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"POST-MODERN" SOVEREIGN DEBT CRISIS: DID MEXICO NEED AN INTERNATIONAL BANKRUPTCY FORUM?

John H. Chun

INTRODUCTION

On the evening of January 30, 1995, Leon Panetta, the White House Chief of Staff, received two distressing phone calls within the space of a few minutes.¹ One caller was Guillermo Ortiz, the Mexican Finance Minister. Mr. Ortiz anxiously reported that Mexico was beset by a capital flight—foreign bondholders were dumping their tesobonos³ holdings and fleeing Mexico in a speculative panic.⁴ These investors, not willing to roll over⁵ the maturity of their tesobonos, were now redeeming them at a frenzied rate.⁶ Mexico, trying to honor its obligations by faithfully exchanging the bonds for hard currency, was dangerously depleting its exchange reserves.⁷ Without an immediate infusion of foreign aid, Mexico would have to impose exchange con-

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2. Id. Capital flight occurs when a country, like Mexico, needs fresh loans in order to finance an investment project to repay old loans. Jeffrey Sachs, Do We Need an International Lender of Last Resort 6-7 (Apr. 1995) (unpublished manuscript, on file with the Fordham Law Review). If fresh loans are granted and the investment project is completed, the country can repay the preexisting debt. Id. If no new loans are made, however, the preexisting debt will be defaulted. Id. at 7. Each investor fears that every other investor will not subscribe to the new loan. Id. Thus, every individual creditor, expecting the country to default, will refuse to extend new loans because the creditor does not want to incur additional losses. See id. Instead, each individual creditor will rush to unload his investments from that country. See id.
3. Tesobonos are short-term bonds indexed to the U.S. dollar but repayable in pesos. See Daniel Dombey, Tesobonos May be Good Devaluation Hedge, LDC Debt Rep., Aug. 29, 1994, at 1-2. Thus, investors, fearful of a possible Mexican peso devaluation, bought tesobonos to hedge against this risk. Id.
4. See Graham et al., supra note 1, at 4.
5. Roll over is the "[blanking term for extension or renewal of short term loan from one loan period . . . to another." Black's Law Dictionary 1330 (6th ed. 1990).
trols,\(^8\) abandon the convertibility\(^9\) of the peso and essentially default on the remainder of its debt obligations.\(^{10}\)

The other caller, Speaker of the House Newt Gingrich, added to the troubling reports from Mexico.\(^{11}\) According to the Speaker, Congress would not approve President Clinton's requested $40 billion aid package for Mexico for at least another two weeks.\(^{12}\) Despite the initial bipartisan support for the aid,\(^{13}\) dissent in Congress had caused the package to stall.\(^{14}\) Some members of Congress expressed skepticism to the notion that the Mexican crisis posed a serious threat to international financial stability, arguing instead that the aid package was primarily intended to bail out\(^{15}\) Wall Street investors who had speculated in Mexican debt instruments.\(^{16}\)

This development greatly troubled the Chief of Staff. Time was of the essence—the Clinton Administration could not wait for the Con-

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8. A country's imposition of exchange controls usually includes the following restrictions: (1) prohibiting residents from transferring the country's currency to non-residents without the government's authorization, while requiring non-residents to obtain permission to transfer the state's currency to another non-resident; (2) requiring non-resident holders of the state's currency to obtain state approval prior to transferring the currency to the state's residents; (3) prohibiting its residents from holding foreign currency without the state's permission. Richard W. Edwards, Jr., International Monetary Collaboration 382 (1985). Because the holder of a state's currency has a claim on its economy, a state imposes exchange controls to regulate the magnitude and nationality of those claims. Id. at 381.

9. A currency is freely convertible when the state issuing the currency in no way restricts the right of residents or non-residents to hold the currency, the manner in which its currency may be exchanged for foreign currency, the currencies for which its own currency may be exchanged, and a non-resident holder's use of its currency. Id.

10. See Graham et al., supra note 1, at 4. The peso, valued at an anemic 6.35 against the dollar, was at a historic low, merely half its value from a month earlier. Id. "If Mexico had resorted to foreign exchange controls, it 'would have been a true world catastrophe as the pressure on other [states] to follow would have been tremen-

dous . . . .' " Id. (quoting Michel Camdessus, Managing Director of the International Monetary Fund).

According to one commentator, however, Mexico would not have dared to institute exchange controls. See Cynthia C. Lichtenstein, The Mexican Crisis: Who Should Be a Country's Lender of Last Resort?, 18 Fordham Int'l L.J. 1769, 1775 (1995) [hereinafter Lender of Last Resort]. The "new rules" of the international capital markets would not have tolerated this act of default and international investors would have shunned Mexico in the future. See id.


12. Id.


16. See infra note 132 and accompanying text.
gressional aid to materialize. To calm investors, restore their confidence in the long-term solvency of the Mexican economy, and plug the hemorrhage of investment from Mexico, quick approval of an aid package was vital. Mexico was Washington’s “star pupil” in market-based reforms and its failure could cause politicians in other developing countries to reconsider the wisdom of their own market-based reforms. Worse, a Mexican debacle could cause investors in other developing economies to reappraise the risk of their investments there and trigger a contagious effect on neighboring countries. A delay could precipitate a repeat of the 1982 debt crisis when multiple Latin American countries were simultaneously unable to repay their debt.

President Clinton himself also expressed disappointment in the delay in Congress. Although the possibility remained that Congress might eventually pass the originally requested $40 billion aid package, President Clinton stated that “it [would] not do so immediately [and]

17. Douglas Jehl, Slow-Building Despair Led to Decision on Aid, N.Y. Times, Feb. 1, 1995, at A16. According to Treasury Secretary Robert Rubin, “there was only a very short time in all likelihood to act in which to avert crisis, financial distress and probably default in Mexico.” Graham et al., supra note 1, at 4.


19. Graham et al., supra note 1, at 4; see infra note 108 and accompanying text.

20. Graham et al., supra note 1, at 4; see infra notes 155-58 and accompanying text.

21. The causes of the 1982 Mexican collapse were sown when Latin American countries, during the 1970s, borrowed heavily from United States banks to finance balance of payments deficits caused by large increases in oil prices and to invest in infrastructure projects. See Patricia A. Wertman, Mexico Financial Crisis, 1982 and 1995: Similarities and Differences, Congressional Research Service Report for Congress, Feb. 3, 1995, at CRS-1, CRS-4 [hereinafter Mexico Financial Crisis]. Despite the size of the loans, the Latin American countries gambled that the high inflation during the 1970s would continue and thus translate into loan repayment with depreciated dollars in the future. Id.

The banks were eager to lend in order to generate interest on the large capital deposits from wealthy Arab countries, who were generating huge profits from the increase in oil sales. Id. The banks, in their eagerness to lend, did not scrutinize the economies of the borrowing countries or the uses to which the borrowers were putting the money. Alberto Gonzalo Santos, Note, Beyond Baker and Brady: Deeper Debt Reduction for Latin American Sovereign Debtors, 66 N.Y.U. L. Rev. 65, 72 (1991). Had they chosen to look, the banks would have noticed that the borrowers were investing in inefficient public projects that would not generate enough income to repay the loans. Id. at 74.

In 1979, when the U.S. Federal Reserve increased United States interest rates to combat inflation, the Latin American gamble was lost and the debtor nations soon found themselves unable to pay their debts. Id. at 75. For a more detailed discussion of the 1982 crisis, see John H. Makin, The Global Debt Crisis (1984).

By most accounts, the debt crisis lasted until the implementation of the Brady Plan in 1989. See infra note 108 and accompanying text. For purposes of this Note, the years between 1982, the year in which Mexico defaulted on its external debt, and the introduction of the Brady Plan in 1989 will be referred to collectively as the “1982 debt crisis.”

22. Jehl, supra note 17, at A16.
therefore, it [would] not do so in time."\textsuperscript{23} No international channels existed to which the Clinton Administration could turn for effective management of a crisis with the magnitude of Mexico's.\textsuperscript{24} The crisis was unique due to the speed with which it developed, the possible disastrousness of its consequences, and the amount of money required to remedy it.\textsuperscript{25} Despite the urgent need for an effective solution, however, no institution assumed responsibility for managing the crisis.\textsuperscript{26} This vacuum in international financial management forced the Clinton Administration to choose between two evils: (1) bypassing traditional consultation and approval procedures at the International Monetary Fund ("IMF")\textsuperscript{27} and the Bank for International Settlements ("BIS")\textsuperscript{28} in order to secure a hasty $50 billion bailout drawn primarily from United States and IMF resources which would outrage and embitter international and Congressional leaders,\textsuperscript{29} or (2) risk the possibly far-reaching and devastating economic effects of a Mexican economic collapse.\textsuperscript{30} The Clinton Administration chose the former option.\textsuperscript{31} Commentators have termed the 1995 Mexican crisis the first "post-modern" crisis\textsuperscript{32} or the first crisis of the twenty-first century.\textsuperscript{33} The crisis in Mexico was the product of a changing international financial

\textsuperscript{23} Graham et al., supra note 1, at 4.

\textsuperscript{24} See Michel Camdessus, Address at the Council of the Americas Conference (May 22, 1995), in State Dep't Briefing, May 22, 1995, at 5 (on file with the Fordham Law Review) [hereinafter Camdessus Address]; see also U.S. and International Response to the Mexican Financial Crisis: Hearings before the House Comm. on Banking and Financial Services, 104th Cong., 1st. Sess. 5, 6 (1995) (statement of Alan Greenspan, Chairman of the Federal Reserve Board) [hereinafter Greenspan Testimony]; Moises Naim, Mexico's Larger Story, 99 Foreign Pol'y 112, 112 (1995); Patricia A. Wertman, The Halifax "Emergency Financing Mechanism": Expanding the General Arrangements to Borrow (GAB), Congressional Research Service Report for Congress, June 30, 1995, at CRS-1 to -2 [hereinafter Halifax] (observing that the principal question raised by the Mexican crisis was the ability of international monetary institutions to deal with short-term capital or the "hot money").

\textsuperscript{25} Naim, supra note 24, at 122; see infra part I.C.

\textsuperscript{26} The Bank for International Settlements, on January 3, 1995, had pledged to lend $5 billion to Mexico. See Graham et al., supra note 1, at 4. The International Monetary Fund, on January 26, 1995, had also pledged to loan Mexico $7.8 billion, its largest loan ever. Id. The news of the loans, however, failed to calm the markets. See id.

\textsuperscript{27} For a background of the IMF, see infra part IV.B.

\textsuperscript{28} The Bank for International Settlements is generally regarded as the bank for central banks. See Edwards, supra note 8, at 56. It was established in 1930 in Basle, Switzerland to enhance cooperation between central banks. Id. at 52. The BIS performs a wide variety of banking transactions for its shareholder banks, including making advances to them, holding current and time deposits, and buying and selling gold and foreign exchange. Id. at 56.

\textsuperscript{29} See infra notes 119-34 and accompanying text.

\textsuperscript{30} Kenneth N. Gilpin, Far-Reaching Effects Seen If Mexico Rescue is Halted, N.Y. Times, Jan. 23, 1995, at D1.

\textsuperscript{31} See infra part I.B.

\textsuperscript{32} Thomas L. Friedman, New Mexico, N.Y. Times, Mar. 15, 1995, at A25.

\textsuperscript{33} See Camdessus Address, supra note 24, at 1; James D. Humphrey II, Note, Foreign Affairs Powers and "The First Crisis of the 21st Century:" Congressional v.
system within which technological innovations, the use of risky financial instruments, and the recent growth of and dependence on short-term capital have forged deeper financial integration but have also subjected many developing nations to the risks of an irrational capital flight similar to that which occurred in Mexico. Simultaneously, the globalization of the securities markets has dramatically expanded the global reach of financial turbulence caused by investors who, en masse, move their money around the world. In sum, although economic indicators in Mexico in the aftermath of the bailout were generally positive, the Mexican crisis was not an economic aberration. Rather, the Mexican crisis revealed deep fault lines underlying the international financial system which are capable of creating upheaval at any time.

World leaders have recognized the urgent need to fashion an international mechanism that can respond to a post-modern crisis. At the Group of Seven ("G-7") summit in Halifax, Nova Scotia on June


34. In this Note, the term “developing country” or “developing nation” applies to the same countries that were formerly labelled as “less developed countries” in the 1970s and as “emerging markets” in the 1990’s. Mexico Financial Crisis, supra note 21. at CRS-5 n.21. The group of developing countries includes: Egypt, Pakistan, Argentina, Brazil, Mexico, and India. See 1994 International Monetary Fund, Annual Report at vi (1994). Notably, the coining of the term “emerging market” corresponded to the same time these countries began floating large amounts of bonds in the capital markets; perhaps issuers coined it in an effort to reduce risk perception in the minds of investors. Mexico Financial Crisis, supra note 21, at CRS-5 n.21.

35. See Naim, supra note 24, at 125.

36. See infra notes 150-58 and accompanying text.


38. Naim, supra note 24, at 112; see Camdessus Address, supra note 24, at 4.


At a time when the United States may be increasingly disinclined to take on new financial obligations and when the international community lacks the resources or international arrangements to carry the burden, establishing techniques for governments to reduce or renegotiate debts in an orderly way rather than reaching for patchwork bailouts may be crucial to maintaining economic stability.

Id.

The first proposal calls for the creation of an Emergency Financing Mechanism (“EFM”) that would entail the doubling of the General Arrangements to Borrow (“GAB”), which currently stand at about $26.6 billion. This proposal would provide the IMF with approximately $50 billion to loan the next time a country faces a liquidity crisis similar to Mexico’s. This fund would function like a domestic lender of last resort to ensure investors that their capital would be protected against sudden economic shifts. Investors, relying on the presence of this institution to protect their capital, would not panic and withdraw their investments from a country during a period of financial stress.

The second proposal suggests the creation of an International Bankruptcy Agency (“IBA”) within which a country facing a liquidity crisis can renegotiate its debts with its creditors. This forum would

41. Id.
42. For an extensive discussion of the GAB and the EFM proposal, see infra part III.B.

The G-10 members are the United States, the United Kingdom, Belgium, Netherlands, Sweden, France, Italy, Germany, Canada and Japan. Edwards, supra note 8, at 72.

44. Liquidity is defined as an entity's ability to “convert [its] assets into cash.” Black's Law Dictionary 931 (6th ed. 1990). A country suffers a liquidity crisis when it does not have sufficient currency immediately available to meet the demands of its creditors. See Sachs, supra note 2, at 5.
45. See Halifax, supra note 24, at CRS-5.
46. See infra part III.B.2.
47. See infra part III.B.2.


Others supporting this proposal are Representative Jim Leach, Chairman of the House Banking and Financial Institutions Committee, see Currency, supra note 39, at 5 (“One suggestion that I believe should be explored is the feasibility of creating an international insolvency or bankruptcy process for nation-states to resolve situations similar to that which occurred in Mexico.”), Michel Camdessus, Managing Director of
administer debtor-oriented provisions similar to those found in U.S. Bankruptcy Code Chapter 9 ("Chapter 9"). Proponents of this suggestion have called on the IMF to administer this forum.

This Note argues that the second proposal is the preferable solution. A bankruptcy agency, not an emergency fund, is the more effective method for providing the fast, decisive action required to counter the extraordinary speed with which creditors can relocate their money worldwide. Part I of this Note employs the Mexican crisis as a case study to illustrate the vulnerability of sovereign debtors and the international financial system as a whole to speculative creditor panics. Part II discusses Chapter 9 of the U.S. Bankruptcy Code and the protections it provides domestic municipalities against speculative creditor panics. Part III then explores both the IBA proposal, including the key Chapter 9 provisions it might administer, and the proposal to establish the EFM. Part IV compares both proposals in light of three primary factors and argues that the IBA proposal is more effective than the EFM proposal. This part also contends that the IMF should organize the bankruptcy agency and, following the model of the World Bank, establish the agency as a separate affiliate.

James Hurlock offers a third alternative to the IBA and EFM. Rather than an international forum to handle debt restructuring, he proposes that debtor and creditor nations should submit their disputes to the United States and English legal systems, countries with sophisticated bankruptcy codes and commercial laws. See James B. Hurlock, The Way Ahead for Sovereign Debt, 14 Int'l Fin. L. Rev. 10, 12 (1995). Choice of law clauses in debtor/creditor loan documents most often point to American or British law. Id. Both countries should open their courts to resolve disputes between sovereign debtors and creditors while closing their courts to creditors who seek to undermine the reorganization process. Id. This would require an amendment to their foreign sovereign immunity laws. In the United States, the Foreign Sovereign Immunities Act could be amended to immunize the property of a foreign state from attachment if a rogue creditor defied the decision of a majority of similarly-situated creditors who had negotiated a debt readjustment with a sovereign debtor. Id.

A fourth proposal offered is for the establishment of an International Bondholder's Corporation. William R. Cline, International Debt Reexamined 482 (1995). This organization would insure international bonds issued by developing countries in exchange for the payment of a premium. Id.

49. See Stephen A. Silard, International Law and the Conditions for Order in International Finance: Lessons of the Debt Crisis, 23 Int'l Law. 963, 971 (1989) [hereinafter Lessons of the Debt Crisis] (suggesting the international implementation of procedures similar to those found in Chapter 9); infra part II.

50. See Camdessus Address, supra note 24, at *6; Jim Leach, Country Going Bankrupt? Call the IMF, Wall. St. J., Apr. 10, 1995, at A20 [hereinafter Call the IMF]; Sachs, supra note 2, at 22; infra part IV.B.

51. While the two proposals are not mutually exclusive, the creation of a bankruptcy agency should make the EFM dispensable.

52. See infra part IV.A.

53. The factors are: (1) the mechanism's ability to respond quickly and decisively to creditor panics; (2) the mechanism's ability to minimize moral hazard; and (3) the mechanism's ability to respond to multiple creditor panics. See infra part IV.A.

54. For a background of the World Bank, see infra note 416.
under the IMF umbrella. This Note concludes that an urgent need exists for the international community to establish procedures to manage the next "post-modern" crisis and that the IBA proposal is the most effective management solution.

I. INTERNATIONAL FINANCIAL VULNERABILITY: THE MEXICAN CASE STUDY

This part uses the Mexican crisis as a case study to highlight broader trends in international finance which demonstrate that the Mexican crisis is a harbinger of future crises. After discussing the causes of the crisis and the subsequent United States-sponsored bailout, this part explores the vulnerability of other nations to the spontaneous capital flight that Mexico suffered. Finally, this part concludes that established international procedures to aid countries in financial distress are inadequate to address speculative creditor panics that can result from heavy short-term capital investment.

A. The Causes of the Crisis

The seeds of the 1995 crisis were sown in 1988 when Mexico initiated an economic adjustment strategy to limit inflation, which stood at an annual rate of 160%. Among the economic strategies adopted to achieve this were: (1) tight fiscal policies; (2) the restructuring of the external debt; (3) the liberalization of industrial regulations to enhance competitiveness; and (4) the implementation of a "crawling

55. See Patricia A. Wertman, The Mexican Economy under the Salinas Administration, 4 Mexico Trade & L. Rep. 9, 9 (1994) [hereinafter Salinas Administration]. The rate of inflation is defined as the percentage rate of change in the general price level, the measure of the purchasing power of a currency, from one period to the next. Robert E. Hall & John B. Taylor, Macroeconomics 59 (3d ed. 1991). Inflation reduces the purchasing power of currency.

56. International Monetary Fund, World Economic Outlook 90 (May 1995) [hereinafter Outlook].

57. See Salinas Administration, supra note 55, at 9. The belt-tightening measures included a reduction in marginal tax rates, strict control over non-interest expenditures, and a reduction in interest rate payments through a restructuring of the external debt. Outlook, supra note 56, at 90.

58. See Salinas Administration, supra note 55, at 10-11. In contrast to 1985, when domestic government debt was valued at 28.8% of nominal gross domestic product and external debt represented 68% of the nominal gross domestic product, in 1988 these figures had been reduced to 11.9% and 31.5% respectively. Id. Reducing the external debt in this manner benefitted Mexico by reducing the level of their interest payments on the debt.

59. See Naim, supra note 24, at 116. Mexican authorities freed interest rates, removed credit controls and lending restrictions, and abolished reserve requirements and mandatory liquidity ratios. Outlook, supra note 56, at 90. In addition, to spur trade competitiveness, Mexico unilaterally cut its import tariffs and eased restrictions on foreign investment and foreign ownership of businesses in Mexico. Id. at 91.
system that fixed the peso to the dollar to stabilize the value of the peso and to inhibit its chronic inflationary tendencies.\textsuperscript{61}

These policies achieved success. In the early 1990s inflation fell from 160\% to single digits and the gross domestic product ("GDP")\textsuperscript{62} grew at a faster pace.\textsuperscript{65} The United States rewarded Mexico for its successful economic turnaround by approving the North American Free Trade Agreement ("NAFTA").\textsuperscript{64} In addition, private investors showered Mexico with credit totalling nearly $60 billion over a four-year period, lifting the Bank of Mexico's international reserves from $6.5 billion at the end of 1989 to $25.5 billion by the end of 1993.\textsuperscript{65}

This tremendous investment, however, had a downside. While it was generating prosperity in the early 1990s, it was also masking the gravity of Mexico's current account deficit,\textsuperscript{66} which in 1994 stood at about $29.4 billion.\textsuperscript{67} The deficit in the current account resulted from the large increase in private spending that followed the reduction in

\textsuperscript{60} A crawling peg fixes the value of a nation's currency to that of another, while letting it gradually depreciate at preannounced rates. See id. at 90. Mexico, by instituting the crawling peg and fixing the exchange rate to that of the dollar, hoped to force its inflation rate to converge with the lower rate of inflation in the United States. See Humphrey, supra note 33, at 184-85. In 1991, the Mexican authorities, to allow more flexibility in their exchange rate, added an intervention band within which the currency could fluctuate. Outlook, supra note 56, at 90. The ceiling of the band was allowed to depreciate at predetermined rates. \textit{id.}

\textsuperscript{61} See Naim, supra note 24, at 116; William Cline, \textit{Managing International Debt: How One Big Battle Was Won}, Economist, Feb. 18, 1995, at 17 [hereinafter \textit{Big Battle}].

\textsuperscript{62} GDP is derived by subtracting the value of a nation's contribution to productive services overseas from gross national product ("GNP"). Hall & Taylor, supra note 55, at 42. GNP is "the value, at current market prices, of all final goods and services produced within some period by a nation." Paul A. Samuelson & William D. Nordhaus, \textit{Economics} 973 (13th ed. 1989).

\textsuperscript{63} Outlook, supra note 56, at 91. GDP rose from an average growth of 0.5\% a year between 1985 and 1988 to 3.5\% between 1989 and 1992. \textit{id.} The fiscal balance which stood at a 12.5\% of nominal GDP deficit in 1988, improved to a 0.5\% surplus in 1992. \textit{Salinas Administration, supra} note 55, at 10.


\textsuperscript{65} Outlook, supra note 56, at 91.

\textsuperscript{66} The current account balance is a calculation of a nation's balance of payments with regard to merchandise and services that are imported and exported. Samuelson & Nordhaus, supra note 62, at 966. A balance of international payments is "a statement showing all a nation's transactions with the rest of the world for a given period." \textit{id.} A deficit in the current account is registered when a country's total imports exceed total exports.

inflation and increase in domestic and foreign credit.\textsuperscript{68} Furthermore, although the "crawling peg" system was initially a valid way to fight inflation,\textsuperscript{69} the peg contributed to the current account deficit by overvaluing the peso\textsuperscript{70} and thereby artificially increased the price of Mexican exports and reduced the price of imports.\textsuperscript{71} The combination of the extensive borrowing and the crawling peg caused the current account deficit to balloon from about 2.5\% of GDP between 1988 and 1989 to 6.75\% in 1992.\textsuperscript{72}

To subsidize its current account deficit, Mexico relied on portfolio investors to purchase its short-term bonds.\textsuperscript{73} Portfolio investment, composed primarily of purchases of stocks and bonds, however, is more volatile than direct investment.\textsuperscript{74} Mexico, cognizant of the volatility of the short-term capital, hoped to prevent capital flight through the government's continued attractiveness to foreign investors.\textsuperscript{75} The government, despite the dangerously increasing current account deficit, projected that as Mexico's competitiveness improved and international treaties increased access to foreign markets, exports would rise and Mexico's dependence on foreign capital would subside.\textsuperscript{76}

In 1994, however, Mexico suffered a series of untimely international and domestic setbacks which caused investors to rethink their investments and jeopardized the sustainability of Mexico's spending policies.\textsuperscript{77} Internationally, the strong economic expansion in the United States and other industrial countries provided a more attractive investment option.\textsuperscript{78} Federal Reserve Chairman Alan Greenspan simultaneously tightened economic conditions in the United States by hiking United States interest rates, thereby decreasing the supply of

\textsuperscript{68} See Outlook, supra note 56, at 91. Between 1989 and 1992, total imports grew at an average annual rate of 24\%, exceeding the pace of non-oil exports while private savings fell by 10\% of GDP. \textit{Id.}


The peso effectively appreciated more than 60\% from the end of 1987 to the end of 1992. Outlook, supra note 56, at 91. Because Mexico had a higher rate of inflation than the United States, the crawling peg system contributed to this overvaluation. Unlike a free-floating exchange regime, where the peso would have depreciated and "equalized prices between the two countries," the peso soon became overvalued in relation to the dollar in a peg regime. Humphrey, supra note 33, at 184-85.

\textsuperscript{71} See Pool & Stamos, supra note 7, at 30-31.

\textsuperscript{72} Outlook, supra note 56, at 91.

\textsuperscript{73} Naim, supra note 24, at 113. Between 1989 and 1993, Mexico sold approximately $20 billion in bonds. See Cline, supra note 67, at 450.

\textsuperscript{74} See Naim, supra note 24, at 114. Direct foreign investment ventures include a multinational corporation buying or establishing a factory in the foreign country or investing in a mine or a plantation. See \textit{id.} at 124.

\textsuperscript{75} \textit{Id.} at 117.

\textsuperscript{76} \textit{Id.} at 118.

\textsuperscript{77} See Outlook, supra note 56, at 93.

\textsuperscript{78} \textit{Id.}
available credit for foreign investment.\textsuperscript{79} Domestically, a sequence of political disturbances, including the first Chiapas rebellion on January 1, 1994\textsuperscript{80} and the assassination of presidential candidate Colosio on March 23, 1994, fostered political uncertainty and caused the large capital investments that followed NAFTA to dry up, dropping international reserves by $11 billion after the assassination.\textsuperscript{81}

A tighter monetary policy at this juncture could have reduced the size of the current account deficit in early 1994 and an earlier widening of the intervention band, within which the peso floated,\textsuperscript{82} could have assured the markets that the authorities were committed to maintaining the crawling peg regime and would moderately, rather than drastically, devalue the peso.\textsuperscript{83} The Mexican government, however, believed that the economic problems were political in origin and hoped that a stabilization of the political situation would calm the markets.\textsuperscript{84} Consequently, Mexico failed to react adequately to the changing economic climate and its own economic jeopardy. President Salinas, eager to allay investors' fears of a devaluation, swapped about $13 billion in private-sector holdings of cetes, short-term bonds indexed to the peso, for tesobonos, short-term bonds indexed to the dollar but repayable in pesos.\textsuperscript{85} This swap benefitted investors because the burden of currency risk shifted from private foreign investors to the Mexican government—the Mexican government was now obliged to pay the full dollar value of the bonds regardless of the prevailing value of the peso.\textsuperscript{86}

The Mexican central bank was not politically independent enough to voice a dissenting opinion and thus followed the government's agenda.\textsuperscript{87} The United States, because of its preoccupation with Rus-

\textsuperscript{79} Naim, supra note 24, at 113.

\textsuperscript{80} See Tim Golden, Mexican Troops Battling Rebels; Toll at Least 57, N.Y. Times, Jan. 3, 1995, at A1. The Zapatista Army of National Liberation, whose goal was to improve the position of the Mexican poor, incited the rebellion. Id. at A1, A9. The rebellion was timed to coincide with the effective date of NAFTA. Id. at A1.

\textsuperscript{81} Outlook, supra note 56, at 93. The Mexican crisis renewed the debate over the wisdom of NAFTA. David E. Sanger, Reopening Old Battles, N.Y. Times, Jan. 20, 1995, at A1, A20.

\textsuperscript{82} See supra note 60 for a discussion of the intervention band.

\textsuperscript{83} See Outlook, supra note 56, at 96.

\textsuperscript{84} Naim, supra note 24, at 118-19 (stating that the Salinas Administration believed that political shocks, like the Chiapas rebellion, were scaring away investors). Because 1994 was an election year and the Mexican ruling party, the Partido Revolucionario Institutional, was facing its most difficult challenge from the opposition in 65 years, austere economic reforms would have been political suicide. Marc Levinson, How It All Went South, Newsweek, Mar. 27, 1995, at 32, 33 ("A strong peso meant cheap Buicks and bluejeans, and happy consumers were vital if candidate Zedillo was to [win the election].").

\textsuperscript{85} Outlook, supra note 56, at 93.


\textsuperscript{87} See Naim, supra note 24, at 115 ("This demonstrates that in [Mexico,] where personalities count more than institutions, laws are not enough.")
sia's economic reforms and the Uruguay Round of GATT, was not vigilantly monitoring Mexico's economic health. The IMF did not respond either; Mexico was no longer under close IMF supervision because its last loan from the IMF expired in May 1993. For months before the crisis, Mexico did not release any official information about its international reserve levels, capital flow trends, or short-term debt obligations. Without anyone to sound the warning that Mexico was recklessly importing goods and that its currency was overvalued, foreign investors blindly pumped dollars into the economy, aggravating the Mexican peso's overvaluation.

Shortly after the inauguration of President Zedillo on December 1, 1994, renewed political turbulence coupled with rumors about a possible devaluation of the peso sparked a capital flight which led to a rapid loss of $3.5 billion in reserves. On December 20, 1994, Mexico announced a 12.7% devaluation of the peso which aggravated the capital flight, causing international reserves to fall to $10.5 billion. One day later, after an additional loss of reserves of $4 billion, the Mexican government allowed the peso to float to protect its exchange reserves.

88. See id. at 120. Mexico had fostered a robust image of its economy during the Congressional debate over the passage of NAFTA in 1993. Id.

The General Agreement on Tariffs and Trade ("GATT") is a multinational document which outlines the rules of conduct of trade and whose objective is to eliminate trade barriers. See A.I. MacBean & P.N. Snowden, International Institutions in Trade and Finance 63 (Policy Studies Institute: Studies in Economics Vol. 18, 1981).

89. 1995 Economic Program, supra note 67, at 8.

90. Naim, supra note 24, at 120.

91. See id. Some controversy exists as to whether the Clinton Administration was warned of the crisis prior to the devaluation. CIA reports in July 1994 indicated that Mexican foreign reserves were being depleted in order to prop up an overvalued peso. David E. Sanger & Anthony DePalma, On Both Sides of the Border, Peso Ills Were Long Ignored, N.Y. Times, Jan. 24, 1995, at A1, A9 [hereinafter Peso Ills]. Even in 1993, reports indicated that a devaluation was likely to occur in Mexico. See Stephen Fidler & Damian Fraser, Dark Cloud of Devaluation Gathers Over Mexico, Fin. Times, Feb. 24, 1993, at 6. The Clinton Administration, however, has denied prior knowledge of the likelihood of a devaluation. R. Jeffrey Smith & Clay Chandler, Peso Crisis Caught U.S. by Surprise, Wash. Post, Feb. 13, 1995, at A1, A16.

92. President Zedillo was elected on August 17, 1994. Smith and Chandler, supra note 91, at A16.

93. Outlook, supra note 56, at 94; see also Richard Lapper et al., Equity and Debt Markets Suffer, Fin. Times, Dec. 23, 1994, at 6 (describing the capital flight in Mexico).

94. Mexico Financial Crisis, supra note 21, at CRS-3. The devaluation was intended to rectify the overvaluation of the peso, thus reducing the price of Mexican exports and increasing the costs of imports. See id. at CRS-2 to -3.

95. Outlook, supra note 56, at 94.

96. Tim Golden, Mexico Will Float Its Battered Currency, N.Y. Times, Dec. 22, 1994, at D1. By floating the peso, the Mexican government allowed the markets to determine the value of the peso. See Edwards, supra note 8, at 684 (describing the effects of a floating exchange regime). Because of the reduced demand for the peso, it dropped in value. See Golden, supra, at D1. The United States and Canada, Mexico's NAFTA partners, quickly arranged $7 billion in emergency credits for Mexico. Id.
Investors were angered. Mexican Finance Minister Jaime Serra Puche, a few days earlier, had promised that the peso would not be devalued. Concerned that Mexico would not be able to finance its short-term tesobonos debt, on which the 1995 payments exceeded reserves by $23 billion, foreign investors punished Mexico by refusing to roll over their maturing tesobonos. Sixteen billion dollars worth of these tesobonos were due to mature in early 1995. Because of its greatly diminished reserves, the Zedillo Administration was unable to meet the redemption demands of all the bondholders.

B. The Controversial Bailout

In December 1994, Mexico suffered a liquidity rather than a solvency crisis. The Mexican crisis in 1995 was not a replay of the crisis in 1982. Although in 1982 Mexico's economic problems were largely structural, including such characteristics as a closed economy and a dependency on oil as its primary export, by 1995 Mexico had opened its economy and liberalized its trading policies. Thus, although Mexico had sufficient incoming oil revenue to honor the random repayment demands of its bondholders, Mexico did not have the resources at hand to redeem immediately the maturing bonds from a panicking multitude of bondholders.

Given the long-term health of the Mexican economy, President Clinton would not allow Mexico to fail. The Clinton Administration feared a repeat of the 1982 Latin American collapse, when a number

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98. Sachs, supra note 2, at 18.
100. See id.
101. See, e.g., Big Battle, supra note 61, at 17 (arguing that the Mexican crisis resulted from illiquidity, rather than a fundamental inability to pay its debts); Stephen Fidler, A Clearer View Now of Mexico's Debt Troubles, Fin. Times, Jan. 14-15, 1995, at 3 (stating that U.S. officials have argued that Mexico was a liquidity, not a solvency issue); Going With The Flows, Economist, Jan. 28, 1995, at 74 (referring to Mexico's current liquidity crisis); Mexico Financial Crisis, supra note 21, at CRS-1 (same).

For a definition of liquidity, see supra note 44. The general definition of "solvency" that the commentators above employed is the "ability to make ultimate payment of obligations then owed from assets then owned." Black's Law Dictionary 1394 (6th ed. 1990).

102. See Cline, supra note 67, at 17; For a discussion of the 1982 crisis, see supra note 21.
103. See Cline, supra note 67, at 499; Mexico Financial Crisis, supra note 21, at CRS-3. While in 1982, oil accounted for 75% of exports, the Mexican economy in 1995 was more diversified and oil only counted for 36% of exports. Id.
104. See Cline, supra note 67, at 499 ("[T]he problem this time was one of cash flow and, in particular, the rollover of some $17 billion in dollar-indexed treasury bonds (tesobonos) held by foreigners.").
of Latin American countries, led by Mexico, were simultaneously in economic trouble. If Mexico was forced to impose exchange controls or a moratorium on debt repayment, the investors who suffered as a result would reconsider their investment in other developing economies in Latin America, possibly precipitating a more widespread crisis. Furthermore, should Mexico fail, protectionism would resurface. This development would pose a severe setback both for the Latin American countries that had struggled to grow out of their debt under the Brady Plan, and for the United States, which had a vested economic interest in the health of these economies. Finally, and perhaps most importantly, American investors in Mexican stocks and bonds would suffer a potential loss estimated at about $8-$10 billion.

President Clinton, upon learning about Congress' reluctance to disburse aid to Mexico quickly, abandoned the $40 billion request and ordered a policy switch to "Plan B." Plan B was an alternative financing package based on a $20 billion infusion from the United States' Exchange Stabilization Fund ("ESF").

106. See Graham et al., supra note 1, at 4.
108. The Brady plan was a voluntary debt reduction program designed to reduce Latin American debt by allowing sovereign debtors to exchange bank debt for bond debt at a discount of either the principal or interest rate. Rory MacMillan, The Next Sovereign Debt Crisis, 31 Stan. J. Int'l L. 305, 313-15 (1995). By 1994, 18 Brady Deals had forgiven $61 billion in debt, Big Battle, supra note 61, at 18, and had effectively ended the debt crisis. Cline, supra note 67, at 270.
109. See infra note 154.
112. See Graham et al., supra note 1, at 4. Under Plan B, the United States provided support in three forms: short-term swaps with the Federal Reserve where dollars were exchanged for pesos; medium-term currency swaps with maturities of three to five years; and guaranteed securities with maturities of five to ten years. See U.S. and International Response to the Mexican Financial Crisis: Hearings Before the House Comm. on Banking and Financial Services, 104th Cong., 1st Sess. 375, 376 (1995) (memorandum from Walter Dellinger, Assistant Attorney General, to Edward S. Knight, General Counsel to the Treasury Department) [hereinafter Dellinger Memo]. Mexico was allowed to draw on the $20 billion over the following 12 months.
Twenty billion dollars, however, was not enough. Additional funds were necessary to demonstrate to foreign investors that Mexico had the financial capability to honor its bonds and restore investor confidence in Mexico. The Clinton Administration turned to the BIS and the IMF, two supporters who had earlier pledged to lend Mexico $5 billion and $7.8 billion, respectively. The Clinton staff asked Andrew Crockett, the General Manager of the BIS, to increase the BIS contribution to Mexico from $5 billion to $10 billion. Crockett, reluctant to promise such a large sum of money, only agreed to consider the request.

The Clinton staff next contacted the IMF. After heavy negotiations, Michel Camdessus, Managing Director of the IMF, approved a $17.8 billion loan to Mexico, the largest loan the IMF had issued in its fifty-one year history. Supplemented by this huge commitment by the IMF, Canada agreed to lend $1.5 billion and international banks agreed to lend $3 billion.

President Clinton, on February 1, 1995, announced the promised aid from the BIS and the IMF. Officials at the BIS and the IMF were

See Mexican Bailout a Relief But Hard Year is Feared, LDC Debt Rep., Feb. 6, 1995, at 1, *3 (on file with the Fordham Law Review) [hereinafter Hard Year]. Mexico, in return, established an "oil facility" at the New York Federal Reserve in which it was obligated to deposit about $7.5 billion in annual earnings from oil exports and from which the United States and other bailout creditors may draw upon should Mexico default. Id. But see U.S. and International Response to the Mexican Financial Crisis: Hearings Before the House Comm. on Banking and Financial Services, 104th Cong., 1st Sess. 269, 271 (1995) [hereinafter Whalen Statement] (letter from Christopher Whalen, Chief Financial Officer of Legal Research International, Inc.) (stating that Mexican oil reserves are actually unavailable as collateral on the bailout because most of the dollar revenues from oil sales are already pledged to pay other debts).

The Exchange Stabilization Fund was originally established to stabilize the United States dollar and foreign currencies. See 31 U.S.C. § 5302(b) (1988). To this end, it is employed to "buy and sell foreign currency, enter into swap arrangements with foreign countries and guarantee obligations of foreign governments." U.S. and International Response to the Mexican Financial Crisis: Hearings Before the House Comm. on Banking and Financial Services, 104th Cong., 1st Sess. 355, 355 (1995) [hereinafter Stabilization Fund]. "Subject to the approval of the President...[the ESF] is under the exclusive control of the Secretary [of the Treasury]." 31 U.S.C. § 5302(a)(2) (1988). The ESF, at the time of the Mexican crisis, had assets totalling about $37 billion, $29.5 billion of which was available for Mexico. Stabilization Fund, supra, at 355.

113. See Graham et al., supra note 1, at 4.
114. See supra note 26.
115. See Graham et al., supra note 1, at 4.
116. See id.
118. Id. The commercial banks were J.P. Morgan and Citibank. Hard Year, supra note 112, at *4.
outed.\textsuperscript{120} Officials at the BIS felt that the United States, in bad faith, had treated the proposed $10 billion BIS loan as a foregone conclusion, rather than as a proposal the BIS had only agreed to consider.\textsuperscript{121} At the IMF, parties opposed to the loan argued that IMF funds were being used to bail out risk-taking American mutual and pension fund managers.\textsuperscript{122} Opponents were shocked by the size of the IMF contribution, which was nearly seven times larger than Mexico's quota\textsuperscript{123} and three and one-half times more than the IMF had ever lent in its history.\textsuperscript{124} They felt that such excessive lending would create a moral hazard\textsuperscript{125} and lending precedents that the IMF would be

\textsuperscript{120} Graham et al., supra note 1, at 4. The prevailing sentiment internationally was that the Mexican crisis was a regional rather than a systemic problem, which the United States should handle alone. George Graham & Stephen Fidler, Europeans Angry at U.S. over Mexico, Fin. Times, Feb. 4-5, 1995, at 3. The United States, by seeking large sums of foreign aid, was irresponsibly avoiding its regional obligations. George Graham, Ministers Put Mexico Rift Behind Them, Fin. Times, Feb. 6, 1995, at 5 [hereinafter Mexico Rift].

\textsuperscript{121} Graham & Fidler, supra note 120, at 3. In fact, the BIS had originally envisioned its $5 billion as a short-term “bridge” loan until a larger IMF loan was arranged. See Graham et al., supra note 1, at 4. Later, at the BIS, Hans Tietmeyer, the Bundesbank president, said that the $10 billion had been approved. \textit{Id.} It was to be, however, more of a “bookkeeping exercise” than an actual loan. \textit{Id.} Mexico could include the $10 billion as part of its bailout package, but the funds would not actually be transferred to Mexico. The money would remain in the central banks. \textit{Id.}

\textsuperscript{122} See Graham et al., supra note 1, at 4. In the voting to approve the loan, six of the IMF’s 24 Directors abstained from the vote. Graham & Fidler, supra note 120, at 3. This was a significant mark of their displeasure given that almost all IMF board decisions are reached by consensus. \textit{Id.}

\textsuperscript{123} See 1995 Economic Program, supra note 67, at 8. Current access rules to the General Resources Account allow a country to borrow 100% of its quota with a cumulative limit of 300%. \textit{Id.} Mexico’s quota was about $2.6 billion and, thus, the IMF loan was nearly an unprecedented 700% times greater than Mexico’s quota. \textit{Id.}

Quotas are the contributions of IMF members to its General Resources Account. See Edwards, supra note 8, at 12. The General Resources Account consists of “national currencies, special drawing rights, and gold.” \textit{Id.} Contributions to the account by member nations are determined by individual quotas, an amount which roughly reflects the importance of the nation’s currency in the world economy. Daniel D. Bradlow, \textit{The International Monetary Fund: An Overview of its Structure and Functions, in International Borrowing: Negotiating and Structuring International Debt Transactions} 399, 399 (Daniel D. Bradlow ed., 2d ed. 1986).

\textsuperscript{124} See Graham et al., supra note 1, at 4.

\textsuperscript{125} The traditional definition of moral hazard, as applied to fire insurance, is: 

\begin{quote}
[T]he risk or danger of the destruction of the insured property by fire, as measured by the character and interest of the insured owner, his habits as a prudent and careful man or the reverse, his known integrity or his bad reputation, and the amount of loss he would suffer by the destruction of the property or the gain he would make by suffering it to burn and collecting the insurance.
\end{quote}


Applied to the context of a sovereign debtor, the term moral hazard denotes the reduction in the deterrence of future fiscal responsibility caused by the debtor’s receipt of a bailout.
unable to meet in the future. The IMF had always prided itself on its even-handed treatment of all members. In addition, IMF member nations felt that Michel Camdessus and the Clinton Administration had clandestinely arranged this loan without consulting with IMF officials.

Congress' criticism of the bailout echoed that of the IMF officials' disapproval. Members of Congress also felt they had not been adequately consulted about the use of the Exchange Stabilization Fund. They believed they should have had the chance to approve the disbursement of such a large sum of aid. Some Representatives questioned the wisdom of bailing out Mexico, a country with "a long and painful past of undisciplined financial mismanagement." Critics of the bailout suggested that the true intent of the aid was to bail out wealthy Wall Street investors. Other critics suggested that United States intervention was unnecessary because the investors and the Mexican government, left alone, would work out a mutually acceptable arrangement themselves. Finally, even those who favored a bailout supported a multinational effort instead of a bailout where the United States functioned alone as a "liquidity backstop" when a global crisis threatened the international financial system.

126. See Naim, supra note 24, at 128; Jeffrey D. Sachs, Mexican Precedent for Ukraine, Fin. Times, Feb. 17, 1995, at 17 (stating that after the precedent established in Mexico, the IMF should arrange a similar package for the Ukraine).


128. See Graham et al., supra note 1, at 4.

129. See Janet Hook & James Gerstenzang, House Passes Bill to Block Bailouts Similar to Mexico's, L.A. Times, July 20, 1995, at D1 ("We never had a chance to vote on the merits of this issue."). (quoting Rep. Marcy Kaptur (D-Ohio)).

130. See id. For an extensive discussion supporting the power of the President to disburse the funds under his own foreign affairs authority, see Humphrey, supra note 33, at 181.


132. See, e.g., U.S. and International Response to the Mexican Financial Crisis: Hearings before the House Comm. on Banking and Financial Services, 104th Cong., 1st Sess. 180, 182 (1995) [hereinafter Wanniski Testimony] (statement of Jude Wanniski, president of Polyconomics, Inc.) ("The people who benefit most from a peso devaluation ... are those insiders who borrow a great many pesos, sell them for dollars, and repay them with fewer dollars after the devaluation."); Whalen Statement, supra note 112, at 270 ("The proposed $40 billion rescue package ... actually is a hidden subsidy for Wall Street and Mexico's elite . . . .").


134. Currency, supra note 39, at 6 (statement of Representative Jim Leach).
C. The Wider Implications of the Mexican Crisis

A generalized debt crisis similar to that which occurred in the 1980s is unlikely to occur in the 1990s.\textsuperscript{135} Individual countries with significant external debt, however, are increasingly likely to suffer liquidity crises similar to Mexico's.\textsuperscript{136} In the 1990s, large volumes of highly mobile international bonds and portfolio investment replaced relatively stable syndicated bank loans\textsuperscript{137} to developing economies.\textsuperscript{138} After the

\textsuperscript{135} See Going With the Flows, supra note 101, at 74 ("Despite Mexico's current liquidity crisis, the economic fundamentals of the 20 or so emerging economies . . . are strong.").

\textsuperscript{136} See Cline, supra note 67, at 481; International Monetary Fund, World Economic Outlook 59 (Oct. 1995); MacMillan, supra note 108, at 307-08; Prowse, supra note 133, at 12; see also Lender of Last Resort, supra note 10, at 1777 (urging a rethinking of multilateral responses to a debt crisis given the increased access of developing countries to global bond and equity mutual funds); Camdessus Address, supra note 24, at 4 ("Vastly increased financial flows across national borders have also made countries that participate in international financial markets much more vulnerable to adverse shifts in market sentiments."); A Modest Proposal, supra note 43, at 19 (stating that the IMF and World Bank's current purpose and functions do not address the perils of the present capital markets).

In October 1995, after the Mexican collapse, the United States again faced the prospect of a liquidity crisis in another important trading partner, Japan, whose banks were burdened with $400 billion worth of bad loans. Keith Bradsher, Fearing Japanese Bank Frailty, U.S. Agrees to Give Future Help, N.Y. Times, Oct. 17, 1995, at A1, D6. The United States Federal Reserve took advance precautions, arranging to provide Japanese financial authorities instantly with billions of dollars in cash should a sudden cash crisis take place. \textit{Id.} at A1. The Federal Reserve sought to send an international message that Japan had the financial capabilities to honor its debt and to prevent a panic mentality among bank depositors. \textit{Id.} This arrangement marked the first time the Federal Reserve took advance precautions to guard against a possible crisis. \textit{Id.} The circumstances motivating the precautions taken by the Federal Reserve bore many resemblances to the situation in Mexico. Troubled Japanese banks, despite their solvency, did not have sufficient cash at hand to honor their debt obligations to a panicking multitude of depositors. \textit{Id.}

\textsuperscript{137} Syndicated bank loans are devices by which creditors enter into a partnership to raise large sums of money that they would not otherwise be able to raise on their own due to regulatory constraints. Derek Asiedu-Akrofi, Sustaining Lender Commitment to Sovereign Debtors, 30 Colum. J. Transnat'l L. 1, 4 (1992). Syndication also permits creditors to spread the risk of an investment because each creditor is only committed to a part of the loan. \textit{Id.}


Notably, after the Mexican crisis, the trend has reversed, with new direct investment now outpacing portfolio investment. See Paul Lewis, Multinationals Raised '95 Investment in 3d World 13%, N.Y. Times, Mar. 13, 1996, at D5.
Latin American debt crisis in 1982 exploded the myth that sovereign debt was immune from default, commercial banks ceased lending to developing countries. Instead the banks focused on protecting themselves by selling off bad loans through the Brady Plan and debt-for-equity conversions. The bankers gave way to portfolio investors, who between 1987 and 1992 poured investment into developing countries, increasing their presence from $6.2 billion in 1987 to $37.2 billion in 1992, with an additional increase of $26.9 billion in the first half of 1993. Twenty-five countries, led by Mexico, Argentina, Brazil, and Venezuela, raised approximately $80 billion in the international bond markets.

This increased investment in developing countries arouses concern because investors were not responding to an attractive risk but rather to the collapse of interest rates in the United States market. American investors, motivated by the prospect of high yields, searched for markets that would enhance the return on their investments. In ef-
fect, a tremendous amount of short-term capital is "sloshing around the globe in search of the highest return," intensifying the risk of capital flight in all emerging markets relying on these flows as a source of funding.147 The speculative nature of short-term capital, coupled with technological breakthroughs that allow the execution of financial transactions within seconds,148 subjects many developing nations to the risks of harsh, arbitrary, and irrational capital flight by thousands of anonymous investors.149

majority rather than the minority form of debt in the 1990s, the implicit senior status of bonds disappeared. Id.


149. Naim, supra note 24, at 125; see also Clayton, supra note 147, at 9 ("Mexico is not the first, and it won't be the last financial crisis aggravated by the increasing amounts of highly mobile [short-term] capital." (quoting Paul Volcker, former chairman of the Federal Reserve Board)).

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A speculative capital flight, however, can destroy a developing economy, negatively affecting those nations with whom the emerging market has significant economic ties. The globalization of securities markets has introduced unprecedented changes in "how quickly, how deeply, and how far the shock waves of a crash can be felt" when investors en masse decide to move their money. Because global markets are interdependent, "one failure in a global financial market may affect the entire structure of that market." Bond lending and portfolio investment are particularly dangerous because the shifts in market psychology have a highly contagious effect. This effect is evidenced by Latin American investors' "flight to quality" after the Mexican crisis.

150. See Naim, supra note 24, at 125-27. Responding to whether a Mexican default would have created a systemic crisis, a French official noted, "We don't know how the international markets would have reacted, but in the end, the risk of a default by Mexico could not be run." Graham et al., supra note 1, at 4.


The globalization trend in securities markets exploded in 1984 when international securities trading increased from a volume of about $110 billion in 1984 to over $227 billion in 1990. Van Zandt, supra, at 57. A number of factors contributed to the globalization movement: (1) innovative financial instruments that attracted new investors by simplifying investments; (2) an increased demand for capital among developing countries and deficit-ridden developed countries corresponding to an increased supply of investment funds among creditors; (3) deregulation in advanced economies that facilitated market access; and (4) the volatility of exchange and interest rates that, as a prudential matter, fueled the need for diversification as an investment strategy. Gruson, supra, at 304-05. For an in-depth historical study of the globalization movement, see Eric Helleiner, States and the Reemergence of Global Finance (1994).

152. Naim, supra note 24, at 121-22; see Camdessus Address, supra note 24, at 3.

153. Gruson, supra note 151, at 307-08; see International Bankruptcy Code, supra note 48, at *5 ("In the fluid and integrated world we inhabit, the instability of a major country like Mexico can have repercussions and reverberations around the world . . . ."). For a conflicting viewpoint, see later reports stating that although neighboring economies were hurt by the peso crisis, Latin America Recovering, IMF Says, L.A. Times, Oct. 6, 1995, at D12, there was only a "modest threat to the stability of the international financial system." Chandler, supra note 6, at A1.

The Mexican devaluation sparked a capital flight in other countries, demonstrating a phenomenon dubbed the "Neighborhood Effect." The "neighborhood" is determined not by geography but rather by the perceived volatility of a debtor's economy. Investors typically cluster groups of countries into certain "neighborhoods" and will treat them similarly. A perceived threat in one country will apply to the other countries in that cluster. Consequently, after the Mexican devaluation, financial markets from Argentina to Spain to Hong Kong were weakened, including those in Poland, South Korea, Turkey, Bulgaria, India, Malaysia, Pakistan, and the Phillipines.

The Mexican crisis demonstrated that mutual fund investors will quickly move their money at any sign of risk. It also confirmed that the "liberalization of international capital flows has created a world in which the sovereignty of any one nation is surrendered to the forces of private financial speculation." This situation stands in contrast to the 1980s when large commercial bankers were the primary lenders to developing countries. The bankers then entered into direct investment in factories and infrastructure, affording the debtor governments some leverage in debt renegotiation proceedings because the bankers were relatively committed to their investments. Today, a government relying on large portfolio investment is at the mercy of the whims of mutual fund managers. As one commentator noted, "Capital is capable of staging a general political strike against the policies of any nation state . . . by simply voting against that country's currency and bonds in the private marketplace."

D. The Vacuum in International Financial Management

No international and mutually acceptable procedures are in place to respond effectively to a speculative capital flight of the magnitude and speed that occurred in Mexico. One commentator noted, "The world's financial system has . . . raced ahead of the institutional infra-

156. Naim, supra note 24, at 125.
157. Id. at 125-26.
159. See Naim, supra note 24, at 127.
160. Canova, supra note 149, at 1351-52.
161. See Cline, supra note 67, at 426.
162. See Naim, supra note 24, at 124.
163. Id. at 124-25.
164. Canova, supra note 149, at 1352.
165. "The speed at which international markets have evolved over the last 25 years has been much faster than the capacity of governments and international organizations to cope." Friedman, supra note 32, at A25 (quoting Mexican President Ernesto Zedillo).
structure for crisis management."166 Traditionally, a debtor country who wished to renegotiate with creditors followed a three-step procedure beginning with the negotiation of a standby arrangement with the IMF.167 The country then renegotiated with its official creditors in the Paris Club.168 The Paris Club will only renegotiate debt when the debtor country is in a state of "imminent default" and has negotiated a standby arrangement with the IMF.169 Finally, the debtor state renegotiated with its private commercial creditors in the London Club.170 In the London Club, commercial banks required the debtor to have first negotiated an IMF standby arrangement and a Paris Club rescheduling.171 As a policy matter, both Clubs retain an ad hoc character for the negotiations to reinforce the exceptional nature of debt renegotiations.172

As the crisis in Mexico demonstrated, these traditional ad hoc and lengthy renegotiation procedures are unsuited to maintain investor confidence during a speculative capital flight in an era of highly mobile short-term capital. An ability to respond quickly and decisively to restore confidence in creditors is critical to prevent these panics. The

166. Suratgar, supra note 48, at 495.
167. Alexis Rieffel, The Role of the Paris Club in Managing Debt Problems 2 (Essays in Int'l Fin. No. 161, 1985). The IMF devises standby arrangements in order to enforce the implementation of economic reforms that it requires the debtor to adopt in return for an IMF loan. Jeanne Asherman, The International Monetary Fund: A History of Compromise, 16 N.Y.U. J. Int'l L. & Pol. 235, 264-65 (1984). For example, the IMF may require a limitation on the amount of credit, an increase in taxes, a decrease in government expenditures, or a devaluation of the currency to increase the price of imports. Id. at 264. Under a standby arrangement, the borrower receives its loan in installments and must meet certain "performance conditions" in order to receive the next phase of the loan. Id. at 265-66.

In the Mexican bailout, Michel Camdessus had agreed to disburse $7.8 billion to Mexico immediately in one chunk rather than through a typical installment process. Mexico Rift, supra note 120, at 5. German officials argued that this action undermined the IMF's principles of disbursing loans in phases. Id. Later, upon reconsideration, the IMF disbursed the $7.8 billion in two phases. Id.

168. Rieffel, supra note 167, at 2. The Paris Club was established in 1956. Karen Hudes, Coordination of Paris and London Club Reschedulings, in International Borrowing: Negotiating and Structuring Loan Transactions 451, 451 (Daniel D. Bradlow ed., 2d ed. 1986). The Paris Club is not an official institution and it does not have a fixed membership. Rather, it represents a set of renegotiating procedures for the re-adjustment of debt to official creditors. Rieffel, supra note 167, at 3. The traditional participants are the 24 member countries of the Organization for Economic Cooperation and Development ("OECD"). Id.


170. Rieffel, supra note 167, at 2. The London Club represents a set of renegotiation procedures for the renegotiation of debt owed to commercial creditors. Id. at 3. In the London Club, the creditors will generally form a steering committee to negotiate with the sovereign debtor. Hudes, supra note 168, at 453. This committee will draft a model renegotiation agreement with the debtor state. Each individual bank creditor will then sign their own separate agreement with the sovereign debtor based upon the model agreement. Id.

171. Hudes, supra note 168, at 452.
172. Id. at 451.
capital flight that the Mexican economy suffered was a crisis of confidence among individual investors similar to that which occurs among depositors during a bank run\(^{173}\) or among creditors of a business during a period of financial stress.\(^{174}\) In both situations, individual depositors and creditors race to be the first either to withdraw their deposits from a bank or seize assets ahead of other creditors.\(^{175}\) Thus, when international investors noticed that Mexico had $29 billion in tesobonos falling due in 1995 with Bank of Mexico reserves at around $6 billion, the creditors panicked.\(^{176}\) Each individual creditor realized that if other creditors refused to roll over their bonds, Mexico would be in default because its reserves were inadequate to meet the demands of all its creditors.\(^{177}\) Thus, each creditor demanded repayment, pushing Mexico to the brink of default.\(^{178}\)

In the domestic context, Congress established the Federal Reserve\(^{179}\) and the Federal Deposit Insurance Corporation\(^{180}\) to prevent speculative bank runs by assuring depositors in advance of any panic that aid would be speedily forthcoming to the bank should a panic occur.\(^{181}\) Similarly, to prevent creditors from pushing a government entity to the brink of default, Congress established Chapter 9 of the U.S. Bankruptcy Code to immediately impose an automatic stay on creditor attachment of debtor assets upon petition by the debtor municipality.\(^{182}\) This forces creditors to give a municipal debtor some breathing room to readjust its debts and to maximize repayment to the creditors.\(^{183}\)

\(^{173}\) Bank runs occur when individual depositors question the liquidity of a bank during a period of financial stress and withdraw their money in full to protect their deposit. See Gillian Garcia & Elizabeth Plautz, The Federal Reserve: Lender of Last Resort 17 (1988). Because most deposit accounts at a bank can be immediately withdrawn at almost no cost to the depositor and without any substantial penalties, borrowers will race to withdraw their money rather than risk losing their deposit should the bank become insolvent. \textit{Id.}

\(^{174}\) Sachs, supra note 2, at 6-7.

\(^{175}\) \textit{See id.} at 10-11.

\(^{176}\) \textit{Id.} at 18.

\(^{177}\) \textit{Id.}

\(^{178}\) \textit{See supra note 2.}

\(^{179}\) The Federal Reserve was established in 1913 with three major purposes: (1) to provide money to expand the economy without promoting inflation; (2) to prevent depositor panics by ensuring depositors that banks would have sufficient liquidity should a bank panic occur; and (3) to supervise banking procedures. See Garcia & Plautz, supra note 173, at 36.

\(^{180}\) The Federal Deposit Insurance Corporation ("FDIC") was established in 1933 to insure deposits in commercial banks. See Federal Deposit Insurance Corp., FDIC: Symbol of Confidence 1.

\(^{181}\) \textit{See Sachs, supra note 2, at 6. The Federal Reserve has the ability to create money and is thus the "ultimate liquidity backstop" to break the expectations of a panic. Garcia & Plautz, supra note 173, at 43.}

\(^{182}\) \textit{See infra part II.}

\(^{183}\) \textit{See infra part II.}
These domestic safeguards, however, are sorely lacking in the international context to assure international investors, before the onset of a panic, that their credit is protected. The IMF, the Paris Club, and the London Club do not promise speedy aid in advance of a panic but rather only after the troubled country agrees to policy reforms. The rescheduling often consists of a series of "overexciting and... last-minute cliff-hangers" which are only arranged upon an emergency. Thus, a developing nation, without the promise of immediate aid to honor its short-term obligations, will face a massive exodus of investors who refuse to roll over old debts and race to withdraw their money. At the same time, however, the developing country lacks the protections that would accompany a bankruptcy petition under the United States’ Chapter 9 or the benefits of a large scale and quick injection of liquidity that a domestic lender of last resort, like the Federal Reserve, would provide.

Creditor panics are tragically self-fulfilling. Individual creditors and depositors, fearing the loss of their capital, will effectuate their worst fears by engaging in a short-sighted panic and destroying a bank, a corporate enterprise, or even a nation’s economy despite the entity’s long-term solvency prospects. If the investors had remained calm and given the debtor some breathing room to readjust its debts, the investors would have maximized the possibility for full repayment. The next part will demonstrate that, in the domestic context, Chapter 9 protects domestic municipalities from creditor panics and maximizes the repayment to creditors by promoting orderly debt renegotiation between creditors and illiquid municipalities. Chapter 9 can serve as a model for the establishment of an international bankruptcy procedure.

II. United States Bankruptcy Code Chapter 9: The Domestic Model

This part discusses the protections that Chapter 9 provides for municipalities against speculative creditor panics. This part argues that the purposes underlying Chapter 9 apply with equal force in the inter-
national context to sovereign debtors. It then highlights four Chapter 9 provisions available to municipalities in domestic bankruptcy but not currently available to sovereign debtors in the international context.

A. The Purpose of Chapter 9 and its Applicability to Sovereign Debtors

As the Mexican crisis demonstrated, sovereign debtors are vulnerable to creditor panics during periods of financial stress. Creditors, fearing a moratorium on debt repayment, race to unload their investments in the debtor country. Sovereign debtors, suffering a creditor panic, must find avenues to settle their financial difficulties without suspending the provision of "essential public services" and thereby collapsing into "social and financial chaos."192

Municipalities in the domestic context face the same issues. Individual creditors in the domestic context, spurred by the "first come, best served" rule,193 also race to withdraw their investments ahead of other creditors during periods of financial stress.194 This race, absent some third-party intercession, will send the municipality into economic collapse. If the creditors, as a group, had given the sovereign or the municipality some breathing room to readjust its debt, this economic chaos could have been avoided.195

Chapter 9196 of the U.S. Bankruptcy Code197 protects municipalities from creditor panics and averts economic chaos.198 Chapter 9

194. Sachs, supra note 2, at 11.
195. See id. at 13-14.
198. See Sachs, supra note 2, at 11. To file for relief under Chapter 9, a municipality must meet five requirements: (1) It must be a municipality (defined in 11 U.S.C. § 101(40) (1994) as a "political subdivision or public agency or instrumentality of a State"); (2) the municipality must be authorized to file for relief under Chapter 9 by "State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor" under Chapter 9; (3) the municipality must be insolvent, 11 U.S.C. § 101(32)(C) (1994) (defining the debtor as insolvent when it is "not paying its debts as they become due unless such debts are the subject of a bona fide dispute" or is "unable to pay its debts as they become due"); (4) the municipality wishes to create a plan to adjust its debts; and (5) the municipality either (a) "has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan;" (b) "has negoti-
provides a forum for financially distressed municipalities to renegotiate their debts with their creditors and promotes collective action by creditors through four specific provisions: (1) the automatic stay;\textsuperscript{199} (2) the post-petition creditor preference;\textsuperscript{200} (3) the plan of readjustment;\textsuperscript{201} and (4) the cramdown provision.\textsuperscript{202} These four provisions are crucial in protecting domestic municipal debtors because they correspond to the four points in debt readjustment when collective action is most difficult to obtain: (1) at the onset of illiquidity; (2) when new credit is required; (3) when a plan of readjustment must be formulated; and (4) when a readjustment of the debtor’s repayment schedule must be approved by the creditors.\textsuperscript{203}

Chapter 9 also affords a number of procedural protections to protect the municipality’s governmental affairs from impermissible interference by its creditors. Municipalities are not subject to involuntary bankruptcy petitions\textsuperscript{204} and they have the exclusive right to file the plan of adjustment.\textsuperscript{205} Unlike Chapter 11, under which the court may appoint a trustee to govern the debtor’s affairs,\textsuperscript{206} Chapter 9 protects the rights of the state to control its political subdivisions\textsuperscript{207} and the right of the municipal debtor to manage its internal affairs.\textsuperscript{208} This preserves the municipality’s power to govern its own domestic spending priorities without judicial interference.\textsuperscript{209}

Despite their similar vulnerability to creditor panics and need to maintain economic stability, sovereign debtors do not enjoy the same level of protection from creditor panics as municipalities. No international agency exists that applies an international version of Chapter 9 and to which a sovereign debtor can turn for protection.\textsuperscript{210} Consequently, as Mexico demonstrated, a sovereign debtor suffering a credi-
tor panic must anxiously wait until an aid package can be arranged by a developed creditor country, like the United States. Similarly, developed countries, like the United States, must hope in nervous anticipation that its aid package is large enough to limit the hemorrhage of credit from the sovereign debtor.

1. Four Chapter 9 Provisions

This subpart discusses four Chapter 9 provisions that could establish the basis for an international bankruptcy procedure and that could provide protection for sovereign debtors similar to that enjoyed by domestic municipalities. The four provisions are: (1) an automatic stay; (2) a post-petition creditor preference; (3) a plan of readjustment; and (4) a cramdown procedure.

a. The Automatic Stay

An immediate effect of filing a bankruptcy petition under Chapter 9 is to automatically stay creditors and all other parties in interest from commencing or continuing lawsuits and enforcing or collecting claims or judgments against the debtor. The stay lasts for thirty days and then terminates unless the court, after notice and a hearing, renews the stay. The stay has several purposes: to prevent creditors from harassing the municipal debtor, to promote the orderly administration of the debtor’s assets and avoid their dissipation, and to aid the municipal debtor in rehabilitating its economic condition by allowing it to use its assets free from financial pressures. Creditors who attempt to enforce their claims in spite of the stay may be held in contempt of court.

b. Post-Petition Creditor Preference

Although the automatic stay protects the municipal debtor’s assets from its creditors, the municipality may still lack an adequate cash flow to return to economic health. Lenders, however, are understandably unwilling to extend credit to an illiquid municipality without priority as to repayment. To encourage creditors to lend to the financially distressed municipality, Chapter 9 provides for a post-petition creditor preference. This provision permits a municipality to obtain unsecured credit by granting the new loan priority of repay-

212. Id. § 901(a) (incorporating 11 U.S.C. § 362(d)-(e) (1994)).
215. See Sachs, supra note 2, at 11.
216. See id.
ment over all administrative expenses, unsecured creditors, and junior liens already encumbering the property of the debtor.\textsuperscript{218} If these incentives prove to be ineffective, the court, after notice and a hearing, may authorize the municipality to issue new debt instruments which will have repayment priority ahead of all debt incurred prior to the Chapter 9 petition.\textsuperscript{219}

c. Plan of Adjustment and its Contents

A municipality will generally file a plan of adjustment of its debt either with the petition or at some later date fixed by the court.\textsuperscript{220} The plan must divide the creditors into separate classes and each class must consist of substantially similar claims.\textsuperscript{221} The debtor has broad discretion in designing a plan of adjustment and may modify the rights of all creditors relating to repayment of principal, interest, or repayment method.\textsuperscript{222}

The plan of adjustment is a product of the negotiations between the municipality and creditors to find a mutually acceptable plan for adjusting outstanding debt.\textsuperscript{223} Chapter 9 authorizes the establishment of a creditor committee to negotiate a readjustment plan with the debtor.\textsuperscript{224} This committee’s powers include the right to investigate any issue regarding the debtor pertaining to the negotiation of a plan and the right to participate in the negotiation and formulation of the plan.\textsuperscript{225} Later, the committee will vote on the plan and, if necessary, object to its confirmation.\textsuperscript{226}

d. Cramdown Provision

The cramdown provision prevents a small minority of creditors who dispute the reorganization plan from preventing its enactment.\textsuperscript{227} A qualified majority of creditors may override the dissent of an impaired\textsuperscript{228} class by meeting two requirements. The first requirement is

\begin{itemize}
  \item [218.] \textit{Id.} \textsection 901(a) (incorporating 11 U.S.C. \textsection 364(c) (1994)); Dixon & Manthe, supra note 214, at 149-50. Administrative expenses are expenses such as the costs necessary to preserve the estate and to pay the wages and salaries of those administering the bankruptcy proceeding. 11 U.S.C. \textsection 503 (1994). The post-petition preference is generally interpreted to grant priority over operating expenses of the bankruptcy case. Dubrow, supra note 192, at 563.
  \item [219.] 11 U.S.C. \textsection 901(a) (incorporating 11 U.S.C. \textsection 364(d) (1994)).
  \item [220.] \textit{Id.} \textsection 941 (1994).
  \item [221.] 11 U.S.C. \textsection 901(a) (incorporating 11 U.S.C. \textsection 1122 (1994)).
  \item [223.] \textit{Id.} at 275.
  \item [224.] 11 U.S.C. \textsection 901(a) (incorporating 11 U.S.C. \textsection 1102 (1994)).
  \item [225.] \textit{Id.} \textsection 901(a) (incorporating 11 U.S.C. \textsection 1103(c) (1994)).
  \item [226.] \textit{Id.} \textsection 901(a) (incorporating 11 U.S.C. \textsection 1126 (a)-(c) (1994)).
  \item [228.] A class of claims is not impaired if:
that at least one impaired class must accept the plan.\textsuperscript{229} A class of claims has accepted the plan if creditors holding two-thirds in amount of the claims and consisting of one-half of the number of creditors approve or are not impaired by the plan.\textsuperscript{230} The second requirement is that a court must find that the plan "does not discriminate unfairly, and is fair and equitable" with respect to the dissenting, impaired class.\textsuperscript{231} The "unfair discrimination" standard requires that the debtor treat all classes of equal rank identically under the plan.\textsuperscript{232} The "fair and equitable" doctrine requires that senior creditors receive full compensation before junior creditors receive payment.\textsuperscript{233}

These four provision are currently unavailable to protect a sovereign debtor although it is vulnerable to the same sort of creditor panic that can send a municipal debtor into an economic collapse. Cognizant of this vacuum in international financial management, the G-7, at the Halifax summit, floated two proposals as management solutions: (1) the establishment of an international bankruptcy agency that would institute an international version of Chapter 9 to extend similar protections to sovereign debtors and promote orderly debt renegotiation; or (2) the establishment of an EFM, which would serve as a lender of last resort.\textsuperscript{234} The next part examines both proposals.

\section*{III. Two Proposals Discussed: The International Bankruptcy Agency and the Emergency Financing Mechanism}

This part discusses the two proposals offered at the G-7 summit in Halifax.\textsuperscript{235} This part first explores the IBA, how it might function and apply the four Chapter 9 provisions outlined above to protect sovereign debtors. This part then discusses the alternate proposal, the establishment of an Emergency Financing Mechanism, which would function as an international lender of last resort.\textsuperscript{236}

\begin{itemize}
  \item the plan with respect to each claim in the class (1) cures any prior default, reinstates the maturity of each claim and does not alter the legal, equitable, or contractual rights of the holder of each claim, or (2) provides for the payment in cash of the allowed amount of each claim on the effective date of the plan.
\end{itemize}

Dubrow, supra note 192, at 577-78.

\textsuperscript{229} See 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 1129(a)(10) (1994)). The court must also find, inter alia, that the plan has been proposed in good faith. 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 1129(a)(3)).

\textsuperscript{230} 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 1126(c) (1994)).

\textsuperscript{231} Id. § 901(a) (incorporating 11 U.S.C. § 1129(b)(1) (1994)).

\textsuperscript{232} See Dixon & Manthe, supra note 214, at 157.


\textsuperscript{234} See infra part III.B.

\textsuperscript{235} See supra notes 41-50 and accompanying text.

\textsuperscript{236} See supra notes 41-50 and accompanying text.
MEXICAN FINANCIAL CRISIS

A. The International Bankruptcy Agency and the Establishment of an International Chapter 9

The International Bankruptcy Agency should be an arbitration forum to which sovereign debtors would petition for protection from creditor panics. Two key advantages to arbitration are that its proceedings are generally less contentious than court proceedings and that the parties can establish the procedural rules and regulations that will govern the management of the dispute. This reduces confrontation for the debtor state who desires to maintain a good relationship with investors upon whom it will rely to refinance its existing debt. In addition, because the arbitration panel will be deciding sensitive matters regarding preferences and cramdown which may implicate issues of sovereignty, the parties must perceive that the arbitration process is independent of the norms of any one domestic bankruptcy system.

The agency's facilities should be available on a voluntary basis. The IBA would only acquire jurisdiction over a dispute through a procedure for double consent. Those who agreed to establish the agency would not submit themselves to compulsory jurisdiction but would only signal their willingness to use the agency's renegotiation forum. To obtain jurisdiction over international investors, sovereigns agreeing to the establishment of the agency would introduce clauses


239. See id.


241. This is the practice currently followed in the ICSID. A country, ratifying the ICSID convention, only expresses a willingness to use ICSID machinery. Ibrahim F. I. Shihata, Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA, 186 ICSID Rev.-Foreign Inv. L.J. 1, 4. [hereinafter Greater Depoliticization]. ICSID jurisdiction is only obtained when a member state specifically consents to the dispute in question. Id. In most cases, an ICSID arbitration clause is expressly included in an investment agreement or it is included in an investment treaty or national code. Malcolm D. Rowat, Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA, 33 Harv. Int'l L.J. 103, 109 (1992) [hereinafter Multilateral Approaches].

into loan and bond sale agreements providing that, in case of default, both parties would submit to the jurisdiction of the agency.\textsuperscript{243}

Once a party has submitted to IBA jurisdiction, the IBA would assure all participants that no party to the agreement may unilaterally revoke consent.\textsuperscript{244} In addition, consent to IBA arbitration would exclude any other remedy.\textsuperscript{245} An IBA reorganization plan would bind the parties without exceptions.\textsuperscript{246} All parties agreeing to the establishment of the IBA would pledge to confer upon a reorganization plan by the IBA the same force as a decision in each parties' own court.\textsuperscript{247}

The establishment of the IBA would benefit both sovereign debtors and creditors. With the addition of a third-party bankruptcy agency and without new lending to add to the creditors' risk as well as to the sovereign's debt burden, creditors would be better able to afford to agree to a reorganization plan with a longer refinancing period for debtors.\textsuperscript{248} Furthermore, in contrast to an expensive bailout similar to the one provided to Mexico, the costs of operating an international bankruptcy agency would be relatively low.\textsuperscript{249}

The IBA's adoption of international Chapter 9 procedures would properly respect debtors' sovereignty because the international agency would not interfere directly in the political and economic affairs of the debtor nation.\textsuperscript{250} Chapter 9 recognizes that the "essential task" of the bankruptcy agency "is to keep the state functioning in an orderly and necessary manner—in provision of law enforcement, public order, a stable currency, basic social protection, and necessary public infrastructure—while at the same time eliminating the underlying economic policies that led to the [economic] disorder."\textsuperscript{251} Thus, adoption of the IBA proposal would leave governance in the hands of elected political officials and prevent a bankruptcy agency and creditors from interfering in the government's municipal affairs.

The IBA should administer bankruptcy provisions similar to those found in Chapter 9.\textsuperscript{252} While a full-blown bankruptcy procedure may

\textsuperscript{243} See Lessons of the Debt Crisis, supra note 49, at 975; see also Oechsli, supra note 237, at 333 n.160 (stating that parties in their loan agreements may specify that, in case of a dispute, an arbitration organization will handle the matter).

\textsuperscript{244} For the corresponding ICSID practice, see Greater Depoliticization, supra note 241, at 7.

\textsuperscript{245} Id. at 8 (discussing the parallel procedures followed in the ICSID).

\textsuperscript{246} Id.

\textsuperscript{247} Similarly, no exception exists to the binding character of an ICSID award. Id. at 8. The ICSID award has the effect of a final judgment in the courts of the member states. Id. at 9.

\textsuperscript{248} See A Middle Way, supra note 48, at 34.

\textsuperscript{249} Id.

\textsuperscript{250} See supra notes 204-09 and accompanying text.

\textsuperscript{251} Sachs, supra note 2, at 14.

\textsuperscript{252} See supra notes 198-202.
be unrealistic given the differences in national bankruptcy codes, an international bankruptcy agency that administered a limited international Chapter 9 procedure would be more feasible.

1. The Automatic Stay

A nation suffering a speculative creditor panic would be authorized to file a bankruptcy petition, after which the IBA would issue an automatic stay. The agency, upon granting this stay, would allow creditors to object to the filing of the petition on some of the same grounds afforded by Chapter 9. For example, the creditors may object that the debtor did not make a bona fide attempt to negotiate with creditors prior to filing. Alternatively, the creditors may object that the

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253. See Barry Eichengreen & Richard Portes, Crisis? What Crisis? Orderly Workouts for Sovereign Debtors 42 (1995) [hereinafter What Crisis?]. For example, the U.S. Bankruptcy Code treats a debtor more favorably than the bankruptcy laws in the United Kingdom or Germany. Id. at 14. Unlike the United States, the United Kingdom requires the debtor to obtain the approval of creditors prior to the approval of administrative priority for post-petition loans. Id. at 11. Eichengreen and Portes do, however, endorse a limited international bankruptcy procedure which would include a temporary stay and a cramdown provision. Id. at 18.

254. In pushing for the establishment of international bankruptcy procedures, Professor Sachs presents the ludicrously divergent treatment accorded to the R.H. Macy Corp. and Russia when both experienced financial difficulties. Sachs, supra note 2, at 20-21. When Macy's filed for Chapter 11 protection in the United States, it immediately received an automatic stay and three weeks later obtained $600 million in post-petition financing. Id. Professor Sachs contrasts this approach with the treatment Russia received when it notified its G-7 creditors that it would be unable to continue to service its debt. Unlike Macy's, Russia neither received an automatic stay nor quickly received new financing from private creditors or the IMF. Sachs, supra note 2, at 20-21. Rather, the international community allowed individual creditors and foreign governments to harass Russia with legal challenges and intense foreign political pressure. Id. at 21; see also Jeffrey Sachs, The Reformers' Tragedy, N.Y. Times, Jan. 23, 1994, at E17 (discussing the failings of the IMF and world leaders in dealing with the Russian debt crisis). For an article supporting Professor Sachs' viewpoint, see Leonard M. Salter, Can the Soviet Union Use a Chapter 11? Would It Be Effective?, 96 Com. L.J. 90 (1994).

The United Kingdom and Germany oppose the creation of a bankruptcy agency. The establishment of this agency under IMF auspices would empower the IMF to set aside contracts and to compel creditors to accept the approval of readjustment agreements. See Davis, supra note 40, at A4. The United Kingdom and Germany believe that such ideas are "too grandiose and favour[ ] more modest measures, particularly increased surveillance of key economies to pre-empt financial shocks." Mark Tran, UK to Oppose International Bankruptcy Court Proposal, Guardian, June 14, 1995, at 12. Furthermore, Germany argued that Chapter 9 or Chapter 11 protection for a debtor country would induce a moral hazard by encouraging bad financial policies. See Davis, supra note 40, at A4.

255. An quasi-automatic stay already exists in international debtor/creditor relations—a country may unilaterally impose a moratorium on debt repayment. Hurlock, supra note 48, at 11. Countries, with assets at risk of attachment in foreign countries, have generally refrained from this act of default. Id. Moreover, sovereign debtors have sought to maintain continued creditworthiness. See infra notes 357-58 and accompanying text.

256. See supra note 198.

257. See supra note 198.
debtor did not file to adjust its debts in good faith but rather was fraudulently using the international Chapter 9 provision as a vehicle to avoid repayment of its debt. Because creditors have recourse to these safeguards, a debtor would be less likely to use the threat of a bankruptcy petition as leverage against its creditors.

2. Post-Petition Creditor Preference

With the post-petition creditor preference, a nation in financial distress can give new creditors preference for their loans, assuring them of timely repayment and thus enhancing the possibility that the debtor will receive new credit. The commercial banks' reluctance to lend to Mexico following the devaluation demonstrates the need for this preference. Commercial bankers in 1995 were unwilling to extend fresh loans to Mexico because they were skeptical that the bailout would revitalize Mexico. They feared that the conditions imposed on Mexico would instead create a deep recession. Accordingly, the $50 billion rescue plan included only $3 billion from private sector commercial banks. The United States had originally hoped that large banks such as Citibank and J.P. Morgan would have been heavy contributors to the bailout package. Commercial banks, however, after being burned in Latin America during the 1980s, were unwilling to return without repayment priority.

258. See supra note 229.

259. This automatic stay would not have the destabilizing effects it would have had in the 1980s. For a discussion of the 1982 debt crisis, see supra note 21. At that time, the creditors consisted primarily of the largest international money center banks who were so overextended in their loans that they had to ensure the receipt of interest payments by the debtor countries to avoid writing off the debts as unrepayable and consequently suffering enormous losses. MacMillan, supra note 108, at 321. Loans to Mexico and Brazil accounted for 90.3% of the total bank capital of the nine largest U.S. banks. Mexico Financial Crisis, supra note 21, at CRS-4. Under United States regulatory and accounting rules, banks would have had to declare all of these loans as non-performing if interest payments been suspended for more than 90 days after their due dates. MacMillan, supra note 108, at 321. An automatic stay may have threatened the financial stability of commercial banks and destabilized the entire international financial system. Today, because the debt is widely dispersed among thousands of bondholders, see supra notes 143-44 and accompanying text, an automatic stay would not have the same destabilizing impact.

260. See supra notes 215-19 and accompanying text.

261. After the 1995 crisis, investment barely trickled back into Latin America. See David E. Sanger & Anthony DePalma, U.S. Bailout of Mexico Verging on Success or Dramatic Failure, N.Y. Times, Apr. 2, 1995, at A1 [hereinafter Dramatic Failure] (stating that rather than a trickle, the United States needed a "river" of investment if the bailout was to succeed).
A clear preference for post-petition loans and a hierarchy of preferences among post-petition loans would also be useful in averting a repetition of the dispute which arose between the Europeans and Americans following the bailout. Still smarting from the United States' failure to consult with them in arranging the bailout, officials at the BIS insisted that their loans have some repayment priority over the United States' own $20 billion. The BIS officials felt that because they were pressured to extend loans for an essentially American problem, the United States' funds should be the first in and the last out. This repayment preference, however, was never accepted by the United States.

3. Plan of Readjustment

Upon the grant of an automatic stay, the petitioning nation would have the exclusive right to file a plan of adjustment under the international Chapter 9. While the bondholders would not have a right to file a plan, they would have the right as creditors to vote on a plan and object to the confirmation of the plan. Mexico, given the chance, may have filed a plan under which it would have rescheduled its quickly maturing tesobonos debt, staggering its repayment and offering more attractive interest rates for a longer maturity period. Alternatively, rather than rescheduling, Mexico may have tried to repay the bonds by raising new money through private lenders, offering its oil revenues as collateral.

In formulating a plan of repayment and preferences, the petitioning nation could draw upon various historical methods of classifying its creditors. In the past, repayment preferences have been attached to bonds issued for the economic and financial rehabilitation of the country. Similarly, repayment preferences have been given to loans that were incurred under a newly formulated readjustment plan and intended to assist an insolvent debtor to repay previous loans. In

266. See infra notes 275-77 and accompanying text.
267. See Mexico Rift, supra note 120, at 5.
268. See Graham et al., supra note 1, at 4.
269. See Mexico Rift, supra note 120, at 5.
270. See id.
271. See supra notes 220-26 and accompanying text.
272. See supra note 226 and accompanying text.
273. See Ackerman & Dorn, supra note 133, at 21.
274. See Sachs, supra note 2, at 18.
275. See Edwin Borchard, State Insolvency and Foreign Bondholders 341 (1951). For example, Greece in 1898, granted a preference for a floating gold debt because these loans allowed the banks of Greece to resume regular financial transactions. Id. at 342.
276. Id. at 342 & n.15 (Greece, in 1898, and Mexico, in 1930, gave preferences for loans that were issued to discharge obligations under a debt readjustment plan).
other cases, repayment priority has been given to loans based simply on the chronological order in which the loans were received.\textsuperscript{277}

To comment on the plan, foreign tesobonos bondholders could organize themselves into a committee.\textsuperscript{278} Unlike the 1980s, where a tripartite decision-making structure, involving the sovereign debtor, the IMF, and commercial banks, renegotiated loans, the current bankruptcy negotiation will involve bilateral negotiations between the sovereign debtor and the committee of bondholders.\textsuperscript{279} Hopefully, national governments including the United States will encourage their citizens to organize bondholders' protective committees similar to those that emerged during the debt crisis in the early twentieth century.\textsuperscript{280} These committees would have the power to investigate all matters regarding the debtor relevant to the formulation of a plan, to participate in negotiations and discussions with the debtor, and to perform any other services in the interests of the creditors represented by the committee.\textsuperscript{281}

The IBA would have the authority to evaluate formally the debtor's economic situation in order to objectively ascertain its economic circumstances.\textsuperscript{282} After this evaluation, the IBA would determine whether the plan proposed by the debtor nation was formulated in good faith, whether the plan was in the best interest of creditors, and was feasible.\textsuperscript{283} The agency, upon approving the plan, would issue a binding plan of readjustment similar to that achieved under Chapter 9.\textsuperscript{284} The agency then would have the power to monitor the debtor's faithful compliance with the plan.\textsuperscript{285}

\begin{itemize}
\item \textsuperscript{277} Id. at 344.
\item \textsuperscript{278} See MacMillan, supra note 108, at 337.
\item \textsuperscript{279} Id. at 344.
\item \textsuperscript{280} See id. at 337-38. After the stock market crash in the United States in 1929, the ensuing worldwide depression caused defaults throughout Europe and Latin America. Borchard, supra note 275, at 193. The State Department, in the wake of this crisis, established the Foreign Bondholders' Protective Committee, an autonomous committee which was incorporated on December 13, 1933 to negotiate with sovereign debtors. Id. at 193-196. The State Department wanted to avoid entangling itself in the readjustment negotiations while also lending some governmental support to the efforts of the bondholders' committee. See id. at 193. The bondholders committee's power was derived from its semi-official status. Id. at 198. While the committee did not have binding authority to make decisions for the bondholders, its recommendations carried considerable weight. Id.
\item For an overall discussion of the 1930s bond defaults, see Barry Eichengreen & Richard Portes, Debt and Default in the 1930s, 30 Eur. Econ. Rev. 599 (1985).
\item \textsuperscript{281} See supra note 225 and accompanying text.
\item \textsuperscript{282} A Middle Way, supra note 48, at 33.
\item \textsuperscript{283} See supra note 229 and accompanying text.
\item \textsuperscript{284} See Brett H. Miller, Note, Sovereign Bankruptcy: Examining the United States Bankruptcy System as a Forum for Sovereign Debtors, 22 Law & Pol'y Int'l Bus. 107, 126-27 (1991).
\item \textsuperscript{285} See A Middle Way, supra note 48, at 34.
\end{itemize}
In a readjustment process, the IBA may lengthen the financing of the principal and interest over a longer maturity or may write down debts to match the debtor's economic capacity to repay. Because each creditor has an incentive to wait and see if the other creditors make concessions while holding out for a full repayment of its own claim, a cramdown provision is necessary to prevent a “free rider” problem. The cramdown power forces dissenting creditors to accept terms agreed upon by a qualified majority of creditors.

The IBA, to enforce the cramdown, could rely upon the IMF's Section 2(b) powers. Section 2(b) creates extraterritorial recognition of foreign exchange controls in IMF member states. The IMF's Articles of Agreement VIII (2)(b) provides that “exchange contracts” involving an IMF member that are contrary to an IMF sanctioned exchange control regulations are unenforceable. This provision is binding upon all members of the IMF and their respective judicial and administrative authorities. The IMF could plausibly sanction the

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286. Sachs, supra note 2, at 11.
287. See id.; A Middle Way, supra note 48, at 33.
288. See supra notes 227-33 and accompanying text.
289. Sachs, supra note 2, at 19; see Christopher Greenwood & Hugh Mercer, Considerations of International Law, in What Crisis?, supra note 253, at 105, 111.

Section 2(b) of Article VIII of the IMF Agreement provides:

Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, co-operate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

Articles of Agreement of the International Monetary Fund, December 27, 1945, art. VIII § 2(b), 66 Stat. 1401, 2 U.N.T.S. 39 (1944) [hereinafter Articles of Agreement].

290. Gerhard Wegen, 2(b) or Not 2(b): Fifty Years of Questions—The Practical Implications of Article VIII Section 2(b), 62 Fordham L. Rev. 1931, 1933-34 (1994).

291. Conflicting interpretations exist as to which financial obligations constitute an “exchange contract.” Id. at 1937. The United States and the United Kingdom define “exchange contract” in the narrowest sense, interpreting it only to cover a contract whose subject is the exchange of currency. Id. This interpretation would include bond purchases that involve international payments and transfers. See Edwards, supra note 8, at 485.

In contrast, continental legal systems interpret “exchange contract” to apply to the sale of goods and services that would impact a nation’s level of foreign reserves. Wegen, supra note 290, at 1938. Under this broad interpretation, virtually any contract would be an “exchange contract,” including a bond purchase because of its potential impact on a nation’s foreign reserves. Id.

292. Judicial decisions generally interpret “exchange control regulations” to include “all regulations that take the form of direct controls on international payments or transfers.” Edwards, supra note 8, at 480.

293. For example, had Mexico imposed IMF-approved exchange controls after the onset of the capital flight, international bondholders could not attempt to enforce their claims in the courts of IMF member states.

294. Id. at 478.
cramdown as a valid "exchange control regulation" and bonds issued to investors could be classified as "exchange contracts."295 Under this interpretation of Section 2(b), creditors could not challenge a cramdown by attempting to redeem their maturing bonds or attaching the debtor's assets in the national courts of their respective states.296

B. The Emergency Financing Mechanism Proposal

As an alternative to the IBA, world leaders, at the Halifax summit, offered a second proposal, the establishment of an Emergency Financing Mechanism.297 The G-10298 members of the General Arrangements to Borrow299 envision the EFM as a set of specific procedures to provide "quick, front-loaded financing [to debtor nations] with strong safeguards" for repayment.300 The EFM will be financed by doubling the resources of the GAB, which currently stand at about $27 billion,301 with separate lines of credit from non-GAB member countries who have current account surpluses.302 Thus, the establishment of the EFM rescue procedures will not alter the existing membership of the GAB303 and the EFM's policies will be modelled largely after those of the GAB.304 This subpart discusses the GAB, and then discuss specifically how the EFM would function as an international lender of last resort.

1. The General Arrangements to Borrow

The GAB is an arrangement of credit lines established by the G-10 in 1962.305 The GAB was established in response to erratic short-term capital flows which were disrupting overall liquidity positions and rates.306 To assist countries suffering short-term capital outflows, the

295. See supra notes 7-10 and accompanying text.
296. See Hurlock, supra note 48, at 12; Sachs, supra note 2, at 19.
297. See supra notes 42-47 and accompanying text.
298. The Group of Ten are the United States, the United Kingdom, Canada, France, Italy, Japan, Netherlands, Belgium, Federal Republic of Germany, and Sweden. Edwards, supra note 8, at 288. Later, the Swiss National Bank was added as an authorized lender. Id.
299. See infra notes 305-19 and accompanying text.
301. See supra note 43 and accompanying text.
302. Camdessus Hopeful, supra note 300, at A194. At this point, it is still unclear which members of the international community will supply the additional funding. See infra note 366 and accompanying text.
303. See Camdessus Hopeful, supra note 300, at A194.
306. Id. at 2.
IMF borrows from the GAB as a supplemental resource when the funds in the General Resources Account are inadequate. GAB resources were originally for the exclusive use of the ten members of the GAB and were intended to deter speculation by displaying to the markets that the IMF has adequate resources to keep currencies stable. The IMF may borrow from GAB members who are experiencing capital inflows to assist other GAB members who are suffering capital outflows. The GAB, however, does not automatically disburse funds to needy members, nor does it promise to lend money in advance of agreed upon policy reforms. In fact, the GAB requires a five-step process before activating its resources. First, an IMF member-nation must consult with the Managing Director of the IMF to determine whether GAB intervention is necessary. Second, the Managing Director consults with the other contributors to the GAB and the Executive Directors of the IMF. The Managing Director will then issue a proposal for calls to inquire into the amount of money each GAB contributor is willing to lend to the requesting country. The proposal must then be unanimously approved by the participants in the GAB, after which the IMF’s Executive Board must approve the arrangement as the fifth and final step in the approval process. After reaching an arrangement, the IMF will administer a standby arrangement for the disbursement of the loan.

2. The EFM’s Function as Lender of Last Resort

Proponents envision the EFM as a set of procedures to be established within the existing GAB to provide quick and temporary aid to

307. See supra note 123.
308. Edwards, supra note 8, at 287-88.
309. Id. at 288. After 1983, IMF members who did not contribute to the GAB were allowed to borrow from the GAB, but they were required to meet stricter conditions. Halifax, supra note 24, at CRS-4.
310. Ainley, supra note 305, at 11.
311. Id. at 11. The IMF, when it borrows from the GAB, promises to pay interest and to make repayments within five years to the participant lenders. Edwards, supra note 8, at 290.
312. Bergsten Statement, supra note 304, at 433.
313. The Managing Director of the IMF is the chairperson of the Executive Board and is selected by the Executive Board. Edwards, supra note 8, at 30. The Managing Director heads and directs the staff of the IMF. Id.
314. Ainley, supra note 305, at 15.
315. Id.
316. Id. The Managing Director usually requests from a GAB member an amount in proportion to its contribution. Id. at 17.
317. Id. at 15. If unanimous approval by the participants cannot be reached, a binding weighted vote will be taken. Id.
318. Id. at 15-16. The Executive Board is responsible for the general operations of the IMF. Edwards, supra note 8, at 28. It consists of 22 Directors and is chaired by the Managing Director. Id. at 29. Although 5 Directors are appointed by the 5 countries who contribute the largest quotas, the other 16 are elected for two year terms. Id.
319. See Edwards, supra note 8, at 289; see supra note 167.
countries suffering from a speculative creditor panic. The EFM will function as an international lender of last resort ("LLR") analogous to the Federal Reserve in the domestic context.\textsuperscript{320} In the domestic context, an LLR's function is to protect solvent banks suffering a speculative panic among their depositors.\textsuperscript{321} Bank runs, absent a lender of last resort, are a constant threat because depositor confidence is fragile.\textsuperscript{322} Depositor perceptions are susceptible to misinformation and inaccurate judgments about the quality of the bank's loans because accurate data is difficult or impossible to obtain.\textsuperscript{323} Consequently, high-strung creditors may "run" on any sign of financial downturn, leading to contagion and a possible systemic financial crisis.\textsuperscript{324}

An effective LLR, to prevent such a panic, must possess certain characteristics. First, unlike other lenders who might demand assurances of repayment prior to a loan, an LLR needs no such assurance because it will have better information than private-market depositors about the soundness of a financial institution. An LLR will be committed to act immediately and prior to the negotiation of a repayment plan.\textsuperscript{325} Furthermore, the LLR must have the resources to manage the largest potential crisis in order to properly maintain investor confidence during periods of financial stress.\textsuperscript{326} Finally, an LLR must be able to prevent the moral hazard that might result from its presence.\textsuperscript{327}

The Mexican crisis demonstrated that the international securities market is susceptible to crises similar to domestic bank runs, exposing the need for an international LLR analogous to a domestic LLR. In Mexico, for example, because international investors faced imperfect information about Mexico's long-term solvency, they refused to roll over their credit.\textsuperscript{328} Mexico, like a domestic bank, was also heavily indebted on short-term loans and thus was subject to the intemperances of the fragile confidence of its investors.\textsuperscript{329} Finally, because of

\begin{itemize}
\item \textsuperscript{320} See Sachs, \textit{supra} note 2, at 18.
\item \textsuperscript{321} See Jack Guttentag and Richard Herring, \textit{The Lender-of-Last-Resort Function in an International Context} 4 (Essays in Int'l Fin. No. 151, 1983).
\item \textsuperscript{322} \textit{Id.} at 6.
\item \textsuperscript{323} \textit{Id.}
\item \textsuperscript{324} \textit{Id.}
\item \textsuperscript{325} \textit{Id.} at 5-6. "Central to the LLR function is a willingness to accept a risk unacceptable to other lenders." \textit{Id.} at 4.
\item \textsuperscript{326} \textit{Id.} at 10.
\item \textsuperscript{327} \textit{Id.} Two types of moral hazard can result from the presence of an LLR: (1) an LLR may reduce the risk of engaging in highly speculative investments and therefore may encourage such activity and; (2) an LLR may encourage those who are near insolvency to "go-for-broke" in order to obtain LLR assistance. \textit{Id.}
\item \textsuperscript{328} Mexico's crisis was one of short-term illiquidity, as opposed to long-term insolvency, although investors raced to withdraw their money. \textit{See supra} notes 101-04 and accompanying text.
\item \textsuperscript{329} \textit{See supra} notes 159-64 and accompanying text. In the international financial system, confidence among investors is even more fragile than in the domestic context. Guttentag & Herring, \textit{supra} note 321, at 2. Perceived risk among international inves-
the globalization of the securities markets, the risks of contagion and a systemic crisis emanating from Mexico were great.\textsuperscript{330}

In sum, the establishment of the EFM would ostensibly provide international safeguards similar to those provided by a domestic LLR. The EFM as a lender of last resort would serve to assure investors, in advance of a speculative investor panic, that their investments enjoy protection and that speedy, short-term relief is available should a panic occur. Proponents of the EFM argue that it would deter the onset of a crisis mentality by displaying to the markets in advance of a panic that it is authorized to lend a large sum of money to a temporarily illiquid nation in the event a panic materializes. The next part demonstrates, however, that the EFM will fail as an effective LLR.

IV. TWO PROPOSALS COMPARED: THE IBA IS THE MORE EFFECTIVE SOLUTION TO MANAGE "POST-MODERN" SOVEREIGN DEBT CRISES

This part compares the EFM proposal with the IBA proposal in light of three factors and argue that the IBA proposal is preferable. This part also argues that the IMF is the proper organization to establish the IBA. Because the IMF is an inherently political organization, however, the IMF, following the World Bank’s establishment of the International Center for the Settlement of Investment Disputes ("ICSID") and the Multilateral Investment Guarantee Agency ("MIGA"), should organize the IBA as a separate and independent affiliate.

A. Three Primary Considerations

The international community, following the Mexican crisis, recognized the urgent need to establish procedures to manage the next "post-modern" crisis. Three considerations are critical in deciding the type of mechanism to establish: (1) whether the mechanism can act quickly and decisively; (2) whether the mechanism can prevent a moral hazard; and (3) whether the mechanism can respond to multiple and simultaneous crises. The following discussion will demonstrate that the IBA is better able to satisfy these three criteria.

1. The Speed With Which the Mechanism Can Respond to Speculative Creditor Panics

The EFM, operating under policies similar to those that govern the GAB, will not promise to lend money to a debt-ridden country in ad-

\textsuperscript{330} See supra notes 152-56 and accompanying text.
vance of a crisis.\footnote{331} Rather, following traditional GAB policies, the EFM will demand policy reforms prior to the approval of a rescue loan to ensure prompt repayment.\footnote{332} This prerequisite, however, undermines an essential function of an LLR: its willingness to provide emergency funding in advance of policy reforms to maintain creditor confidence.\footnote{333} Traditional requirements of consultation and negotiation were feasible in the 1980s when the primary lenders were commercial banks who were restrained by sharing clauses\footnote{334} and a collective sense of doom should any of them act individually.\footnote{335} Lending in the 1990s, however, comes primarily from thousands of individual bondholders.\footnote{336} There is, therefore, a greater risk of panic in the 1990s because the bondholders are not similarly restrained and thus less prone to act collectively. The EFM, contrary to its stated policy, must be “willing[ ] to accept a risk unacceptable to other lenders” and it must guarantee the prompt award of aid prior to securing policy reforms.\footnote{337} Otherwise, the result of any EFM loan will be “too little, too late.”\footnote{338} By the time the EFM loan arrives, the debtor government will be under an onslaught from its creditors.

A bankruptcy forum, because it is not a lender but a regulator, would be able to act quickly and decisively.\footnote{339} Unlike the EFM, which is directly lending taxpayer dollars and must be circumspect in its lending, the IBA is simply facilitating the receipt of new loans by the debtor country from post-petition creditors.\footnote{340} Thus, while EFM policies intrinsically resist quick action, the IBA may immediately impose an automatic stay upon the filing of a bankruptcy petition to impose collectivity on the creditors and forestall a race to grab available assets.\footnote{341} It can thus quarantine a debtor state from its creditors while

\footnote{331. See Camdessus Hopeful, supra note 300, at A194 (“We will never say in advance, never be committed to rescue a country because it is a country. . . . We will only do that . . . in proportion of the effort of the country to put its house in order.”); George Graham, IMF Crisis Plan Draws on Mexican Lesson, Fin. Times, Oct. 2, 1995, at 6 (“Even with new procedures . . . smooth consultation [in the EFM] may be difficult when, as in the Mexican crisis, a decision is needed overnight.”) [hereinafter IMF Crisis Plan]; see supra part III.B.}
\footnote{332. See supra notes 312-19 and accompanying text.}
\footnote{333. See supra note 329 and accompanying text.}
\footnote{334. A sharing clause is a provision introduced into a syndicated bank loan to prevent a single rogue bank from recovering a disproportionate share of repayment after a debtor defaults. Lee C. Buchheit & Ralph Reisner, The Effect of the Sovereign Debt Restructuring Process on Inter-Creditor Relationships, 1988 U. Ill. L. Rev. 493, 502. For a general discussion about maintaining the commitment of sovereign lenders through syndicates, see Asiedu-Akrofi, supra note 137, at 1.}
\footnote{335. See infra notes 382-84 and accompanying text.}
\footnote{336. Cline, supra note 67, at 481.}
\footnote{337. See Guttentag & Herring, supra note 321, at 4.}
\footnote{338. See Sachs, supra note 2, at 21.}
\footnote{339. See id.}
\footnote{340. Id.; see supra notes 260-70 and accompanying text.}
\footnote{341. See supra notes 255-59 and accompanying text.}
collective, disinterested analysis establishes the true situation and devises the best course of action.\footnote{Suratgar, supra note 48, at 497.}

2. The Prevention of Moral Hazard

The EFM creates a moral hazard because it distorts the view among both governments and investors that portfolio investment is a venture that they enter into at their own risk.\footnote{Greenspan Testimony, supra note 24, at 8; see Minton-Beddoes, supra note 105, at 130-31; Ackerman & Dorn, supra note 133, at 21; Halifax, supra note 24, at CRS-5.} Under the EFM proposal, national governments will marshall public taxpayer money to soften the misfortune visited upon risk-taking portfolio investors.\footnote{Id. For a viewpoint that argues that no valid reason supports LLR lending and that it always generates a moral hazard, see Roland Vaubel, The Moral Hazard of IMF Lending, World Economy, Sept. 1983, at 291.} Future investors, relying on a forecasted EFM bailout, will engage in risky investing because their losses ultimately will be borne by creditor governments and multilateral financial institutions.\footnote{See Minton-Beddoes, supra note 105, at 131. Further, authorizing an international LLR to lend enormous sums of money to countries suffering an "unjustified" speculative attack is impractical due to the absence of any objective measure to determine how much money is necessary to prevent the panic. Id. For a viewpoint that argues that no valid reason supports LLR lending and that it always generates a moral hazard, see Roland Vaubel, The Moral Hazard of IMF Lending, World Economy, Sept. 1983, at 291.} With the availability of the EFM, moreover, investors will downgrade the potential risks of an emerging market. A two-tier market will result where investors will classify emerging economies either as one the EFM is likely to aid or one that the EFM is likely to ignore.\footnote{Ip, supra note 127, at 10. This undercuts the IMF's widely praised practice during the 1982 debt crisis of pressuring commercial banks to issue involuntary loans as a condition for new IMF money. See MacMillan, supra note 108, at 318. The IMF forced banks to issue these loans because it was more appropriate for private creditors and borrowers to participate actively in their own debt renegotiation than for the IMF to act as a lender of last resort. Id. The involuntary loans extracted from the banks were the price they paid for their poor lending judgment. See id. at 318-19. If the IMF had shouldered the burden of lending money alone without additional bank aid, the IMF would have undertaken the responsibility of debt repayment to the banks, relieving the debtor of its responsibility and rewarding the irresponsibility of commercial banks. See Ip, supra note 127, at 10.} A country like Mexico, confident that the health of its economy was vital to the global econ-

\footnote{Naim, supra note 24, at 128; see Ip, supra note 127, at 10.}

\footnote{See Ackerman & Dorn, supra note 133, at 21.}
omy, would treat the EFM as "no fault" insurance for its economic mishaps. 347

The EFM, to prevent a moral hazard, has proposed a number of tactics. In addition to maintaining strictly the ad hoc nature of its loans and refusing to promise aid in advance of agreed upon policy reforms, 348 the EFM will have two requirements. First, there must be an actual risk of contagion to result foreseeably from a debtor state's economic demise. 349 Second, the EFM will impose severe conditions on a recipient nation's economic policies in return for a loan. 350

These policies are of questionable value in eliminating a moral hazard. The EFM's ad hoc policy is antithetical to the primary purpose of an LLR. 351 An effective LLR must promise money in advance of agreed upon policy reforms in order to prevent possible confidence crises. 352 If investors must speculate about the provision of aid to a country in economic crisis, then the LLR has abdicated its primary function. Furthermore, imposing strict conditions to prevent moral hazard is counterproductive. Following the bailout, the austere conditions imposed on Mexico were predicted to send Mexico into a recession. 353 Because of the stringency of the conditions imposed on Mexico, investors feared that the "draconian" terms would produce not just a "cleansing recession, but a revolutionary despair." 354

The availability of an international Chapter 9 is preferable to the EFM because it will not create a moral hazard. 355 A readjustment

347. See Vaubel, supra note 343, at 293. Notably, a similar moral hazard problem exists with the EFM's domestic counterpart, the Federal Reserve. See Garcia & Plautz, supra note 173, at 167-68. Lender of last resort lending by the Federal Reserve interferes with market forces which reward the productive and punish the unproductive. Thus, the "financial safety net . . . has removed many of the anti-risk incentives at depository institutions." Id. at 167. For a more in-depth discussion of this issue, see Edward J. Kane, Appearance and Reality in Deposit Insurance: The Case for Reform, 10 J. Banking & Fin. 175 (1986).

348. See supra note 331 and accompanying text.

349. Id., supra note 10.

350. Id. As a condition of the 1995 bailout, the Mexicans agreed to produce a budget surplus, reduce credit growth, and provide frequent and detailed reports of its economic and financial status. Id. at 10. Mexico agreed to raise gasoline prices by 35% and electricity by 20%. Anthony DePalma, Mexico Initiates an Economic Plan of Extended Pain, N.Y. Times, Mar. 10, 1995, at Al. Mexico's value added tax will increase to 15%. Id. The United States has also demanded that Mexico raise its interest rates to 60%. International Bankruptcy Code, supra note 48, at *4.

351. See supra note 325 and accompanying text.

352. Id.


354. Id. This fear is justified given that IMF conditions historically have been criticized for curing the ill patient by sending him into a coma. See Cheryl Payer, The Debt Trap: The International Monetary Fund and the Third World 47 (1974).

355. Hurlock, supra note 48, at 10 ("Experience has proved wrong those who feared that a bankruptcy debt discharge would tempt debtors into profligacy."); Nader Testimony, supra note 107, at 72 (arguing that rather than a bailout fund that sets terrible precedents and moral hazards, an organization should serve as a "referee" for a settlement between debtors and creditors where both make sacrifices).
under the international Chapter 9 will not provide an avenue for a debtor nation to procrastinate on fundamental economic reforms.\textsuperscript{356} Rather, the IBA, employing both internal and external pressures, can expedite the same deep economic reforms that the EFM intends to foster by its imposition of economic conditions in return for a bailout. Internally, sovereign debtors will undertake voluntary economic reforms to keep creditors "sweet" and to attract new lending to service their debts.\textsuperscript{357} Debtors, by their past cooperativeness, have displayed a genuine ambition to maintain continuing creditworthiness.\textsuperscript{358} Externally, the IBA acts as a third party in readjustment negotiations to judge not only the adequacy of the debtor's plan but also to monitor the debtor's behavior under the plan to ensure compliance.\textsuperscript{359} The body of precedent the IBA will eventually establish will set expectations to determine which petitions will be accepted, what procedures will be used, and the extent of debt readjustment that the debtor can expect.\textsuperscript{360}

3. The Ability to Handle Multiple Liquidity Crises Simultaneously

The Mexican bailout was enormous, totalling about one-half the value of Mexico's external debt in 1982.\textsuperscript{361} The United States intended to send a message to the international financial community that Mexico had the backing of the United States and the IMF and was worthy of continuing confidence.\textsuperscript{362} If, however, another Latin American country were to suffer a debt crisis in the near future, another $50 billion would not be available.\textsuperscript{363} An LLR, however, "should have resources which, if not unlimited, are well in excess of the largest needs that it is likely to face in a crisis."\textsuperscript{364} In the domestic context, because the Federal Reserve can print money, it has unlimited access to capital.\textsuperscript{365} Judging from the difficulty it has had in raising the additional capital to double the

\textsuperscript{356} See Sachs, supra note 2, at 14.
\textsuperscript{359} See A Middle Way, supra note 48, at 33-34.
\textsuperscript{360} See Oechsli, supra note 237, at 330.
\textsuperscript{361} See MacMillan, supra note 108, at 306.
\textsuperscript{362} Id.; see supra part I.B.
\textsuperscript{363} MacMillan, supra note 108, at 306.
\textsuperscript{364} Guttentag & Herring, supra note 321, at 10.
\textsuperscript{365} Garcia and Plautz, supra note 173, at 43.
GAB, the EFM would be unable to undertake several large crises at once. Because the EFM will not have adequate resources, it will not be able to maintain properly the confidence of creditors and ensure they act collectively.

In contrast, the IBA, because it is a regulator, not a lender, can review and grant multiple petitions from sovereign debtors for an automatic stay against creditor repayment demands. The IBA’s ability to manage multiple crises is necessary in today’s era of short-term portfolio finance when multiple countries may simultaneously face a shortage of capital during a creditor exodus. The United States assumed that easing the crisis in Mexico would in turn calm the financial markets in other emerging markets. The “Neighborhood Effect,” however, raises the possibility that financial markets would conclude that other countries with similar economic circumstances as Mexico needed similar arrangements and would withdraw their money from those countries as well. The IBA, by issuing automatic stays and convening multiple arbitration panels, can effectively manage the “neighborhoods.”

B. The IMF Should Organize the International Bankruptcy Agency As a Separate and Independent Affiliate

The IMF should organize the IBA because the IMF specializes in aiding countries in short-term liquidity crises and the IMF is already the central coordinating institution of sovereign debt. Further, organizing the IBA affords the IMF an opportunity to reestablish itself in its original role as lender to sovereign debtors who need short-term liquidity funding. The IMF, however, is an inherently political organization. Thus, following the model of the World Bank Group, it should establish the IBA as a separate and independent affiliate under the IMF umbrella.

1. The IMF Specializes in Aiding Countries in Liquidity Crises

The Bretton Woods Agreement established the IMF precisely to manage liquidity crises similar to the one Mexico suffered in 1995.
Since its inception at Bretton Woods in 1944, the IMF has had two responsibilities: the management of international liquidity and cooperative balance of payment adjustments. The IMF's founders envisioned the organization as one that would provide temporary aid to nations in balance of payment difficulties in order to avoid restrictive trade practices and promote a code of good monetary behavior.

In accord with the IMF's purposes, the Mexican crisis in 1995 represented a disruption in temporary cash flow, not a failure of long-term solvency. In the late 1980s, Mexico enacted long-term structural

The IMF was established in 1944 in Bretton Woods, New Hampshire. Asherman, supra note 167, at 235. Article I of the Articles of Agreement enunciates the purposes of the IMF:

I) To promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

II) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

III) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

IV) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

V) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

VI) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Articles of Agreement, supra note 289, art. I.


The Bretton Woods participants, during the interwar period, had engaged in competitive currency devaluations, multiple currency practices, exchange controls and import licensing, all which hindered international trade and global prosperity. Edwards, supra note 8, at 4. Nations realized that a lack of adequate foreign reserves to finance balance of payments deficits was often the cause of destructive trade practices. See MacBean & Snowden, supra note 88, at 37. The IMF was established to lend money under these circumstances and to encourage global monetary cooperation. Asherman, supra note 167, at 235-36.


To this end, the IMF administers the General Resources Account, a pool of monetary assets from which members can draw to meet their balance of payments needs. Edwards, supra note 8, at 12; see supra note 123.

376. See supra note 101.
economic reforms, diversifying its exports and privatizing its economy.\textsuperscript{377} In early 1995, Mexico simply needed a temporary injection of liquidity until it had replenished its foreign reserves through oil sales.\textsuperscript{378} When capital began fleeing before the oil revenues materialized and sizable foreign loans did not appear likely to be granted quickly, Mexico was forced to resort to a destructive devaluation of its currency.\textsuperscript{379} Under these circumstances, the IMF would typically extend a loan to Mexico to aid it with its current account deficit.\textsuperscript{380}

The Mexican crisis, however, confronted the IMF with a scenario it had not previously encountered.\textsuperscript{381} Rather than syndicated bank loans and potential mass ruin restraining individual action by large commercial banks, the IMF in early 1995 encountered a multitude of panicking private portfolio investors and bondholders.\textsuperscript{382} Technological innovations permitted these investors to dump their Mexican investments at the touch of a computer button,\textsuperscript{383} constricting the time frame in which the IMF could act. Furthermore, the immense volume of short-term portfolio investment fleeing Mexico required an amount of money far above what the IMF is normally authorized to lend.\textsuperscript{384}

As the administrator of the IBA, the IMF would be better equipped to deal with these new developments in international investment. The IMF would have the authority to react immediately to a crisis in investor confidence by imposing an automatic stay.\textsuperscript{385} The IMF, simultaneously, would be fulfilling its original role established at Bretton Woods by aiding a temporarily illiquid nation encumbered by a large current account deficit.\textsuperscript{386}

2. The IMF Is the Primary Coordinator of Sovereign Debt Readjustment

The IMF is already the primary coordinating institution of debt management.\textsuperscript{387} Following the 1982 debt crisis, when developing countries turned to the IMF for money to service their debts, the IMF was unwilling to impose unilateral adjustment programs on the developing countries.\textsuperscript{388} Instead, the IMF presided over a quid pro quo system which conditioned the cooperation of commercial banks,

\begin{itemize}
\item \textsuperscript{377} Manzella, supra note 37, at 19.
\item \textsuperscript{378} See supra note 104 and accompanying text.
\item \textsuperscript{379} See supra part I.A.
\item \textsuperscript{380} See Camdessus Address, supra note 24, at 3.
\item \textsuperscript{381} See Cline, supra note 67, at 500.
\item \textsuperscript{382} See id.
\item \textsuperscript{383} See Greenspan Testimony, supra note 24, at 6.
\item \textsuperscript{384} See supra notes 123-26 and accompanying text.
\item \textsuperscript{385} See supra notes 255-59 and accompanying text.
\item \textsuperscript{386} See supra notes 373-75 and accompanying text.
\item \textsuperscript{387} See Bahram Nowzad, The Role of the IMF in Rescheduling International Debt, in Default and Rescheduling: Corporate and Sovereign Borrowers 131, 133 (David Suratgar ed., 1984).
\item \textsuperscript{388} See Asherman, supra note 167, at 296.
\end{itemize}
debtor nations, and the IMF upon the participation of all three parties.\textsuperscript{389} The IMF required the banks to provide fresh loans to debtor states and required debtor states to institute harsh adjustment programs as preconditions for an IMF loan.\textsuperscript{390} Later, a reciprocal requirement materialized under which the IMF and the commercial banks together shaped ways to refinance a debtor country's debts.\textsuperscript{391} The IMF would provide aid to a debtor only if the country's IMF-approved adjustment program included commercial lending.\textsuperscript{392} The banks, in turn, would lend only to countries which had implemented an IMF-approved adjustment program.\textsuperscript{393} This close cooperation between the IMF and the commercial banks enhanced creditor solidarity and forged a strong relationship between the IMF and the commercial banks.\textsuperscript{394} The IMF acted as a "unifying vehicle to internalize for [investment] banks as a whole the external benefits that the rescue package would confer on them."\textsuperscript{395}

As the administrator of a bankruptcy agency, the IMF would continue in this capacity as a "unifying vehicle." It would force bondholders to act collectively to allow the debtor to readjust its debt. The IMF, in return, would protect creditors by overseeing a country's reorganization plan in a manner similar to the IMF oversight of a debtor nation's adherence to an IMF standby arrangement.\textsuperscript{396} Unlike the IMF's past practice of pressuring debtors into accepting conditions unilaterally prescribed by the IMF,\textsuperscript{397} the IBA would allow both debt-

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  \item \textsuperscript{389} See MacMillan, supra note 108, at 319.
  \item \textsuperscript{390} See Asherman, supra note 167, at 297.
  \item \textsuperscript{391} See MacMillan, supra note 108, at 320.
  \item \textsuperscript{392} Id.; see Richard W. Edwards, Jr., Is an IMF Stand-By Arrangement a "Seal of Approval" on Which Other Creditors Can Rely?, 17 N.Y.U. J. Int'l L. & Pol. 573, 573-74 (1985).
  \item \textsuperscript{393} MacMillan, supra note 108, at 320.
  \item \textsuperscript{394} Id. at 320-21.
  \item \textsuperscript{395} Id. at 318 (quoting William R. Cline, International Debt: Systemic Risk and Policy Response 75 (1984)).
  \item \textsuperscript{396} See supra note 167 and accompanying text.
  \item \textsuperscript{397} The IMF has been the object of accusations that it imposes its economic conditions at the expense of a nation's welfare. Melissa H. Birch, The International Monetary Fund, in Dealing with Debt: International Financial Negotiations and Adjustment Bargaining 19, 25 (Thomas J. Biersteker ed., 1993); see John Williamson, On Seeking to Improve IMF Conditionality, 73 Am. Econ. Rev. 354, 357 (1983). Critics suspect that the IMF unilaterally imposes austere conditions to ensure that large commercial banks from the northern hemisphere are repaid at the cost of the political stability of a debtor nation. Oechsli, supra note 237, at 322. In addition, the IMF faces accusations that it unilaterally imposes the same economic prescriptions on all debtor countries, regardless of their individual circumstances. See Sidney Dell, Stabilization: The Political Economy of Overkill, in IMF Conditionality 17, 22 (John Williamson ed., 1983); see also A Modest Proposal, supra note 43, at 20 (stating that the IMF treats "deep structural problems as short-term liquidity crises").

Historically, the net effect of IMF-imposed policies was to lower the standard of living in the debtor countries by causing unemployment and increasing the price of goods for the entire population. Brian Trubitt, Note, International Monetary Fund
ors and creditors to participate in fashioning the plan of adjustment.\textsuperscript{398} Under the IMF's oversight, debtors can fashion a plan of adjustment according to their own perceived best interests and creditors can comment on and object to the plan.\textsuperscript{399}

3. The IMF Can Reassert its Original Role in World Affairs

An increasing need is present among both developing and developed countries for an agency that can respond to spontaneous and unexpected shifts in market psychology among portfolio investors, and provide aid for subsequent short-term liquidity crises.\textsuperscript{400} The Mexican crisis demonstrated that neither the IMF nor any international organization, as presently constituted, has the speed or resources to cope in today's capital markets where a massive outflow of short-term foreign capital can result from the touch of a computer button.\textsuperscript{401} The IMF, acting as an international bankruptcy agency, would fill this vacuum in international financial management while reasserting its original role as lender to temporarily illiquid nations.\textsuperscript{402} Although the Bretton Woods organizers originally envisioned the IMF as a global organization to aid all countries in short-term liquidity crises, the IMF has strayed from that original purpose.\textsuperscript{403} The IMF has "lost most of its relevance" for developed countries\textsuperscript{404} and has been rele-


\textsuperscript{398} See supra part III.A.3.

\textsuperscript{399} See supra notes 224-26 and accompanying text.

\textsuperscript{400} See supra part I.C.

\textsuperscript{401} While the IMF was designed as an "international lender of last resort," Sachs, supra note 2, at 3, "[t]he IMF as currently constituted is simply not large enough to deal with [the Mexican crisis] itself" nor can it react quickly enough to respond effectively to confidence crisis. \textit{U.S. and International Response to the Mexican Financial Crisis: Hearings before the House Comm. on Banking and Financial Services}, 104th Cong., 1st Sess. 13, 20 (1995) (statement of Warren Christopher, Secretary of State).

\textsuperscript{402} See Minton-Beddoes, supra note 105, at 126-27.

\textsuperscript{403} Id.

\textsuperscript{404} Id. at 127. The demise of the original par value system, which had empowered the IMF to oversee global exchange rates, was a serious blow to the IMF's normative powers from which it has never fully recovered. Carreau, supra note 375, at 1995. The par value system was a system of officialized and mandatory exchange rates supervised by the IMF. \textit{Id.} at 1994. Under the Articles of Agreement, states agreed: (1) to value their currencies according to the prevailing value of gold; (2) to maintain this value; and (3) to refrain from modifying this par value without first seeking IMF approval. \textit{Id.} This par value system collapsed when President Nixon announced the United States' withdrawal from the par value system and allowed the dollar to float. \textit{Id.}

Developed, industrial countries are now coordinating their exchange rates outside of the IMF. See Minton-Beddoes, supra note 105, at 127. Furthermore, because the Eurocurrency markets provide a source of unconditional finance, developed countries no longer turn to the IMF for funding. \textit{Id.} For the developed countries, the IMF "collates useful statistics, undertakes useful economic research, and occasionally rec-
gated to controlling the finances of developing countries. The IMF now primarily extends long-term loans to developing countries to enable them to "grow their way out of their extreme debt burden." The IMF's involvement in providing long-term aid, however, encroaches upon the activities originally reserved for the World Bank. Consequently, the significant overlap in their functions has led to calls for an IMF/World Bank merger. By renewing its focus on countries with temporary liquidity problems in its capacity as an IBA, the IMF can distinguish its role from that of the World Bank.

C. The IMF Should Establish the IBA As an Independent and Separate Affiliate

The IMF, as presently constituted, cannot act as a neutral arbiter of provisions similar to those found in Chapter 9 of the Bankruptcy Code. The IMF, unlike most public international law organizations, follows a weighted voting system under which voting power is based on quota size. In this system, political considerations are often the

Eurocurrencies are those currencies that are transacted by banks outside of the country where the currency is issued and Eurocurrency markets are where these currencies are traded. Ronald I. McKinnon, The Eurocurrency Market 2 (1977).


407. See Carreau, supra note 375, at 1989-90. After the 1982 crisis, the IMF shifted its focus from aiding countries with temporary liquidity problems to aiding those who needed long-term structural reforms, a role originally envisioned for the World Bank. See Bradlow, supra note 123, at 405-06 (stating that the IMF was designed originally to deal with temporary balance of payments issues and not structural deficits); Edward S. Mason & Robert E. Asher, The World Bank Since Bretton Woods 34 (1973). For a discussion of the World Bank, see infra note 416.


409. Id. at 1989-90 (stating that the boundaries between the IMF and the World Bank have grown indistinct).

410. See Hurlock, supra note 48, at 10-11.

411. See William N. Gianaris, Weighted Voting in the International Monetary Fund and the World Bank, 14 Fordham Int'l L.J. 910, 921 (1990-91). Despite protests by other states who wanted equal representation under the doctrine of equality of states, this weighted voting system was implemented at Bretton Woods. See id. at 921-22. The doctrine of equality of states maintains that all states have equal legal rights and duties, and thus they are all entitled to one vote in international organizations regardless of their economic, political, or social differences. Malcolm N. Shaw, International Law 135-36 (2d ed. 1986).

Other organizations do not have weighted voting. For example, the United Nations Conference on Trade and Development ("UNCTAD"), which was created in 1964 to establish multilateral treaties to promote international trade, does not follow a weighted voting system. Gianaris, supra, at 934. Each member of UNCTAD has one
most important factors in decision making. Notably, the IMF has never made an important decision, "no matter how strongly supported by other members of the IMF, which did not meet with American approval." Consequently, a significant amount of distrust of the IMF exists in the developing world.

In contrast to the practices of the IMF, an IBA administering procedures similar to those found in Chapter 9 would have to exercise a relatively dispassionate supervision of bankruptcy cases. The establishment of the International Center for the Settlement of Investment Disputes and Multilateral Investment Guarantee Agency, two of the organizations within the World Bank Group, reflects an increasing international concern for the depoliticization of investment disputes and can serve as models for an IBA. The ICSID provides a forum

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412. Kendall W. Stiles, Negotiating Debt: The IMF Lending Process 6 (1991); see Minton-Beddoes, supra note 105, at 128. Wealthy countries, the primary contributors to the IMF General Resources Account and thus the ones with the most power, are also almost inevitably the major creditors in any sovereign debt crisis. Hurlock, supra note 48, at 11. The IMF has been criticized for aiming to increase the "liberalization of the international economic system and to directly sustain the economic viability of nations considered 'strategic allies' of the major creditors, rather than acting as [a neutral] international economic physician." Stiles, supra, at 6.

413. Asherman, supra note 167, at 257. Although weighted voting procedures exist, rarely is a vote held in the IMF. Gianaris, supra note 411, at 924. Generally, decisions are made by consensus. Id. Voting strength, nonetheless, is crucial in many aspects of IMF decision-making, such as the biennial election of executive directors as well as circumstances when decisions require the approval of special majorities. Id. at 924-25.

414. The Mexican crisis fueled this distrust. The IMF's contribution of $17.8 billion to the bailout reflects less the importance of Mexico to the global economy than upon its strategic importance to the United States. See Minton-Beddoes, supra note 105, at 128.


416. The World Bank was organized at Bretton Woods in 1944 as the sister organization of the IMF. Edwards, supra note 8, at 44. The World Bank's four affiliates—the International Finance Corporation ("IFC"), the International Development Association ("IDA"), the ICSID, and MIGA—form the World Bank Group. See Mason & Asher, supra note 407, at 79-82; Settlement of Disputes, supra note 240, at 98. Unlike the IMF, which was created to provide short-term balance of payments loans, the World Bank lends money for productive investment to underdeveloped countries. Gold, supra note 374, at 505. To join the World Bank, prospective members must first join the IMF. Edwards, supra note 8, at 45. The World Bank, too, follows a system of weighted voting. Id.

417. To depoliticize investment disputes and balance the interests of all parties, the ICSID gives foreign investors direct access to a neutral forum in which to arbitrate disputes in return for the investors' agreement to surrender the protection of the investors' home state. Kenneth S. Jacob, Note, Reinvigorating ICSID with a New Mission and With Renewed Respect for Party Autonomy, 33 Va. J. Int'l L. 123, 127 (1992).
for foreign investors and sovereigns to arbitrate their investment disputes.\textsuperscript{418} MIGA's aim is to stimulate investment in developing countries by insuring investments against non-commercial risks.\textsuperscript{419} Both organizations aim to create fair and impartial decision-making bodies by ensuring adequate representation of both developed and developing countries in investment disputes and to promote investment in developing countries.\textsuperscript{420}

The IMF, following the establishment of the World Bank's ICSID and MIGA, should create the IBA as a "depoliticized" affiliate to supervise the international Chapter 9 process.\textsuperscript{421} Through affiliation with the IMF, the IBA would function not only as a mechanism for

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MIGA seeks to minimize the political aspects of investment disputes by removing the home and host country from the dispute. Gregg B. Brelsford, \textit{International Investment Insurance—The Convention Establishing the Multilateral Investment Guarantee Agency}, 27 Harv. Int'l L.J. 735, 743 (1986). All investor claims are submitted to MIGA. Upon payment of the claim by MIGA, the investor will assign all rights related to the insured investment to MIGA and MIGA will pursue these rights against the host country. \textit{Id.} MIGA also has the authority to facilitate dispute settlement when disputes arise between investors and host countries. See Ibrahim F. I. Shihata, \textit{The Multilateral Investment Guarantee Agency}, 20 Int'l Law. 485, 496 (1986).

Rowat, \textit{supra} note 241, at 107. The ICSID settles disputes by empowering Conciliation Commissions and Arbitral Tribunals to issue binding decisions. See \textit{id.} at 111. Arbitral Tribunals usually consist of three panel members. \textit{Id.} Each party to the dispute appoints one member and a third is appointed by the agreement of both parties. \textit{Id.}

\textsuperscript{418} See \textit{id.} at 127.

\textsuperscript{419} See \textit{id.} at 127.

\textsuperscript{420} See \textit{id.} at 134. Neither organization has a traditional weighted voting structure like the IMF. In the ICSID, each participating state has one representative in the ICSID's governing body, the Administrative Council and each representative is entitled to cast one vote. See Greater Depoliticization, \textit{supra} note 241, at 4.

MIGA, while it retains a system of weighted voting, combines this weighted voting system with the equal representation of developed investor countries and developing host countries. Brelsford, \textit{supra} note 417, at 741. This system provides voting parity among developed and developing countries. \textit{Id.}


The IMF, by contrast, has adapted to global economic changes through the establishment of "financial facilities" within the IMF itself. \textit{International Economic Institutions, supra}, at 70-71. The primary facilities in the IMF are the Extended Facility, the Supplementary Facility, the Compensatory Financing Facility, the Buffer Stock Financing Facility, and the Oil Facility. Tony Killick, \textit{An Introduction to the International Monetary Fund, in The Quest for Economic Stabilisation: The IMF and the Third World 128, 134-35 (Tony Killick ed., 1984) (outlining in detail the purpose of each facility). The World Bank's differing practice of establishing affiliates rather than facilities reflects the manner in which the World Bank finances its loans. The World Bank, unlike the IMF which is funded through subscription from member states, borrows on the international capital markets with backing from official lenders. \textit{International Economic Institutions, supra}, at 73-74. Thus, the separation of affiliates from the World Bank is indicative of the World Bank's desire to keep its official funding separate from its market-based activities and to protect the World Bank from financial risk arising from its new functions. \textit{Id.} at 74.
dispute resolution but also as an "instrument of international policy for the promotion of economic development." Like the ICSID and MIGA, this agency's central mission would be the depoliticization of financial crises to ensure that the parties reach the best economic decisions. The IMF should establish its own separate agency rather than relying on another forum like the ICSID because "the external debt renegotiation process requires continuous oversight and investigation by experts in international finance and economics." Keeping the agency within the IMF would sensibly link the information gathering mechanism with the enforcement mechanism.

The IBA, not the EFM, is the more effective management solution to handle future sovereign debt crises. The IBA can act quickly, it does not generate a moral hazard, and it is relatively inexpensive to administer. The IBA should be organized under the IMF umbrella as a separate and independent affiliate.

Conclusion

The Mexican peso crisis, and the confusion and dissension surrounding the subsequent United States-sponsored bailout, demonstrated that the current procedures for managing sovereign debt crises are outdated and impractical. Globalization, technological innovation, and the growth of short-term capital have created an extremely volatile international financial marketplace where a creditor panic in one nation's economy can detrimentally affect distant economies within minutes. The international community needs an organization that can respond quickly and decisively to creditor panics in multiple nations while minimizing the resulting moral hazard.

The International Bankruptcy Agency is the proper organization to meet this need. The IBA, employing debtor-oriented provisions similar to those found in U.S. Bankruptcy Code Chapter 9, can protect multiple sovereign debtors from an onslaught of high-strung creditors racing to dump their investments. The IBA will not generate a moral hazard, however, because it will force debtors and creditors to negotiate a readjustment plan where concessions will be extracted from both sides. The IBA should be established by the IMF as a separate and independent affiliate under the IMF umbrella. Once established, the IBA would prevent a repetition of the chaos and anxiety that surrounded the Mexican crisis.

424. Id.