justification for their action. *Id.* The second incident occurred in 1902, when Venezuela defaulted on foreign loans to three European countries, Britain, Germany, and Italy, which then retaliated by blockading Venezuela's ports. *Id.* Following the blockade, Argentine Foreign Minister Drago proposed to the United States that they endorse an international agreement barring the use of force to collect sovereign debts. *Id.* Drago argued that the parties to a sovereign loan agreement contract with the understanding that the lender cannot seek specific performance in any court. *Id.*; see Drago, *State Loans and Their Relation to International Policy*, 1 *AM. J. INT'L. L.* 692, 724-25 (1907). Secretary of State Elihu Root supported Drago's proposal and the doctrine was incorporated into the Porter Convention and signed at the Second Hague Peace Conference in 1907. P. JESSUP, *supra* note 1, at 113. The Porter Convention prohibited the use of force to collect unpaid foreign loans whenever the debtor rejected arbitration or failed to comply with the arbitrator's award. *Id.* This language is now reflected in the United Nations Charter's restrictions on the use of force. U.N. CHARTER art. 103 (United Nations Charter prevails over conflicting international agreements); P. JESSUP, *supra* note 1, at 114.

299. P. JESSUP, *supra* note 1, at 114.

300. See *supra* notes 262-65 and accompanying text.

that it might need to borrow from the Fund's reserves.³⁰¹ The Executive Directors, concerned that the Fund's resources could not meet United States' demand, drafted a decision, the General Agreement to Borrow (GAB), proposing the creation of an advisory group known as the Group of Ten.³⁰² The Group of Ten's voting power in the Fund was sufficient to pass the Executive Director's decision over the objections of many developing nations.³⁰³

The Group of Ten antagonized members from developing nations in the late 1960's, when it began negotiating to create a new reserve asset for the Fund.³⁰⁴ After the Fund passed an amendment in 1968,³⁰⁵ a group of developing countries formed a counterpart to the Group of Ten known as the Group

301. Gold, *Uniformity As A Legal Principle of the International Monetary Fund*, 7 LAW & POL'Y INT'L BUS. 765, 791-92 (1975).

302. *Id.* The Group of Ten is comprised of eight nations: Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, and the United States, and two European central banks, the Deutsche Bundesbank and the Sveriges Riksbank. Participants and Amounts of Credit Arrangements, IMF Doc. 1289-(62/1) (Jan. 5, 1962) reprinted in SELECTED DECISIONS OF THE EXECUTIVE DIRECTORS 79 (1970). The Group of Ten would determine when the Fund should use its power to borrow money granted by the Fund Agreement, *supra* note 3, art. VII, § (2). Gold, *supra* note 301, at 792. The General Agreement to Borrow (GAB) proposed that the Fund could use its article VII § (2) power only when the Fund needed to borrow money to cover transactions with members of the Group of Ten. *Id.*

303. Gold, *supra* note 301, at 792; General Agreement To Borrow, IMF Doc. (1289-(62/1) (Oct. 24, 1962) reprinted in SELECTED DECISIONS OF THE EXECUTIVE DIRECTORS 68 (1970). Many Fund members objected to the exclusivity of GAB because it appeared to violate the Fund Agreement's principle of uniformity among members. Gold, *supra* note 301, at 807-08. "Uniformity" is the combination of two concepts. *Id.* at 765-67. Uniformity means that the Fund Agreement creates the same rights and obligations for all members. *Id.* The term also means that the Fund's financial and regulatory policies apply equally to all members. *Id.* The principle of uniformity is consistent with the Fund's goal of "promoting international monetary cooperation." *Id.*; see Fund Agreement, *supra* note 3, art. I, § (i).

For developing countries, uniformity is a two-edged sword. On one side, developing countries may use uniformity to ensure that they receive as many benefits from the Fund as do other members. Gold, *supra* note 301, at 766. On the other side, uniformity prevents developing countries from arguing that they should get preferential treatment from the Fund because they need more assistance than other members. *Id.*

304. *Id.* at 807-08. The Group of Ten initially wanted to limit the discussion of SDR's to members that had a "substantial amount of gold" and were the "major trading and financial countries." *Id.* (citing Group of Ten, Report to Ministers and Governors by the Group of Deputies (July 7, 1966)).

305. First Fund Amendment, *supra* note 3.

of Twenty-Four.³⁰⁶ Throughout the 1970's, this group lobbied for the adoption of several measures designed to enhance their bargaining position with the Fund and commercial bank lenders.³⁰⁷ The developing members' lobbying efforts met with some success in 1978 when the Fund approved the second amendment to the articles,³⁰⁸ and in mid-1979 when the Executive Directors passed a decision loosening the requirements of conditionality.³⁰⁹

Rumors of a Latin American "debtor's cartel" surfaced periodically in the international financial press following the rescheduling of Mexico's debt in late 1982.³¹⁰ Throughout 1983 and 1984, smaller Latin American debtors, particularly

306. Report of the Chairperson of the Group of Twenty-Four, Manila (Jan. 26-Feb. 7, 1976), reprinted in V COLLECTED DOCUMENTS OF THE GROUP OF 77, at 285 (1981) [hereinafter cited as Report of the Group of Twenty-Four].

307. Gold, *supra* note 301, at 782. The Group of Twenty-Four consists of eight ministers or senior officials from each of the following regions: Asia, Africa, and Latin America. *Id.* n. 53.

One of the Group of Twenty-Four's proposals was the idea of linking the Fund's allocation of SDR's to development assistance. *See id.* at 782. The Group of Twenty-Four also proposed a reform of the Fund's lending system. *Id.* at 796. The Group wanted developed countries to grant debtor nations easier access to the financial markets, and wanted the developed nations to exempt developing countries from controls on imports and long-term investment. *Id.* at 797. The group also hoped to establish a new advisory committee that would protect the interests of indebted nations. *Id.* at 798. This committee, the Council, would review with the Executive Directors "the aggregate net flow of real resources to developing countries, its financing, and the consistency of the balance of payments aims of countries with their targets for the transfer of resources to developing countries." *Id.* The Council and the Executive Directors would be required to consider the special circumstances of developing countries when making their review. *Id.*

308. Second Fund Amendment, *supra* note 3; see J. GOLD, *supra* note 63, at 11. The Second Amendment continued to require the Fund to impose conditions on the use of its resources, Second Fund Amendment, *supra* note 3, art. V, § 3, but for the first time provided that the Fund "may have special policies for special balance of payments problems, provided that these policies also involve conditionality." J. GOLD, *supra* note 63, at 11. One such special policy was the "extended arrangement," which provided a longer repayment period than the traditional one year limit of stand-by arrangements. Second Fund Amendment, *supra* note 3, art. V, § 3(a); J. GOLD, *supra* note 63, at 11-12.

309. J. GOLD, *supra* note 63, at 15. Although "[m]ost of the decision is declaratory of the practice that has emerged in the years since 1968, . . . the decision includes certain new or clarified elements, largely in deference to the views of developing members." *Id.*

310. See, e.g., *Debtor Nations Throw Down the Gauntlet—Gently*, Bus. Week, July 9, 1984, at 98; *A New Crunch for Third World Debt*, Bus. Week, May 28, 1984, at 28; *Gang of Four*, Economist, May 26-June 1, 1984, at 88, 93; Werrett, *Looking for Financial Medicine*, Inst. Inv., July 1983, at 279.

Bolivia and Ecuador, proposed that the region's debtors form a negotiating cartel against the Fund and the commercial banks.³¹¹ These countries hoped that a cartel could use its joint bargaining strength to negotiate lower financial charges.³¹² The large Latin American debtors ignored the cartel proposal at first,³¹³ but in May of 1984, the Presidents of Argentina, Brazil, Colombia, and Mexico issued a joint statement calling for the reduction of interest rates and other financial charges and for longer grace periods and maturities on renegotiated loans.³¹⁴ Finance ministers from these countries met with their counterparts from Bolivia and Ecuador in late May,³¹⁵ and again in June.³¹⁶

2. The Creditor Group

In debt reschedulings of recent years, the Fund's conditionality has created the "knowledge or presumption that the international institutions would be available to provide assistance in case of need . . . [and] a strong incentive for banks to expand excessively their exposure to potential problem countries."³¹⁷ The November 1982 creditors meeting orchestrated by the Fund not only encouraged the creditors to enlarge their

311. *Gang of Four*, Economist, May 26-June 1, 1984, at 88, 93.

312. *Id.* In a May, 1983 meeting in Quito, Ecuador, the United Nations' Economic Commission for Latin America and a regional debtor's club, the Sistema Economico Latinamericano, urged Latin American debtors to combine their information on the terms of their foreign loans. Werrett, *Looking for Financial Medicine*, Inst. Inv., July 1983, at 279.

313. *Many Patients, Little Medicine*, Euromoney, Mar. 1983, at 36, 46.

314. *Gang of Four*, Economist, May 26-June 1, 1984, at 88.

315. *Id.*

316. Riding, *Latin Debt: Postponing The Burden*, N.Y. Times, Sept. 23, 1984, at F9, col. 1. The large Latin American debtors may have decided to use the image of a cartel in mid-1984 for several reasons. First, the United States' prime rate rose by 1.5% during the first five months of 1984. *Gang of Four*, Economist, May 26-June 1, 1984, at 88. This increase in interest rates was sufficient to "offset virtually all the \$1 billion increase in [Mexico's] nontraditional exports so painfully achieved in 1983." *Id.* Second, debtors like Mexico and Argentina may have seen the "negotiating cartel" as a way to project a show of force for the benefit of the United States and European countries meeting at the economic summit in London on June 7. *See id.* In addition, Argentina's support for joint action was a reaction to domestic politics. The Peronist party was criticizing the newly elected Alfonsin for his "willingness to negotiate with the IMF." *A New Crunch for Third World Debt*, Bus. Week, May 28, 1984, at 29. The Peronists, who controlled the Argentine Senate, were pressuring Alfonsin to end negotiations with the Fund and bargain directly with the banks. *Id.*

317. POLICY ISSUES, *supra* note 4, at 124.

exposure to foreign loans, but created a counterbalance to the emerging image of a "debtor's cartel."³¹⁸ The large commercial banks have openly acted in concert only on limited occasions and for limited purposes.³¹⁹

V. *ECONOMIC INTERDEPENDENCE AND THE
SOVEREIGNTY OF DEBTOR NATIONS: THE
ILLUSORY DISTINCTION*

Accepted definitions of sovereignty distinguish between an infringement of a state's sovereignty and its dependence on the economic conditions of another nation.³²⁰ This distinction turns on the perception that economic dependency occurs voluntarily, while a violation of a nation's sovereignty is beyond the state's control.³²¹ When used to evaluate the impact of enormous international loans on the sovereignty of debtor nations, this distinction between voluntary and involuntary actions loses its significance. Through their unprecedented volume of foreign debt, countries like Mexico and Argentina have moved beyond export-import dependency into a state of symbiosis.³²²

The traditional legal concept of sovereignty as "absolute, uncontrolled state will," designed to protect the territorial integrity of the state,³²³ no longer is a useful framework for the analysis of international problems.³²⁴ By founding international organizations and developing international law, the international community has attempted to "substitut[e] some kind of joint sovereignty, the supremacy of common will,"³²⁵ for the traditional parameters of a state's authority.

The concept of "joint sovereignty" also has become inadequate for the purpose of analyzing modern international debt.³²⁶ The media of international economic cooperation, particularly the Fund, have encouraged the formation of two

318. See *supra* notes 220-316 and accompanying text.

319. See *supra* notes 284-89 and accompanying text.

320. See *supra* note 1 and accompanying text.

321. See *supra* note 2 and accompanying text.

322. See *supra* notes 79-83 and accompanying text; see also Solomon, *supra* note 104 at 361.

323. P. JESSUP, *supra* note 1, at 40-41.

324. See *supra* notes 15-29 and accompanying text.

325. P. JESSUP, *supra* note 1, at 13.

326. See *supra* notes 30-43, 79-89 and accompanying text.

opposing powers: the commercial banks and their sovereign debtors. Joint sovereignty drew these forces together, but the debt problem these groups administer is now beyond the control of the mechanisms of joint sovereignty.³²⁷

The international community could respond to this development in a number of ways. A coalition of member nations from the United Nations, the Group of 77, has formed a movement for a New International Monetary Order which proposes, inter alia, the reorganization of the Fund as an institution devoted to the long-term development needs of its members.³²⁸ The Fund has not followed this plan because it would require fundamental changes in the Fund's mandate as a forum for resolving temporary balance-of-payments problems. In addition, such a proposal is also politically unworkable because its underlying goal is the redistribution of wealth and power from developed to developing nations.³²⁹ Another way to bring the current debt situation within the existing structure of international law would be to expand the role of central banks like the United States Federal Reserve. This proposal is also politically unworkable. Despite the Federal Reserve's keen interest in the renegotiation of foreign sovereign debt, and its significant contribution to renegotiations since the Mexican crisis of 1982,³³⁰ the central bank must continue to be a subtle participant in the resolution of such debt problems. If it did formally participate in the renegotiation process on the international level, the central bank's actions would "imply inherently controversial economic political judgments about other countries by the U.S. government,"³³¹ and would increase debtor nation's fear of interference with reserved economic rights. A better solution

327. See *supra* notes 14-29 and accompanying text.

328. Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201, U.N. GAOR 6th Special Supp. (No. 1) at 1, U.N. Doc. A/9599 (1974); Charter of Economic Rights and Duties of States, G.A. Res. 3281, U.N. GAOR Supp. (No.31) at 50, U.N. Doc. A/9946 (1975). Article 17 of the Charter of Economic Rights and Duties of States provides that "[e]very State should co-operate with the efforts of developing countries to accelerate their economic and social development by . . . extending active assistance to them, consistent with their development needs and objectives, with strict respect for the sovereign equality of States and free of any conditions derogating from their sovereignty." *Id.* at 53-54.

329. See Report of the Group of Twenty-Four, *supra* note 306, at 286.

330. See *supra* notes 286-89 and accompanying text.

331. Volcker, *How Serious is U.S. Bank Exposure?*, Challenge, May-June 1983, at 11, 17.

would be to create a special international forum to address the present and future needs of the commercial banks and their sovereign debtors. Such an organization would legitimize the influence of commercial bank creditors, restore the credibility of Fund conditionality, and prevent the use of "sovereignty" to justify repudiation of international obligations and the economic cooperation such obligations represent.

CONCLUSION

Modern economic interdependence, in the form of immense foreign debt, cannot be dismissed as a voluntary condition that preserves the autonomy of sovereign states. Existing levels of international debt, exacerbated by the lending policies of a supranational structure that increased the participation of private commercial banks, blur the line between voluntary and involuntary action. At one moment the commercial banks appear to be managing the economies of their sovereign debtors through the conduit of Fund conditionality. At the next moment, the debtors appear to have the upper hand, using their indebtedness in short-term money to perpetually delay repayment. The banks manipulate the debtor's need for renegotiation, while the debtors manipulate the banks' need to remain solvent. Every change in the variables of modern economic interdependence: political control, exports, interest rates, and oil supply, shifts this delicate balance of need and power. Escalating foreign debt and the increased exposure of private commercial banks has created a new economic relationship that is beyond the existing legal framework for joint international cooperation.

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