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Santa Barbara

From Crisis to Consensus:

US Banks, Latin American Debt, and the Making of the Washington Consensus (1955-1989)

A dissertation submitted in partial satisfaction of the

requirements for the degree of Doctor in Philosophy

in History

by

Nicholas Alexander Cohen

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June 2024

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From Crisis to Consensus:

US Banks, Latin American Debt, and the Making of the Washington Consensus (1955-1989)

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by

Nicholas Alexander Cohen

ACKNOWLEDGMENTS

Dedicated to Julie and Larry Cohen

More than just a culmination of my studies in graduate school, this dissertation is the final product of the various contributions from the people, places, and organizations that have made up my journey through higher education. As cliché as it is, I cannot help but emphasize that while I may have written the words and assembled the document, this dissertation—as I see it—is more so an amalgamation of all the support I have been fortunate enough to receive throughout my studies. I am deeply indebted to all the mentors, friends, family, and teachers listed here, and without their generous support I would have never gotten through my PhD.

My passion for history and interest in political economy began in earnest at the University of Illinois at Urbana Champaign. After tumbling into a history major as a disgruntled dropout from the business school, Professor James Barrett introduced me to history "from the bottom-up" and the role of scholarship in the pursuit of economic justice. Through office hours conversations, Professor Barrett generously helped me channel my general adolescent angst into a scholarship and politics, and first introduced me to the importance of organized labor. In the seminar for history honor's thesis writers, Professor Marc Hertzman encouraged me in my ability to write and helped me believe that grad school was something I was capable of. The most significant support in my undergraduate years, however, came from my dedicated thesis advisor, the late Professor Kathryn Oberdeck. In regular meetings over my senior year Professor Oberdeck provided invaluable feedback on my writing and pushed me to start thinking like a historian, and it was a privilege to get to work with such a great scholar so early in my academic career.

My thinking about political economy was also significantly shaped by the year I was fortunate enough to spend as a research intern at the Sacramento City Teachers' Association before coming to UC Santa Barbara. Thanks to the generosity and support of the elected SCTA leadership including Nikki Milevsky and David Fisher and I was able to learn more about economic justice from inside the labor movement. Without that formative experience, my dissertation research would not have followed the trajectory that it did, and so to the leadership at SCTA I extend my deepest thanks. SCTA executive director John Borsos, himself a history PhD, demonstrated for me what it means to be both a scholar and an activist, and thanks to his guidance I have conducted my dissertation research with one foot firmly planted in the economic realities of the present.

I could not have found a better environment in which to pursue my academic interests than the history department at UCSB. I am beyond grateful to have been able to enjoy the support of such a wonderful staff. I am not sure I would have made it through all the bureaucratic hoops, degree checklists, funding concerns, or other miscellaneous program requirements without the help of our wonderful former graduate program advisor, Rhiannon Parisse. I have also been fortunate to find in the UCSB history department a network of colleagues and friends whose support has been essential in not just the completion of this dissertation, but in my growth as a thinker. My dear friends Neil Johnson, Mattie Webb, and Sarah Dunne all provided generous feedback on chapter drafts and grant applications and to them I give my most sincere thanks.

This project also would not have been possible without the funding and support from several different institutional sources and to all of them I extend my gratitude: The UCSB Center for Cold War Studies; the UCSB History Associates; the UCSB Graduate Student

Association; the UCSB Academic Senate, the Business History Conference; and the Society for Historians of American Foreign Relations.

Each member of my dissertation committee has had a deep influence on the shape of this project, and I feel privileged to have gotten to share my work with such inspiration scholars. I consider myself incredibly luckily to have gotten to take Professor Benjamin Cohen's introductory seminars in International Political Economy in some of the last years that he taught them. It was in these classes that I learned to think beyond the disciplinary confines of academic history, and to push my research beyond the borders of the United States. I may not have ever found this topic, if not for my office hours conversations with Professor Cohen and his insights from a storied, impressive career spanning the decades that this dissertation covers. The same quarter that I was discovering the role of US banks in the Latin American Debt Crisis as a potential research topic, I was fortuitously introduced to Mexican history almost by chance as a teaching assistant for Prof. Veronica Castillo-Muñoz. In my subsequent work with Prof. Castillo-Muñoz I gained an appreciation not just for Mexican history but the larger role of Latin America in the economic history of the 20th century. Thanks to both Professors Cohen and Castillo-Muñoz, the phrase "America and the World" became more than just an academic buzzword for me.

It was a privilege to have written this dissertation under the direct supervision of not just one, but two amazing primary mentors. The co-chairs of my dissertation committee, Professor Nelson Lichtenstein and Professor Alice O'Connor did not just offer suggestions and revisions throughout the writing process—they both consistently kept me thinking about the larger stakes of this project and provided an important counterbalance to my tendency to get lost in the minutia of my source material. Professor Lichtenstein guided me through this

project from the prospectus to the final draft and consistently reminded me to pay attention to the characters at the center of my research. I am especially grateful for Prof. Lichtenstein's generosity with his time, and for the appreciation of IHOP's seasonal menu rotation that our regular meetings at the restaurant inspired in me. Professor O'Connor helped me connect my research of high finance to the production of global inequality. Thanks to her mentorship, my approach to political economy is grounded in its consequences for workers and everyday people and properly representative of what Prof. O'Connor has aptly named the "Santa Barbara School" of political economy.

The last, and most important, pillar of support that I have relied on to complete this dissertation is my family. My journey to graduate school began in Sacramento, where I spent a gap year applying to graduate programs relying on the cooking and support of my loving grandparents Pamela and Don Davis. My sister, Alexis Cohen, has fielded more distressed phone calls about my progress through graduate school than any sibling should. Her belief in me—symbolized by the "It's Dr., Actually" mug she gifted years ago—was instrumental in my success. I am also beyond grateful for my loving partner, Jillian Thornton, who has also spent a more than generous amount of time listening to my worries about this project. It is by no means a coincidence that Jill came into my life around the same time that I finally turned the corner on bringing this dissertation to completion. Finally, the contributions made to this dissertation by my parents, Julie and Larry, are truly immeasurable. I could not have made it through this dissertation, and I would not be who I am today, without their unconditional love and support. It is my personal honor to dedicate this dissertation to them.

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ABSTRACT

From Crisis to Consensus: US Banks, Latin American Debt, and the Making of the Washington Consensus (1955-1989)

by

Nicholas Alexander Cohen

This dissertation explores the business and policy origins of the "Washington Consensus"—the phrase that since the 1990s has served as a sort of shorthand for the much maligned free-market economic reforms that have been instituted across the Global South at the behest of the International Monetary Fund, World Bank, US Treasury department, and other Washington-based economic policy bodies. The Washington Consensus, as a set of ten policy prescriptions including privatization, deregulation, and trade liberalization, was first codified by economist John Williamson in 1989 as a way of navigating out of the Latin American debt crisis of the previous decade. A central focus of the dissertation is the commercial banks in the middle of that debt crisis, and the explosion of bank lending to developing countries in Latin America and the wider Global South in the late 1960s and 1970s that would contribute to the severity of the 1980s debt crisis. While there has been considerable debate around the scope and impact of the Washington Consensus, there is even less agreement about its origins. Some accounts emphasize the role of IMF/World Bank connected development intellectuals, while others, argue that these policies were homegrown, emerging first from Latin American economic and policy circles. *From Crisis to Consensus*, in contrast, explores the largely overlooked role of the US commercial banking

sector, which I argue played a critical role in setting the stage for the crisis and the consolidation of what is now recognized as a foundational policy response to the problems of contemporary capitalism .

In examining the origins of the Washington Consensus, the dissertation seeks to understand its deeper roots stretching back to the emergence of the Eurodollar market in the late 1950s and 1960s. The dissertation recognizes that the Washington Consensus was not built by a single group of actors acting in concert from on high, as previous scholarship on the consensus suggests, but from a highly contingent set of improvisations and policy decisions made in a context of escalating crises. *From Crisis to Consensus*'s intervention is to provide a fuller and more nuanced account of the process, players, agents, and lasting consequences of what is often treated as economically obvious. For the Washington Consensus to work, the New Deal-era regulatory restrictions on American finance had to be undone, and the power of the IMF had to be expanded to become the chief source of financing for developing countries. While scholars have illuminated the role of free market ideology and political conservatism in making the post-Reagan political economic order, the dissertation considers the role of the business elites who stood to benefit the most from the new order. It argues that the Washington Consensus was built in piecemeal fashion in response to the needs of banks. By demonstrating how the US banking sector helped create this new regime of inequality at home and abroad, *From Crisis to Consensus* seeks to enrich our historical understanding of free-market ideology.

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LIST OF ABBREVIATIONS

Bank of International Settlements (BIS)
Central Intelligence Agency (CIA)
Certificate of Deposit (CD)
Council of Economic Advisors (CEA)
Federal Deposit Insurance Corporation (FDIC)
Financial Support Fund (FSF)
General Agreement to Borrow (GAB)
Group of Seven (G7)
Import Substitution Industrialization (ISI)
Inter-American Development Bank (IDB)
International Bank for Reconstruction and Development (IBRD)
International Finance Corporation (IFC)
International Financial Institution (IFI)
International Monetary Fund (IMF)
International Political Economy (IPE)
Less Developed Country (LDC)
Multi-Year Rescheduling Agreement (MYRA)
National Security Council (NSC)
National Security Decision Directive (NSDD)
National Security Study Directive (NSSD)
Organization for Economic Co-operation and Development (OECD)
Organization of Arab Petroleum Exporting Countries (OAPEC)
Organization of Petroleum Exporting Countries (OPEC)
Partido Revolucionario Institucional (PRI)
President's Economic Policy Advisory Board (PEPAB)
Senior Inter-Departmental Group on International Economic Policy (SIG-EP)

INTRODUCTION

THE BANK PANIC THAT NEVER HAPPENED

In 1976, the former banker-turned-novelist Paul Erdman published the speculative economic thriller *The Crash of '79*. Erdman laid out a situation in which the international financial maelstrom left in the wake of the Organization of Arab Petroleum Exporting Countries' (OAPEC) 1973 oil embargo, combined with complex geopolitical striving in the Middle East, would cause a global economic collapse. In the novel, the suave banker Bill Hitchcock, employed by the Saudi Arabian government to manage the country's vast amount of surplus dollars accumulated thanks to the inflated price of oil, stumbles upon a plot by the Shah of Iran to wield the oil weapon to gain even more leverage over the West. Specifically, the Shah conspires to withdraw Iran's immense deposits held at large western banks. Eventually, led by Iran and Saudi Arabia, the rest of the OAPEC nations do withdrawal their deposits, resulting in an economic crisis that spells the literal end of the western industrialized world. As Hitchcock narrates in the opening chapter, set in the wastelands of 1984 California: "in 1979… the world, as we knew it, fell apart…God had nothing to do with it. Men caused it, and a handful of men at that." In addition to political leaders in the Middle East, Erdman's narrative points to the "duplicity of the worlds' bankers" and "the total incompetence of the last three men to occupy the White House."[1]

Over a decade later, in 1987, Erdman wrote another economic disaster novel entitled *The Panic of '89.* The prospective doomsday scenario in this installment lay in the concentration of global debt which had developed throughout the 1970s and 80s across the

[1] Paul Erdman, *The Crash of '79* (New York: Simon and Schuster, 1976,) 7-8.

Global South, and in 1982 had precipitated the Latin American debt crisis. That debt was in large part funded by the deposits of the same oil exporters that were the central subject in *The Crash of '79.* Throughout the 1970s, banks that held the deposits of cash-soaked middle eastern oil exporters found an eager customer base in the developing countries of the world that were struggling to pay their inflated import bills. As opposed to *The Crash of '79*'s focus on the vulnerability represented by the overabundance of "petrodollar" deposits in banks' liabilities, in *The Panic of '89* Erdman wondered what might happen if the petrodollar loan assets banks claimed turned out to be no good—what if the debtors simply decided not to pay their debts. This time, however, a plot lead by the oil and finance ministers of Venezuela and Mexico to rally their fellow Latin American debtor nations to a collective default on their debts to Western banks is ultimately foiled when the plotting minister are assassinated by the Soviet KGB in collaboration with the CIA.[2]

While both 1979 and 1989 came and went without the kind of economic chaos in Erdman's novels, the scenarios in each book, both bestsellers, seemed plausible to contemporary observers. One reviewer described *The Crash of '79,* for example, as "factual and accurate," with an "eerie sense of credibility" lent by Erdman's experience working for large Swiss banks. "His assessment of the vulnerability of the U.S. banking system to large loan losses," the reviewer commented, "has the ring of authority."[3] To the *New York Times*, while taken together the events depicted in *The Panic of '89* were a touch "too fantastic." In a world of investment bankers spinning "complex webs of insider trading," the Reagan administration's blundering in the "Iranian-contra mess," and where a new "major recession"

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[2] Paul Erdman, *The Panic of '89* (Garden City, New York: Doubleday & Company, Inc., 1987.)
[3] Joseph A. Duray, review of *The Crash of '79* by Paul Erdman, *Business Horizons*, June 1978, 88-89.

in the US could possibly lead to the "nationalization of many banks already teetering on insolvency," Erdman's narrative warranted serious consideration.[4]

The subject of this dissertation is what *did* happen in 1989, and why. The Latin American debt crisis did not end in debtor states leading a foiled debt revolt, but rather in the consolidation of a package of ten pro-market policy reforms known as the "Washington Consensus." In November 1989, at a conference hosted by the Washington D.C. think-tank the Institute for International Economics, the British economist John Williamson first used the term Washington Consensus to describe what he saw as the general economic agenda that officials at Washington D.C.-based institutions such as the International Monetary Fund (IMF), the World Bank, and the US Treasury agreed were most needed across Latin America.[5] Since then, the Washington Consensus has gone on to serve as a sort of shorthand for the much-maligned policy stipulations, now widely identified as neoliberal, instituted across the former eastern bloc and Global South at the behest of those same Washington-based international financial institutions. *From Crisis to Consensus* asks why the volatile build-up and eventual crisis of debt in the 1970s and 80s ended in formation of "brave new world" of widening global inequality which scholars have identified as a product of the Washington Consensus.[6]

While the word "consensus" would suggest a kind of universality and certainty, at no point in the years preceding and following the Latin American debt crisis was the triumph of a Western-led consensus inevitable. Erdman was not alone in his view of the extreme stakes

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[4] Jeffrey E. Garten, review of *The Panic of '89* by Paul Erdman, *The New York Times,* January 11, 1987, 9.
[5] Technically speaking, the original description of the Washington Consensus first appeared in a background paper Williamson prepared for the conference. See: John Williamson, *The Progress of Policy Reform in Latin America* (Washington D.C.: Institute for International Economics, 1990.)
[6] Mike Davis, *Planet of Slums* (London: Verso Books, 2006,) 153.

in the debt situation. The press and contemporary observers frequently described the emergence of the 1982 debt crisis in military terms: as a ticking "debt bomb" or a "financial pearl harbor."[7] Indeed, in Latin America at least, the effects of the debt crisis were drastic: the near decade of reversed economic growth, runaway inflation, and high unemployment through the 1980s are known as *La Década Perdida*, or "the lost decade."[8] Meanwhile, consequences for the commercial banks which had made the loans that Latin American countries were unable to pay back were comparatively minimal—despite the fact that nearly all of the largest US money-center banks had built up portfolios of potentially bad Latin American loans equivalent to over 100 percent of their capital.[9] A generator of crisis in both of Erdman's novels was the fact that if all major debtors were to default at once then the major banks would be insolvent, thereby triggering a financial meltdown. This imbalance generates three important questions: First, why was the burden of economic adjustment distributed so unevenly towards debtor states? Second, why did the banks lend so much in the first place? Finally, what alternative paths through the debt crisis had to be overcome to make way for the Washington Consensus?

Seeking to answer these questions, a main contention of *From Crisis to Consensus* is that the Washington Consensus, both the specific policy prescriptions described by

[7] The phrase "debt bomb" was commonly used by the press in describing Latin American debt in the 1980s, for some examples see: Steve H. Hanke, "Defusing the Debt Bomb: Debt for Equity Swaps," *The Baltimore Sun*, August 7, 1985; Nicholas Kristoff, "That International 'Debt Bomb' hasn't Stopped Ticking," *The Jerusalem Post*, March 31, 1985; Larry Reibstein and Joseph Contreras, "Latin America's 'Lost Decade:' As its Leaders Meet, the Debt Bomb Keeps Ticking," *Newsweek*, October 31, 1988. The phrase "financial pearl harbor" was used by William R. Rhodes, a Citibank executive who was prominent in Latin American debt negotiations: William R. Rhodes, *Banker to the World: Leadership Lessons from the Front Lines of Global Finance* (New York: McGraw Hill, 2011,) 182.
[8] On origins of the term "lost decade" to describe Latin America in the 1980s see: Bradley Graham, "No Quick End in Sight for Latin Debt Malaise: Many see 1980s as a Lost Decade," *The Washington Post,* April 12, 1988.
[9] For data on banks' debt exposure see: James Freeman and Vern McKinley, *Borrowed Time: Two Centuries of Booms, Busts, and Bailouts at Citi* (New York: Harper Business, 2018, 211-219.

Williamson and the more general economic regime pointed to by the consensus's critics, did not spontaneously originate in the minds of Washington-based development intellectuals in 1989, but rather has its origins in the three decades preceding the end of the debt crisis, in the large US commercial banks that are central in the Erdman's economic thrillers. Some accounts, such as Williamson's own history of the consensus and that of economist Joseph Stiglitz, emphasize the role of IMF/World Bank connected development intellectuals.[10] Others, including that of Chilean economist Sebastian Edwards, argue that these policies were homegrown, emerging first from Latin American economic and policy circles. This dissertation, in contrast, explores the largely overlooked role of the US commercial banking sector, which I argue played a critical role in setting the stage for the crisis and the consolidation of what is now recognized as a foundational policy response to the problems of contemporary capitalism.

Several critical developments set the stage for what would later emerge as the Washington Consensus. New Deal-era regulatory restrictions on American finance which limited the level of risk commercial banks could assume were gradually undone, and the power of the IMF had to be expanded to give the institution the kind of leverage it would later come to exert on developing countries. Commercial banks broke with industry precedent and starting lending heavily to less-developed-countries, or "LDCs" as they were

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[10] See: John Williamson, "The Strange History of the Washington Consensus," *Journal of Post Keynesian Economics* 27, no. 2 (2004): 195-196; John Williamson, "Did the Washington Consensus Fail?" *Peterson Institute for International Economics,* November 6, 2002, https://www.piie.com/commentary/speeches-papers/did-washington-consensus-fail; John Williamson, "A Short History of the Washington Consensus," in *The Washington Consensus Reconsidered: Towards a New Global Governance* eds. Narcis Serra and Joseph E. Stiglitz (Oxford: Oxford University Press, 2008,) 14-30; John Williamson and Pedro-Pablo Kuczynski, eds., *After the Washington Consensus: Restarting Growth and Reform in Latin America* (Washington D.C.: Institute for International Economics, 2003;) Joseph Stiglitz, *Globalization and its Discontents* (New York: W.W. Norton, 2002,) 54; Joseph Stiglitz, *The Roaring 90s: A New History of the World's Most Prosperous Decade* (New York: W.W. Norton, 2003.)

then known, in Latin America and elsewhere because it offered a lucrative outlet of new business outside of the jurisdiction of domestic banking regulations. The development of the "Eurodollar" market, an overseas loan market for the US dollar and other currencies centered in London, in the 1950s and 1960s provided banks with a new venue to pursue these lending opportunities.

As LDC lending exploded in the balance-of-payments crisis generated by the first oil shock, policymakers in the US turned towards the IMF as an institution capable of backstopping the build-up of debt as an international lender of last resort. To do so, throughout the 1970s and 1980s policymakers gradually increased the size and lending capability of the IMF through several increases in IMF member contribution quotas. The growth of the IMF was a critical step towards forming the Washington Consensus, because to be able to require debtor countries to impose such sweeping economic reforms, the Fund first needed be able to lend enough money to debtor countries to exert such leverage. The size and scope of the IMF today was in no way guaranteed in the birth of the organization at the 1944 Bretton Woods conference. At its conception, the IMF was meant only to lend money to member countries on a temporary basis to support members' fixed currency pegs to the dollar. In the years between the collapse of the Bretton Woods monetary system in 1971 and the end of the Latin American debt crisis in the 1989, the IMF underwent a "silent revolution" which not only greatly expanded the Fund's size, but also its surveillance capabilities.[11] Without this, the policy prescriptions of the Washington Consensus would be left without an effective. enforcement mechanism

[11] The term "Silent Revolution" is part of the title of the IMF's own history of the period between 1979 and 1989, see: James M. Boughton, *Silent Revolution: The International Monetary Fund, 1979-1989* (Washington D.C.: International Monetary Fund, 2001.) For earlier periods see: Margaret G. de Vries and Kenneth J. Horsefield, *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary*

With the authority of the IMF enlarged and secured, banks and Western governments were able to maintain a case-by-case, divide-and-conquer strategy in debt negotiations after the emergence of the debt crisis in the 1980s. Despite several instances of Latin American debtor countries cooperating to push for collective relief, the IMF and banks headed off the threat of a "debtors' cartel" through the carrot of limited debt relief measures and the stick of threatened financial isolation. By closing off the possibility of collective action for debtors, creditors and their governmental allies neutralized the threat of possible loan defaults. As Jerome Roos has explored, this question of "why not default?" is an important one. In the recurrent global financial crises since the 1980s, debtors time and again have decided to assume "the full burden of adjustment" when suspending payments might appear to be a more attractive offer. Roos has shown that government reliance on financial markets, specifically for short-term credit, has increased the structural power of finance enough to deter debt moratoriums.[12] As this dissertation argues, any comprehensive explanation for the near disappearance of sovereign debt defaults must include the Washington Consensus. In the 1980s, IMF conditionality stipulations—which would become codified in the Washington Consensus—effectively served as the cost of admission debtor governments had to pay to maintain access to international private credit markets. The reliance of Latin American states on short term credit in the 1970s and the structural power of commercial banks and the IMF in the 1980s was made through conscious decisions of policymakers to first permit banks to build up such massive loan portfolios and then to shield banks from assuming a greater share

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Cooperation (Washington D.C.: The International Monetary Fund, 1969); Margret Garritsen de Vries, ed., *The International Monetary Fund 1966-1971* (Washington D.C.: International Monetary Fund, 1976); Margret Garritsen de Vries, *The International Monetary Fund 1972-1979: Cooperation on Trial* (Washington D.C.: International Monetary Fund, 1996.)

[12] Jerome Roos, *Why Not Default? The Political Economy of Sovereign Debt* (Princeton: Princeton University Press, 2019,) 2-4.

of the adjustment burden. Throughout this entire process, the Washington Consensus was cobbled together in a piecemeal fashion according to the changing needs of commercial banks.

In examining the material origins of the Washington Consensus, this dissertation intervenes in what Williamson himself has described as a "strange history." In the decades following his original description of the Washington Consensus, Williamson came to lament what he saw a loss of specificity in popular use of the phrase. As he saw it the term he originally used to describe "the central areas of policy reform that most people in Washington thought were needed in most Latin American countries at the time," had come to represent an ideological "battle cry," a phrase that some people could not say without "foaming at the mouth."[13] Both proponents and opponents of the consensus, Williamson felt, had stripped the phrase of what he saw to be a relatively moderate policy agenda in favor of something more radical. The ten original policy prescriptions of the Washington Consensus which Williamson felt were obscured, as he originally described them, were: (1) "Fiscal discipline," (2) "Re-ordering public expenditures priorities," (3) "Tax reform," (4) "Liberalizing interest rates," (5) "A competitive exchange rate," (6) "Trade liberalization," (7) "Liberalization of inward foreign direct investment," (8) "Privatization," (9) "Deregulation," (10) "Property rights."[14]

Given his limited original description, Williamson has objected to the co-option of the term by both the left and the right as a synonym for neoliberalism. This is because the supply-side economics, monetarism, belief in a "minimal state," and capital account liberalization that Williamson views as definitive neoliberal economic policy are absent from

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[13] Williamson, "The Strange History of the Washington Consensus," 195-196.
[14] Williamson, *Progress and Policy Reform*, 10-31.

his original description of the consensus. To Williamson, neoliberal policy never commanded a true consensus in the period stretching from the Reagan administration through that of Bill Clinton. The policy reforms Williamson did include in his original description, however, "had long been regarded as orthodox" in the developed countries which make up the Organization for Economic Co-operation and Development (OECD). To Williamson, debtor countries in Latin America and elsewhere were simply breaking out of "a sort of global apartheid which claimed that developing countries came from a different universe" where "import substitution" and a "leading role for the state in initiating industrialization" were preferred over the OECD model.[15] As of 2008 Williamson conceded that the Washington Consensus had yet to stimulate the kind of growth he originally hoped for, but insisted the further liberalization—through programs like microcredit loans to the poor—would deliver the kind of growth seen in the OECD countries.[16]

The economist Joseph Stiglitz is perhaps the best-known critic of the Washington Consensus and is named specifically by Williamson as representative of unfair critiques from the left. As the chair of President Clinton's Council of Economic Advisers from 1995 to 1997 and chief economist of the World Bank from 1997 to 2000, Stiglitz came to see Washington Consensus policies as drivers of global inequality. Stiglitz and other critics contend that under the Washington Consensus, liberalizing policies were pursued as an end in and of themselves instead of being employed as tools to generate growth. Stiglitz does not object to Williamson's assertion that economic policies in developing countries needed adjustment but sees the imposition of Washington Consensus policy as "too far" and "too fast."[17] What

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[15] Williamson, "Did the Washington Consensus Fail?"
[16] Williamson, "A Short History of the Washington Consensus," 26, 29.
[17] Stiglitz, *Globalization and its Discontents*, 54. Also see: Shahid Javed Burki and Guillermo E. Perry, *Beyond the Washington Consensus: Institutions Matter* (Washington D.C.: The World Bank, 1998); Moises Naim,

Stiglitz and Williamson have in common, importantly, is an image of Washington Consensus policies originating with and percolating down from an implicit intellectual agreement between staff economists and officials at the World Bank, IMF, US Treasury, and wider D.C. policy establishment. For Williamson, the consensus policies represent common economic knowledge in the developed countries and were handed down to developing countries through Washington international financial institutions (IFIs). For Stiglitz, the Washington Consensus represents Western pro-market ideology taken to an extreme in their imposition throughout debtor countries at the behest of IFIs. Both stress the importance of development intellectuals in a top-down dissemination of economic knowledge. In contrast, the economist Sebastian Edwards argues that Washington Consensus policies were largely homegrown, emerging from Latin American policy and economic circles and tailored to the unique political-economic situation of debtor countries. While World Bank and IMF staff had been pushing for open markets throughout the debt crisis, Edwards demonstrates that it was ultimately a new generation of political leaders in Latin America who turned those policy recommendations into a new vision—a "Latin American consensus"—for reform.[18]

While the influence of both Latin American political elites and Washington-based development intellectuals should not be discounted, centering the role of commercial banks in creating the Washington Consensus provides a more nuanced narrative grounded in the material realities of the crisis decades. Policy reform was not pushed in Latin America in the 1980s and 90s only because of the faith of the World Bank, IMF, and neoliberal political elites in the virtue of free markets, but rather because states in Latin America had to keep

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"Washington Consensus or Washington Confusion?" *Foreign Policy*, no. 118 (Spring 2000); Serra and Stiglitz, *The Washington Consensus Reconsidered.*

[18] Sebastian Edwards, *Crisis and Reform in Latin America: From Despair to Hope* (Oxford: Oxford University Press, 1995,) 5-6, 41-43, 58-59.

making payments to US commercial banks to keep the American financial system from collapsing. Commercial bankers represent an important third party in the debt crisis negotiations, often present in the same meeting rooms as representatives from Latin American governments and the IFIs. Policy reforms in Latin America were not only undertaken at the behest of IMF conditionality stipulations and World Bank structural adjustment loans, but also as part of loan rescheduling agreements made with bank advisory committees. *From Crisis to Consensus* bridges Williamson's original conception of the Washington Consensus with the more malleable agenda pointed to by its critics by putting the formation of Washington Consensus policies in this broader context. However moderate the policies described by Williamson might appear to be, they were forged in in the context of a decade-long transfer of capital and resources from Latin America and to creditor countries.

The View from the 1980s and the Legacy of the 1930s

In the 1980s the Latin American debt crisis was a central topic of concern for political scientists and economists working in the field of international political economy (IPE).[19]

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[19] See: Robert Everett Wood, *From Marshall Plan to Debt Crisis: Foreign Aid and Development Choices in the World Economy* (Berkeley: University of California Press, 1986); Robert Devlin, *Debt and Crisis in Latin America: The Supply Side of the Story* (Princeton: Princeton University Press, 1989); Benjamin J. Cohen *In Whose Interest: International Banking and American Foreign Policy*, (New Haven: Yale University Press,1986); Phillip A. Wellons, "International Debt: The Behavior of Banks in a Politicized Environment" *International Organization* 39 No. 3 (Summer 1985: 441-471); Harry Magdoff and Paul M. Sweezy, *Stagnation and the Financial Explosion* (New York: Monthly Review Press, 1986); Rosemary Thorp and Laurence Whitehead, eds., *Latin American Debt and the Adjustment Crisis* (Pittsburgh: University of Pittsburgh Press, 1987); Luis De Sebastian, *La Crisis de America Latina Y La Deuda Externa* (Madrid: Alianza America, 1988); Richard E. Feinberg and Valerina Kallab, eds., *Adjustment Crisis in the Third World* (Washington D.C.: Overseas Development Council, 1984); Penelope Hartland-Thunberg and Charles K. Ebinger, *Banks, Petrodollars, and Sovereign Debtors: Blood from a Stone?* (Lexington, Massachusetts: Lexington Books, 1986); Jackie Roddick, *The Dance of Millions: Latin America and the Debt Crisis* (London: Latin America Bureau, 1988); Jeffrey D. Sachs, ed., *Developing Country Debt and the World Economy* (Chicago: University of Chicago Press, 1989.)

From Crisis to Consensus builds upon their focus on the relationship between banking and foreign policy. The relationship between commercial banks, the United States government, and the IMF and the confluence of their respective interests that this scholarship illuminates, is a critical precondition for the formation of the Washington Consensus. As the political economist Benjamin J. Cohen summarized in 1985, the contemporary period of crisis represented an end to the time when "high finance, in principle at least," could be "kept separate from the 'high politics of international diplomacy."[20] This unification of financial and political interests was a product of and contributed to the unified front between the banks, US Treasury, and IMF in debt negotiations throughout the entirety of the Latin American debt crisis.

Other political scientists and economists writing during the debt crisis echoed Cohen's basic assertion that there was an important realignment of formerly separate policy and financial interests at play. In 1986 the sociologist Robert Everett Wood noted the important shift away from official aid—vis-a-vi the Marshall Plan--toward unofficial aid which had "fundamentally affected the viability of alternative development choices open to Third World Countries."[21] In 1989 the economist Robert Delvin argued that international banks had come to play as "endogenous source of instability in the credit cycle of Latin America."[22] For these observers of the Latin American debt crisis there was a sort of consensus emerging that private finance was replacing state-led forms of economic and political development. While it was too early for these scholars to be talking in terms of the Washington Consensus, their understanding of the changing relationship between the state,

[20] Cohen, *In Whose Interest,* 1.
[21] Wood, *From Marshall Plan to Debt Crisis*, 4.
[22] Delvin, *Debt and Crisis in Latin America*, 2-3.

capital and development set the stage for the debates that would emerge in the following years. The Marxist economists Harry Magdoff and Paul Sweezy, writing in 1986, identified the rise of finance in international politics as a renegotiation of class power. Magdoff and Sweezy looked to the explosion of private and public debt that accompanied the recovery from the stagnation crisis of the 1970s to explain that "capitalists will not invest in additional capacity when their factories and mines are already able to produce more than the market can absorb." The "financial explosion" of the 1980s was therefore not an aberration but rather a natural outcome of a world system in its "monopoly capitalist phase" caught between its endogenously produced "tendency towards stagnation and the forces acting to counter this tendency."[23]

Many other contemporaneous analyses of the debt crisis were rooted in a comparative perspective of earlier confrontations with foreign capital in Latin America stretching back to the 19th century.[24] The economist Albert Fishlow, for example, argued that the burden of adjustment being heavily skewed towards debtors was reminiscent of creditor treatment of Argentina and Brazil during the debt crises of the 1890s. During the 1980s, like the 1890s, blame for debt servicing issues was largely placed on the domestic policy choices of the debtors, instead of market conditions imposed on them by fluctuations in international

[23] Harry Magdoff and Paul M. Sweezy, *Stagnation and the Financial Explosion* (New York: Monthly Review Press, 1986,) 21-23.
[24] See: Barry Eichengreen and Peter H. Lindert, eds., *The International Debt Crisis in Historical Perspective* (Cambridge: The MIT Press, 1989); John H. Makin, *The Global Debt Crisis: America's Growing Involvement* (New York: Basic Books, 1984); Howard M. Wachtel, *The Money Mandarins: The Making of a New Supranational Economic Order* (New York: Pantheon Books, 1986); William Darity Jr. and Bobbie L. Horn, *The Loan Pushers: The Role of Commercial Banks in the International Debt Crisis* (Cambridge, Massachusetts: Ballinger Publishing Company, 1988); Barbara Stallings, *Banker to the Third World: US Portfolio Investment in Latin America, 1900-1986* (Berkeley: University of California Press, 1987.)

finance.[25] The more often cited historical parallel to the 1980s debt crisis, however, was the wave of sovereign defaults during the 1930s. The 1930s, like the 1980s, were preceded by decades of generous bank lending to Latin American governments. Also, like the 1980s, in the 1930s private creditors were eager to get from under their Latin American loans as quickly as possible. The differences between the 1980s and 1930s, as contemporary observers often remarked, were more telling than the similarities. In the 1930s, for example, states across Latin America declared prolonged moratoriums on debt payments until agreeable terms could be settled with the banks. Peru, for example, did not settle negotiations over its 1931 default until l953.[26] After first suspending debt payments in 1927, Mexico did not reach a lasting agreement on its bond debt until 1942.[27] In the 1980s, no such wave of non-payment ever materialized. One complicating factor was that most Latin American foreign debt in the 1930s was in the form of bonds, while in the 1980s most private debt that debtor states accumulated came through bank loans.

By centering the formation of the Washington Consensus in 1989 and the new system of international financial relations which accompanied it, *From Crisis to Consensus* picks up where these earlier analyses left off. Whereas in the 1930s, the void left by the near total retreat of private lenders from Latin America was filled with official government-to-government credits and aid programs, the aftermath of the 1980s debt crisis only deepened the reliance of debtor governments on foreign, private capital. While the global debt crises of the 1930s gave way to a global economic regime defined at Bretton Woods, that left a

[25] Albert Fishlow, "Conditionality and Willingness to Pay: Some Parallels from the 1890s," in *The International Debt Crisis in Historical Perspective*, Barry Eichengreen and Peter H. Lindert, eds. (Cambridge: The MIT Press, 1989,) 86-87.
[26] Stallings, *Banker to the Third World*, 263-264.
[27] Vinod K. Aggarwal, "Interpreting History of Mexico's External Debt Crises," in *The International Debt Crisis in Historical Perspective*, Barry Eichengreen and Peter H. Lindert, eds. (Cambridge: The MIT Press, 1989,) 147-148.

marginal economical role for private financial institutions, the 1980s crisis was followed by the North American Free Trade Agreement (NAFTA) and continued structural adjustment lending in Latin America, the former Eastern Bloc, and East and Southeast Asia. This dissertation explains these differences in outcome by situating the 1980s debt crisis in the larger, more recent body of scholarship on the collapse of Bretton Woods, the end of New Deal financial regulations, and the rise of greater financial marketization of the US and world economy.

Globalization and the Demise of New Deal Politics

At least one reason the Washington Consensus has become synonymous with neoliberalism for many of its critics is that its formation was part of a larger political sea change in the US across the postwar decades defined by the demise of the Bretton Woods system of monetary management, Keynesian liberal politics, and the power and size of organized labor. These changes have been well documented by scholars from diverse range of disciplinary backgrounds, which this dissertation builds upon. A wealth of historical literature has built upon the idea of a rise and fall of what Steve Fraser and Gary Gerstle first called the "New Deal Order."[28] This literature has stressed the failure of the Democratic party to adequately respond to the economic crises of the 1970s and a larger "shock of the global," as well as the role of a well-organized ascendant conservative political project.[29]

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[28] Steve Fraser and Gary Gerstle, *The Rise and Fall of the New Deal Order: 1930-1980* (Princeton: Princeton University Press, 1989); Gary Gerstle, Nelson Lichtenstein, and Alice O'Connor, eds. *Beyond the New Deal Order: U.S. Politics from the Great Depression to the Great Recession,* (Philadelphia: University of Pennsylvania Press, 2019); Romain Huret, Nelson Lichtenstein, and Jean-Christian Vinel, eds., *Capitalism Contested: The New Deal and its Legacies* (Philadelphia: University of Pennsylvania Press, 2020); Gary Gerstle, *The Rise and Fall of the Neoliberal Order: America and the World in the Free Market Era* (Oxford: Oxford University Press, 2022.)

[29] See: Kim Phillips-Fein, *Fear City: New York's Fiscal Crisis and the Rise of Austerity Politics* (New York: Metropolitan, 2017); Niall Ferguson, Charles S. Maier, Erez Manela & Daniel Sargent, eds., *The Shock of the*

Taken together, these works fruitfully explore the role of right-wing ideologues and ineffective Democrat policymakers in bringing on a new political landscape, but have left the role played by business elites less explored. One intervention of this dissertation is to expand this narrative to include the role of the banking elites who stood to benefit from the explosion in sovereign lending in the 1970s and course of the Latin American debt crisis of the 1980s.

Much of this historical work has singled out the 1970s as a "pivotal decade" whereby the devolving New Deal order gave way to a neoliberal one. Daniel Sargent has pointed to the role of "external economic shocks" in the 1970s, for example, in forcing the US to "begin to acknowledge the reality of interdependence in which the autonomy of nations was becoming limited by transnational flows of energy and goods, of money and ideas." [30]Judith Stein, similarly points to period between 1976 and 1980 as an inflection point where the Democrats abandoned the working-class constituencies which made up the New Deal coalition in the face of "the challenges of the globalizing world." In their embrace of "international Keynesianism," the Carter administration upheld free trade politics at the expense of undermining domestic manufacturing and by extension American organized labor.[31] As shown by Meg Jacobs this shift in US politics was also directly attributable to the both the 1973 and 1979 oil shocks, as business interests successfully pushed deregulation through Congress in the name of American competitiveness and energy independence. In the wake of the early 1980s recession, this deregulatory approach to energy policy was

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Global: The 1970s in Perspective (Cambridge: Belknap Press, 2010); Meg Jacobs, *Panic at the Pump: The Energy Crisis and the Transformation of American Politics in the 1970s* (New York: Hill & Wang, 2016); Judith Stein, *The Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (New Haven: Yale University Press, 2010); Jefferson Cowie, *Staying Alive: The 1970s and the Last Days of the Working Class* (New York: The New Press, 2010).

[30] Daniel Sargent, "The United States and Globalization in the 1970s" in *The Shock of the Global*, ed. Niall Ferguson et. al. (Cambridge: Belknap Press, 2010), 49-64.

[31] Stein, *Pivotal Decade*, xii, 154-156.

legitimized thanks to dropping oil prices brought on by high unemployment and a fall in demand.[32]

While the role of the exogenous economic shocks of the 1970s should not be discounted, the history of commercial bank lending to the developing world reveals that the oil shocks could only destabilize the predominant political economic order to such an extent because of the endogenous role played by market actors, specifically the banks. While the volume of commercial bank lending to the Global South did expand greatly in the post-oil shock era of petrodollar recycling, the structure of that recycling was determined by the existence of the unregulated Eurodollar market. LDC lending had begun to take off in the late 1960s because of the lucrative business the Euromarkets offered US commercial banks seeking to escape domestic regulation, and the easily obtainable loans those markets offered to Latin American states eager for funding to continue domestic development agendas without the stipulations mandated by official, public sources of funds. In the wake of the first oil shock, governmental organizations like OECD jockeyed for the role of being the primary recycler of petrodollars but were ultimately outdone by policymakers' preference for leaving the recycling to an already existing private network of private creditors.[33] This dissertation intervenes in the robust historical scholarship on the general crisis of the 1970s by examining these contingencies which shaped the political experience of exogenous shocks.

By providing an apparent band-aid solution to the global oil shock-induced balance-of-payments crisis through petrodollar recycling, commercial banks created different economic crises. In her illuminating study of the 1975 New York debt crisis, Kim Phillips-

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[32] Jacobs, *Panic at the Pump*, 6-7, 9, 280-81, 309-310.
[33] See: Benjamin J. Cohen, "When Giants Clash: The OECD Financial Support Fund and the IMF," in *Institutional Designs for a Complex World: Bargaining, Linkages, and Nesting* ed. Vinod K. Aggarwal (Cornell University Press, 1998.)

Fein demonstrates how commercial banks remade municipal politics through debt leverage. Much like they would with Latin American governments, New York banks facilitated the expansion of municipal debt by enthusiastically underwriting and selling New York City's bonds. As banks began to operate in a more "global context," Phillips-Fein argues, they no longer "saw their economic and political interests as being inextricably linked to those of the city."[34] The New York City debt crisis in many ways foreshadowed the Latin American crisis which would emerge in 1982—banks eagerly lent money to governmental debtors up until they sought greener pastures in other avenues of business. *From Crisis to Consensus* shares in Phillips-Fein's assertion that the reorientation of economic policy towards satisfying creditors was an integral factor in the increased social stratification and inequality of the post-1970s world. The history of commercial banking in the postwar decades, then, offers an important link between the growing inequality both at home and abroad frequently associated with neoliberalism.

Complementing the robust historical literature on the economic crises of the 1970s in the United States, recent scholarship in European economic history has identified the prominent role of the Euromarkets in shaping a new political economic world order. The historian Quinn Slobodian, for example, has looked to the buildup of sovereign debt in the 1970s, "the era of petrodollars and Euromarkets," as the impetus for the creation of a new system of sovereign credit ratings which would eventually develop into a definitive feature of neoliberalism. As developing nations became more embroiled in private credit markets, private actors invented a novel economic indicator— "country risk"—one that central bankers and policy officials would embrace in their push for new forms of international

[34] Phillips-Fein, *Fear City*, 73, 87.

financial management.[35] The work of Benjamin Braun, Arie Krampf, and Steffan Murau has explored how these central bankers created new supervisory networks, via the Bank for International Settlements (BIS), in response to the 1970s proliferation of Euromarket lending. In a process of "positive integration," G-10 central bankers created linkages between the new frontiers of the private sector and public regulatory institutions which enabled the successful expansion of financial globalization.[36] Eastern bloc borrowing in the Euromarkets, as Fritz Bartel has demonstrated, created levels of risk that communist governments were ultimately unable to maintain. The kinds of economic reforms that Eastern bloc states would have to implement to be able to pay back their Euromarket loans, and the consequent reduction in living standards, represented "broken promises" that effectively ended those socialist regimes' legitimacy in the eyes of their civilian populations.[37]

Taken together, this recent scholarship on the history of Eurodollars has revealed how important different policy responses to the novel issues of international finance in the 1970s were in shaping the continued rise of finance in the succeeding decades. Examining the Eurodollar market through the lens of commercial banking and the Washington Consensus, however, reveals the Euromarkets significance in the years preceding the 1970s, as well as what came after. The Eurodollar market would not have expanded to the size that it did without the demand from debtor nations for access to more flexible financing than limited official sources would allow and the supply of loans provided by American banks eager to skirt domestic regulatory restrictions. US banks involvement in these markets, moreover,

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[35] Quinn Slobodian, "World Maps for the Debt Paradigm: Risk Ranking the Poorer Nations in the 1970s." *Critical Historical Studies* 8, no. 1 (Spring 2021,) 1-22.

[36] Benjamin Braun et. al., "Financial Globalization as Positive Integration: Monetary Technocrats and the Eurodollar Market in the 1970s," *Review of International Political Economy* 28, no. 4, 2021, 794-819.

[37] Fritz Bartel, *The Triumph of Broken Promises: The End of the Cold War and the Rise of Neoliberalism* (Cambridge: Cambridge University Press, 2022.)

offers a connection between the stateside crisis of a disintegrating New Deal order with the European phenomenon of a burgeoning offshore market for US dollars. Following Eurodollar lending all the way through the crisis of the 1980s and to the formation of the Washington Consensus underscores how important the policy tools central bankers and other governmental officials developed to deal with and integrate the Euromarkets in the 1970s. That is, the policies of the Washington Consensus were part of a larger process of political economic re-regulation in the interests of international finance. The simultaneous beginning of the end of the Cold War and end of the Latin American debt crisis in 1989 was by no means a coincidence, but rather part of this larger process of economic reconfiguration.

This general trend toward neoliberal governance and greater marketization both in the US and in Europe is echoed in the extant scholarship on the history of the IMF in the neoliberal period. Outside of the material expansion of the Fund, IMF leadership also underwent a transformation in the governing philosophy and attitude towards markets. Throughout the 1980s, specifically, IMF officials came to embrace capital mobility as economic orthodoxy and any attempt at capital controls as unacceptable—a stark reversal of the Fund's approach in the Keynesian postwar years. In doing so, a new generation of Fund leadership expanded the role and purpose of IMF intervention.[38] Recent Latin American economic history scholarship has identified a similar transition among the political elites of debtor countries. By the end of the debt crisis, a generation of political leadership with economic nationalistic tendencies was replaced with pro-market, Ivy League-trained

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[38] See: Jeffrey M. Chwieroth, *Capital Ideas: The IMF and the Rise of Financial Liberalization* (Princeton: Princeton University Press, 2010); Daniel McDowell, *Brother, Can You Spare a Billion? The United States, the IMF, and the International Lender of Last Resort* (Oxford: Oxford University Press, 2017); Claudia Kedar, *The International Monetary Fund and Latin America: The Argentine Puzzle in Context* (Philadelphia: Temple University Press, 2013); Ariel Buira, ed., *The IMF and the World Bank at Sixty* (London: Anthem Press, 2005.)

economists, and lawyers.[39] The history of the Washington Consensus, this dissertation contends, offers a window into how the neoliberal drift of political and economic officials in the US, Latin American debtor countries, and the IMF were forged through a process of mutual construction. Commercial bankers, as a negotiant with each of these three groups of governing elites, served a uniting thread between each group of elites.

Theorizing the Rise of Finance

In addition to the "New Deal Order" framing, scholars of "financialization" offer a complementary theoretical paradigm to account for the rightward shift in political economy throughout the latter half of the twentieth century.[40] In general, this body of scholarship focuses more heavily on the role played by private sector actors and financial markets themselves in remaking politics in the US and elsewhere. Financialization, as defined by Greta Krippner, refers to the channeling of increasingly more profits in the US economy "through financial channels rather than through productive activities." As Krippner argues in her study of the rise of finance in the US between the 1960s and 1980s, liberalizing financial markets enabled policymakers to sidestep the "economic, social, and political dilemmas" of the post-war era which "paradoxically" gave way to a new era of "financial manias, panics,

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[39] See: Sarah Babb, *Managing Mexico: Economists from Nationalism to Neoliberalism* (Princeton: Princeton University Press, 2001); Christy Thornton, *Revolution in Development: Mexico and the Governance of the Global Economy* (Oakland: University of California Press, 2021,) Amy Offner, *Sorting Out the Mixed Economy: The Rise and Fall of Welfare and Developmental States in the Americas* (Princeton: Princeton University Press, 2019); Miguel Angel Centeno, *Democracy Within Reason: Technocratic Revolution in Mexico* (University Park: Pennsylvania State University Press, 1994).

[40] Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge: Harvard University Press, 2011,); Gerald F. Davis, *Managed by the Markets: How Finance Re-Shaped America* (Oxford: Oxford University Press, 2009); Gerald A. Epstein, *Financialization and the World Economy* (Chelentham, UK: Edward Elgar Publishing, 2005), Youn Ki, "Large Industrial Firms and the Rise of Finance in Late Twentieth Century America," *Enterprise & Society* 19, no. 4 (December 2018): 903-945.

and crashes." Reaching a crescendo in the Reagan years, policymakers' embrace of financial markets allowed the Reagan administration to overcome the fiscal crisis generated by the early 1980s recession through the happy discovery that high interest rates in the United States effectively turned the US into the "investment capital of the world" by drawing foreign capital in search of lucrative returns.[41]

The same spike in interest rates that enabled the US to avoid a full-blown fiscal crisis, ironically, also instigated the Latin American debt crisis. The loans that commercial banks made to Latin American debtor states in the 1960s and 1970s were largely variable rate, and in the inflationary environment of the 1970s the real interest rates were at times close to zero or even negative. Beginning in 1979, Paul Volcker's quest to "slay the inflationary dragon" pushed the federal funds rate to over twenty percent in the early 1980s, which astronomically increased the real cost of debt service for debtor countries.[42] Citibank's Walter Wriston went as far as to lay blame for the debt crisis at Volcker's feet: "What nobody knew was that Volcker was going to lock the wheels of the world…and when he threw the United states into the deepest recession since 1933, it spread to the whole world."[43] *From Crisis to Consensus* deepens the financialization narrative by demonstrating the extent to which the US was only able to become a global importer of capital during the 1980s by forcing countries in Latin America and elsewhere to become capital exporters. Decades of economic growth were reversed in Latin America in the same process that allowed the US to restart domestic growth out of the ashes of the stagnation and deindustrialization of the 1970s. The Washington

[41] Krippner, *Capitalizing on Crisis,* 87.
[42] Paul Volcker and Toyoo Gyohten, *Changing Fortunes: The World's Money and the Threat to American Leadership* (New York: Times Books, 1992,) 170.
[43] Quoted in: Philip L. Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown Publishers, 1995,) 760.

Consensus, then, can be understood as a peak manifestation of financialized international political economy in that the consensus policies served as mandates that debtor countries would have to follow to maintain access to international financial markets and therefore reinstate their ability to import capital.

The history of the Washington Consensus also offers a framework for understanding the important role played by traditional financial intermediaries, like commercial banks, in bringing on financialization—a role that thus far has been conspicuously absent from many key works in the field. One hallmark of financialization, as explored by Youn ki, is the alignment of formerly opposed interests of industrial and financial firms on topics like capital mobility. By the end of the 1970s, large American manufactures had entered an "industrialist-financier alliance" which created even more momentum for financial deregulation in the 1980s.[44] Gerald Davis has described this changed character of the US economy in the 1980s as a "Copernican revolution" whereby the larger economy has become oriented around "the gravitational pull of financial markets and their signals." Davis does make passing mention of the "third world debt crisis," along with other events in 1982 like the introduction of the 401(k) plan which marked the year whereby the rise of finance was solidified. The banking sector, to Davis, is important, but only so far as it had become largely disintermediated throughout the 1980s with large banks moving more into the buying and selling of securities instead of traditionally taking deposits and making loans.[45]

What the history of the Washington Consensus adds to this story is the degree to which the gravitational pull of financial markets was forced onto policy makers and the wider economy by the level of risk that had accumulated on the balance sheets of financial

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[44] Ki, "Large Industrial Firms and the Rise of Finance," 904-905, 935.
[45] Davis, *Managed by the Markets*, 1-5, 107.

institutions. Despite persistent anxiety from contemporary observers throughout the 1970s, by the time of the Latin American debt crisis emerged in 1982, commercial banks' debt exposure was significant enough to generate a possible financial panic on the scale of the 1930s. In the 1970s, commercial banks were given leeway because financial markets offered a level of profitability that was becoming increasingly more unobtainable in manufacturing and heavy industry. In the 1980s, commercial banks were given more leeway--in the form of regulatory forbearance—because American regulatory officials were simply too afraid of the alternative of paving the way for widespread financial panic. This fear was compounded by the fact that by the 1980s, the disintegration of the New Deal policy regime which was designed in the 1930s to mitigate and prevent such financial panics was already well underway.

The leverage exerted over the US policy establishment by the US banking sector is representative of what several Marxist economists have described as a global reconstruction of class power in the late twentieth century and rise of neoliberalism. "The rule of so-called international markets," Gerard Dumenil and Dominique Levy argue, "is nothing other than the rule of capital." The demise of New Deal era financial regulation, in this conception, is the blatant reassertion of power of a specific class of capitalists and the institutions in which their interests are represented.[46] Giovanni Arrighi explains this shift in class power through a shift in the formation of capital itself. The era of the New Deal order witnessed finance capital flowing into long-term fixed investments such as infrastructure and building industrial capacity. In the 1970s and 80s, holders of capital withdrew from these fixed investments and sought out more lucrative and liquid returns. In other words, as Arrighi explains, the postwar

[46] Gerard Dumenil and Dominique Levy, *Capital Resurgent: Roots of the Neoliberal Revolution* (Cambridge: Harvard University Press, 2004,) 1-2.

era represented the M-C portion of Marx's M-C-M' formula, while the era of globalization saw those commodities turned back into money, or C-M'.[47] In the understandings of both Dumenil and Levy and Arrighi, the economic transformations of the late twentieth century were less a factor of exogenous shocks like the oil crises, but instead natural developments borne from the contradictions of capital and the need to maintain class power.

From Crisis to Consensus shares in these economists' focus on the relative class power of the financial sector but does so with a greater focus on the centrality of debt relationships. The political economists Mark Blyth and Mattias Matthijs provide a useful theoretical framework for understanding the shift in power from debtors to creditors by describing the key decades of the 1970s and 1980s as a prolonged transition between two separate and distinct "macro regimes," which they define as "the 'hardware' of capitalism (institutions) upon which different 'software' packages (policy targets and the economic ideas that underpin them) can be run." The policy goal of the Keynesian/Fordist macro regime, which came under challenge in the 1970s, was steady and full employment. In the regime that followed, which Blyth and Matthijs describe as neoliberal, that target was substituted for price stability. In a system of endogenous change, the first macro regime undermined itself through the production of high inflation and stagnation, which gave rise to a need for corrective policy stabilizing prices. Blyth and Matthijs argue that the Keynesian macro regime, consequently, could be described as a "debtors' paradise" while the neoliberal era represents a "creditors' paradise."[48]

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[47] Giovanni Arrighi, *The Long Twentieth Century: Money, Power, and the Origins of Our Times (*London: Verso, 2010) 6; M-C-M' prime is Karl Marx's general formula for capital, where M (money) which is used to purchase C (a commodity) which is in turn sold at a higher price for M'. For Marx, money allows this mode of exchange as distinguished from pure commodity exchange, or C-M-C. See: Karl Marx, *Capital a Critique of Political Economy, Vol. 1,* trans. Ben Fowkes (New York: Penguin, 1990,) 253-254.
[48] Mark Blyth and Matthias Matthijs, "Black Swans, Lame Ducks, and the Mystery of IPE's missing macroeconomy," *Review of International Political Economy* 24, no. 2 (March 2017), 209-210, 215.

An important contention of this dissertation is that the Washington Consensus is emblematic, if not the peak manifestation of, an international creditors' paradise. The years between the emergence of the Latin American debt crisis and the emergence of the consensus were spent by commercial bankers garnering continual concessions from both debtors and policymakers. It was clear and readily admitted by contemporary observers that, especially in the earlier years of the crisis, concerns for the banks took precedence over concerns over stability and growth in the debtor governments. Despite security officials continual warning over the potentially destabilizing effects of harsh austerity on fragile Latin American democracy, these concerns were not taken seriously until the solvency of banks was solidly established and governance in Latin America had shifted enough toward the interests of finance that the regimes in place were seen as worth keeping in place. When substantial debt relief was finally offered in 1989 through the US Treasury's Brady Plan, it was through the securitization of discounted remaining debt—a method which reflected the triumph of financialization.

As the financialization scholarship has shown, securitization of increasingly more liabilities enabled the growth of financial markets. Latin American debt was one of these liability pools. Securitizing that debt into bonds allowed banks to offload the remaining risk of their Latin American loan onto secondary markets. By emphasizing this process, *From Crisis to Consensus* situates the Washington Consensus as a key steppingstone towards the proliferation of mortgage-backed securities before the 2008 Financial Crisis. The way major banks avoided serious consequences by leveraging "too big to fail rhetoric" in 2008 was

foreshadowed by the prioritizing of creditor interests out of fear of financial panic in the years preceding the formation of the Washington Consensus.[49]

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This dissertation reveals the slow unfolding of the Washington Consensus over time, and does over the course of five chapters, arranged chronologically. While each chapter toggles between discussion of debtor and creditor country governments as well as the International Monetary Fund, each of these bodies' relationship with commercial banks provides the through line tying each area of analysis together. Because of the difficulty of accessing private corporate archives, and the relative opaqueness of the corporate archival material that is available, each chapter follows the big American commercial banks through the varied sources where banks and bankers do appear: congressional hearings, Treasury department memos, CIA briefing documents, IMF country files, national security directives, the financial trade press, and other assorted primary sources wherever sovereign loans and bank debts were discussed. Much of the scholarship on the Latin American debt crisis, this work included, understandably focuses on the negotiations between the international financial institutions and debtor countries. What other works tend to omit, however, is that the official institutions that make up the Washington Consensus were largely negotiating with debtors on behalf of the banks. Countries in Latin America would not have to negotiate stand-by agreements with the IMF or structural adjustment loans with the World Bank if they did not first have private debts that they needed assistance additional funds to service.

[49] On the origins of "Too Big to Fail," see: Gary H. Stern and Ron J. Feldman, *Too Big to Fail: The Hazards of Bank Bailouts* (Washington D.C.: Brookings Institution Press, 2004.)

Departing from this fact, *From Crisis to Consensus* situates the relationship between debtor countries and IFIs as downstream from those countries' relationship with private banks.

Chapter One opens in the late 1950s charting three parallel developments. First, the beginning of Walter Wriston's ascent through the corporate ranks of Citibank's predecessor, First National City Bank, and subsequent expansion of the bank's international activities. Prior to the New Deal, First National City Bank had already developed a pronounced overseas presence, especially in Latin America. Under the leadership of Wriston and other Citi executives like President George S. Moore, First National City began expanding its international loan portfolio long before the era of petrodollar recycling. Second, the emergence of an offshore market for US dollars in London, which would go on to be known as the Eurodollar market. Given its location overseas, the Eurodollar market offered bankers a respite from US regulatory authorities and a perfect venue from which to carry out their international lending business.

Third, the chapter discusses a general decline in US interest in and funding for official aid programs like the Alliance for Progress and the Marshall Plan. With official aid dwindling, a vacuum was left in the market for development funding that banks, operating through the Euromarkets, were able to fill. US bankers' full embrace of the Euromarket, however, did not develop until 1966 in the wake of the Federal Reserve's attempt to stamp out domestic inflation through limiting credit controls. American bankers learned that they could tap the Eurodollar market as both a source of funds and market for new loans that enabled them to continue to grow their loan portfolios in the face of regulatory attempts to limit credit expansion. On the demand side of the Eurodollar equation, by the late 1960s Latin American debtor countries discovered that the Euromarket provided them with a more

flexible and bountiful source of funding than comparable options from official development agencies. Latin American demand combined with an ample supply of offshore dollars coming from US banks had primed the international economy for the explosion in petrodollar recycling long before the 1973 oil shock.

In the immediate aftermath of the first oil shock, Chapter Two examines the relationship between the growth of international lending and the concurrent expansion in the scope and capacity of the IMF throughout the 1970s. This chapter argues that the explosion in the size of private international capital markets in the 1970s was contingent on the simultaneous reinvention of the Fund as an international institution able to backstop such lending. Following the 1973 crisis, commercial banks doubled down on the lucrative new business of lending to credit-hungry nations in the third and second worlds eager for funds to cope with ballooning balance-of-payments deficits. In response to this same balance-of-payments problem, the IMF began to increase in size and capability through the introduction and gradual expansion of the so-called "Witteveen Facility." By examining political debates in the United States concerning both the growing threat of unprecedented levels of sovereign debt as well as US participation in the Witteveen Facility and the positions adopted by commercial bankers in those debates, this chapter demonstrates that for US policymakers questions over US participation in the Witteveen facility, the regulation of international finance, and the possible threat posed by commercial banks' sovereign debt portfolios were often one and the same. The result of these debates—that the primary responsibility for petrodollar recycling would be left to private banks who would in turn be backstopped by new IMF funds—was crucial in setting up the coming Washington Consensus. As opposed to other options policymakers considered at the time, like giving a greater role to government-

to-government lending, the blended roles of private banks and a stronger IMF created during the 1970s was a critical precondition in shaping the policy dictates of the Washington Consensus.

Chapter Three investigates the emergence of the Latin American debt crisis and the immediate political and business response to the threat of financial panic. The crisis did not only pose a grave threat to the legitimacy of debtor governments but also to systemic financial stability in the US and other creditor nations. This chapter explores the problems posed by the Latin American debt crisis to commercial banks and US foreign policy interests from the point of view of the Reagan White House. Using the regulatory "forbearance" granted to US commercial banks (in the decision not to force banks to reduce their reported capital levels) and emergency credit facilities granted to Latin American governments as an example, this chapter demonstrates how deregulation of the financial sector was colored by the Cold War. Specifically, this chapter focuses on discussions within the National Security Council (NSC) in the year between the initial emergence of the debt crisis in late 1982 and the Reagan administration's successful drive to have Congress further expand US funding of the IMF in November of 1983. Members of the NSC had to balance a desire to curb the radical movements that might be fueled by draconian austerity measures with the need to ensure confidence in the US financial system. Despite these security concerns, the financial rescue packages offered by the US Treasury, the banks, and the IMF came with strict austerity agreements. In the early years of the debt crisis, the centrality of austerity, or "fiscal discipline," in the Washington Consensus was firmly established.

Starting in 1984, the strategy of IMF, commercial banks, and Latin American state officials all shifted away from emergency management and towards more long-term

adjustment. Chapter Four compares debates over strategy between the IMF, creditor states, and banks alongside a few alternative proposals that emerged from Latin American debtors themselves. The strategy that won out was built upon the creation of the multi-year restructuring agreement, which granted debtors some relief in the form of renegotiated repayment terms but tied them into longer periods of more frequent IMF surveillance. This "growth-led" strategy eventually evolved into the US Treasury's Baker plan, which in addition to renegotiated IMF loans, made more room for World Bank involvement in structural adjustment lending. Critically, any kind of debt forgiveness of write down was not yet apart of any official strategy. This chapter argues that the concessions on payment terms debtors were able to secure were offered to head off threats of debtor cooperation and group repudiation. Four leading debtors issued a statement called the "Cartagena Consensus" in early 1984 calling for easier lending terms, and Fidel Castro launched a campaign against paying the debt in 1985. While neither option led to substantial results in and of themselves, they both were enough to scare lenders into offering small concessions on loan terms along with more elaborate carrot-and-stick incentives.

Chapter Five begins in May 1987, when Citibank became the first major US commercial bank to set up a loan-loss reserve for the remaining debts of Latin American countries. Nearly five years after the onset of the Latin American debt crisis, Citi's move toward debt relief marked the beginning of a larger shift in the debt strategy. By the end of the year, Mexico had reached a deal with Morgan Guaranty to offer to exchange $20 billion of outstanding loans for negotiable bonds. Three years later, this securities-based approach to resolving the debt crisis would be formalized with government backing in the US Treasury's "Brady Plan" and issuance of "Brady Bonds." This chapter investigates why direct debt

reduction was only offered to debtor governments after a near decade of declining economic growth. This chapter argues that this shift in debt policy had become palatable to western policymakers after financial stability had first been ensured through stronger bank balance sheets and market-oriented reforms in debtor countries. With bank health ensured, the Reagan administration's insistence on political stability in debtors like Mexico took precedence over earlier concerns over full debt-repayment. The chapter concludes with the original codification of the "Washington Consensus" in Williamson's 1989 conference paper—the same year that, thanks to Brady plan debt reduction the Latin American debt crisis was declared to be over by contemporary observers. By the end of the debt crisis, governments in Latin America had been effectively remade according to the interests of foreign capital.

CHAPTER I

"A 51ST STATE:" THE EURODOLLAR MARKET AND THE ECLIPSE OF NEW DEAL BANKING

In 1955, Treasury Secretary George M. Humphrey testified before the House Committee on Banking and Currency that the burden of funding overseas development programs should be shifted from public financing to private capital. "In the present state of international affairs, it is vital that the United States and the other capital exporting countries maintain good economic relations throughout the free world," Humphrey explained. "This should be done as far as possible," he added, "by the investment of private capital." Humphrey was there to urge Congress to approve the creation of the International Financial Corporation (IFC), with a third of the funding to come from the US. The IFC would be a new kind of international development bank, different form the International Bank for Reconstruction and Development (now known as the World Bank), in that it would provide "venture capital on flexible terms" and would operate "without government guaranty." The IFC would use public money from developed member countries to partner with private investors in the developing world to stimulate economic growth. In Humphrey's estimation, IFC investment in private sector development in the developing world would make those countries "attractive for money from other places in the world to come in there, develop the country, make the jobs and good for people to have."[1]

Humphrey's hopes for the IFC reflect the contradictions of the postwar development order that would come to play out in the following decades. In 1956, a year after Humphrey's

[1] United States Congress, House, Committee on Banking and Currency, *Hearings Before the Committee on Banking and Currency on International Finance Corporation and H.R. 6228*, 84th Cong. 1st sess., July 11 and 14, 1955, 6-8.

testimony, over half of all development funding sent to the Global South came from official governmental sources in the Global North. When private investment did come, it was not through bank loans, but through direct investment of multinational corporations. By 1960 however, 5.2 percent of private funds sent to the developing world came through private bank loans while foreign direct investment dropped from 41 percent to just 23.6.[2] Throughout the 1960s and early 1970s, developing countries in Latin America and elsewhere would begin turning to towards private loans because private loans could offer exactly what Secretary Humphrey hoped the IFC could do—new money with easy terms and without the kind of rigidity imposed by government-to-government lending. During the same period in the United States, the experience of inflationary pressures of the Vietnam war would begin to chip away at the federal government's enthusiasm for official aid and encourage developing countries to look to private credit markets for their funding needs. In other words, the pattern of bank lending to Latin America that would precipitate the debt crisis in the 1980s was in place far before the 1973 oil crisis and recycling of Petrodollars.

This chapter explores the creation of this shift in the paradigm of international economic development, whereby official aid was pushed out in favor of private lending, from both the supply and demand side of the market. On the supply side, by the 1960s US commercial banks were eager to find ways around the restrictions of the New Deal regulatory regime and began to expand internationally in search of new profits. Bankers like Walter Wriston and G.A. Costanzo of First National City Bank (the bank eventually changed its name to Citibank) would capitalize on the history of US banking in Latin America to expand operations there. In the late 1950s, a vehicle for this overseas expansion appeared as the

[2] Robert E Wood, *From Marshall Plan to Debt Crisis: Foreign Aid and Development Choices in the Word Economy* (Berkeley: University of California Press, 1986,) 83.

emergence of the "Eurodollar" market an offshore market for US dollars and other foreign currencies that allowed banks to escape regulations like Regulation Q which limited the earning potential of domestic deposits. US commercial banks could expand their operations both domestically and internationally through the Euromarkets by borrowing through their overseas branches to get around reserve requirements and lending to foreign governments. Despite the efforts of some US policy makers to limit bank activity in the Euromarkets, the new markets remained largely unregulated and therefore attractive for banks like Citi.

On the demand side, government officials in Latin America discovered in the Euromarkets a new source of funds that were easily accessible and came with few stipulations. Leaders in countries like Mexico were eager to maintain the pattern of explosive economic growth that had characterized many Latin American economies in the early postwar decades. Ironically, access to Eurodollars allowed Latin American elites to continue to fund import-substitutions-industrialization programs designed to lessen their countries' dependence on the global north for manufactured goods. In so doing, Latin American debtor countries would come to depend on the global north not only for manufactured goods, but also a steady inflow of private capital. In the 1960s and early 1970s, private loans offered debtor countries a degree of political autonomy that official aid from countries like the US did not. The *Columbia Journal of World Business* described this financial situation created by the Euromarket as a "borrowers' paradise."[3] The political economists Mark Blyth and Matthias Matthijs similarly describe the inflationary environment of the 1970s as a "debtors' paradise."[4] While the effect of inflation of reducing the cost of debt that Blyth and Matthijs

[3] Richard S. Weinert, "Eurodollar Lending to Developing Countries," *Columbia Journal of World Business* 8, no. 4 (December 1973): 35.
[4] Mark Blyth and Matthias Matthijs, "Black Swans, Lame Ducks, and the Mystery of IPE's missing macroeconomy," *Review of International Political Economy* 24, no. 2 (March 2017), 215.

stress was certainly a factor in pushing Latin American governments towards excessive borrowing, the policy autonomy private borrowing conferred to debtors reveals roots of the debtors' paradise were sown earlier in the 1960s, before the inflationary spirals of the 1970s.

A deeper exploration of the emergence and dynamics of the Eurodollar market and its significance in the history of international finance is important because reveals the gradually evolving material and political conditions within which the Washington Consensus would eventually crystallize. Specifically, the Eurodollar market enabled the dependence of Latin American debtors on private loans that they would have to turn to the IMF and World Bank to be able to repay during the 1980s debt crisis. The postwar decades before the 1973 Oil Crisis also witnessed the development of IMF "conditionality"—the phrase used to refer to the kinds of policy stipulations the IMF can attach to loans. While conditionality in the 1950s and 60s was by no means as sweeping, invasive, or enforceable as it would come to be in the 1980s, it was nonetheless significant in establishing the framework through which the Washington Consensus would operate. The creation of and imposition of conditionality was part of larger shift at the Fund—well underway by the 1960s—of its economist staffers drifting away from Keynesianism and towards a more monetarist disposition towards the IMF's purpose. For its part, by the end of the 1960s, the World Bank had relaxed its strict loan standards and increased its loan volume to keep up with the turn of debtor countries towards the Euromarkets and private capital.

Walter Wriston and Citibank

In 1959, the president of First National City Bank appointed an ambitious banker named Walter B. Wriston to head City Bank's overseas division. Wriston had made a name

for himself over the previous decade in the bank's credit department by granting loans to Greek shipping magnate Aristotle Onassis for the construction ocean-fairing oil tankers. By working out a financing deal with Onassis that guaranteed the loan not on the cash value of the physical tanker itself, but on the potential value of the tanker to generate cash in the future through transportation of oil, Wriston had stumbled upon a "revolutionary" method of financing that in the future would be used to back loans of assets previously too risky for bankers. It was this approach to risk that set the 40-year-old Wriston apart from older "conservative grey-haired lenders who had suffered through a depression and a war and for whom any deviation from tried and tested lending was heresy." In the 1950s, Wriston's boldness had paid off and had established Citibank as the "largest ship-financing bank in the world."[5]

Wriston's life before Citi left him with two inclinations that would greatly define his time there: an interest in international affairs and a disdain for government regulation of business. The latter was inherited from his father, a "tight money man" and vocal critic of the New Deal who became the president of Brown University while Walter was in high school. Wriston himself was campus president of the Wesleyan University Wendall Willkie for President Club during the 1940 campaign.[6] The former came from Wriston's Master's Degree at Tuft's School of Law and Diplomacy and short career as junior foreign service officer before being drafted in 1942. These attributes made Wriston something of a maverick in the post-war commercial banking scene. The collapse of high international finance in the Depression years and the rigid bank regulations of the New Deal had made commercial

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[5] Philip L. Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown Publishers, 1995,) 64, 182.
[6] Ibid, 22.

banking both domestically oriented and risk averse. Profits and growth were not priorities. Loans were not a large part of commercial bank investment portfolios and bankers strictly booked loans according to the "three Cs": character, capacity, and collateral.[7]

Much of this conservatism was enforced by the Banking Act of 1933, known as the Glass-Steagall Act. Glass-Steagall relegated commercial banks like Citi to solely taking deposits and making loans to corporate clients by erecting a firewall between investment and commercial banking services. Glass-Steagall's Regulation Q strictly limited how much interest banks could pay to depositors to discourage the kind of reckless interbank competition that had produced the 1929 crash.[8] When Wriston first joined Citibank in 1946 (with the help of his father's connections), he later explained, banking "was the last thing in the world I wanted to do."[9] "Banking was a kind of nice club," Wriston would reflect, "you had your inventories under control because the government told you how much you could pay on your deposits."[10] In other words, upon Wriston's entry to the industry in 1946, the US banking system was of much less importance to both the domestic and international economy than it would come to be.

The kinds of regulations that made banking a boring industry to someone like Wriston stretched back to before the New Deal, and later became a central piece of the larger New Deal financial order. The 1927 McFadden Act, for example, forbade commercial banks from opening branches outside of their home states, and required banks to follow the branching regulations of the state in which they were headquartered. In the prosperity of the

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[7] James Freeman and Vern McKinley, *Borrowed Time: Two Centuries of Booms, Busts*, *and Bailouts at Citi* (New York: Harper Business, 2018,) 183.
[8] Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge, MA: Harvard
University Press, 2011,) 60-61.
[9] Zweig, *Wriston*, 29.
[10] Ibid, 46.

postwar decades, moreover, major American corporations would be liquid enough to utilize retained earnings for investment funds instead of going to banks for loans.[11] Commercial banks' position on the margins of the industrial economy was therefore a central component of the predominance of large industrial firms that was characteristic of the New Deal order. When large companies like Ford of General Electric made profits, they invested the money back into expanding production instead of into financial channels like shareholder dividends.

When Wriston took charge of Citi's overseas division, however, a revival of the kinds of lucrative international operations that Citi pioneered in the opening decades of the twentieth century was underway. In 1914 Citi opened a branch in Buenos Aires, becoming the first nationally chartered bank to expand to foreign soil.[12] Throughout the 1920s, Citi led syndicates of banks underwriting bond issues totaling $750 million for different Latin American nations.[13] In the wake of the nationalist fervor inspired by the Mexican revolution, Citi was the only foreign bank that did not flee the country in the 1920s. In the following decades, Citi was the only foreign bank that was allowed to operate in Mexico as stipulated by their banking laws.[14] Despite several of the issues being mired in corruption controversy and the default of the Bolivian government, in the years before the great crash of 1929 Citi earned the title "Greatest Bank in the Western Hemisphere."[15] When Wriston came to the overseas division in the 1950s, Citi still maintained at least one branch in "nearly every country of economic consequence" in Latin America.[16] As described by Citi's then-president,

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[11] Gerald F. Davis, *Managed by the Markets: How Finance Re-Shaped America* (Oxford: Oxford University Press, 2009,) 108-110.
[12] Zweig, *Wriston*, 37.
[13] Ibid, 41.
[14] George S. Moore, *The Banker's Life* (New York: WW Norton, 1987), 195.
[15] Zweig, *Wriston*, 43.
[16] Ibid, 87.

George S. Moore, the expansion of Citi overseas was mutually beneficial for the US and host countries:

> City Bank was virtuous as well as wise in expanding its foreign branches…Money came out of the mattresses and into the economy when a branch of an American bank opened, and many foreigners became more interested in doing business in a country where there was a branch of an American bank. There's hardly a business that went to Mexico or Brazil in my time that we didn't have a catalytic influence on. Nothing did more to promote American *and* European *and* Japanese investment in Mexico and other Latin American countries than the comforting and constantly useful presence of an American bank.[17]

Moore's sentiments here reflect the kind of excitement over new markets which would come to drive exorbitant bank lending to the developing world in the 1970s. Bankers rationalized their actions through a heroic narrative of economic development and market expansion.

When Wriston took over the overseas division, Cuba was the bank's biggest foreign operation. When Fidel Castro nationalized Cuba's banks, Citi lost $45 Million--$35 million of which were loans to Cuban customers. To Wriston, however, this was no reason to slow international expansion in the future, but just an example of the "'actuarial base' principle—"a term he liked to use for spreading the risk"—in action."[18] To offset the losses incurred by Castro's nationalization, Citi seized $12.4 million in securities held in the United States that the head of the Cuban central bank, Che Guevara, had posted as collateral for a previous loan. Guevara's Banco Nacional de Cuba took Citi to the Supreme Court over ownership of the capital, where the court sided with Citi. So, despite the massive losses Citi incurred in losing ownership of the physical capital Citi's funds had been used to build in Cuba, the victory over Guevara in the courts was enough to convince Wriston that Citi had "learned to exit a country going down the drain with minimal damage."[19]

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[17] Moore, *A Banker's Life*, 196-197.
[18] Zweig, *Wriston*, 137.
[19] Ibid, 138.

With the Cuba experience behind him, Wriston and Citi's overseas division entered the 1960s with an appetite for expansion and a particular interest in Latin America. In 1961, Wriston was summoned to Washington by President Kennedy to solicit aid in Kennedy's Alliance for Progress in Latin America. Kennedy, reeling from the failure of the Bay of Pigs, and Wriston fresh from his losses in Cuba shared an acute interest in developing Latin American economies away from the lure of communism. Wriston and other US business elites, however, were not satisfied with Kennedy's lack of emphasis on private capital and markets. Kennedy's assassination in 1963 brought an end to government enthusiasm over the Alliance for Progress as a government-to-government program. The fizzling out of the Alliance for Progress was part of an end to larger era of direct government aid which began in the wake of World War II with the Marshall Plan, known officially as the European Recovery Program. Between 1948 and 1952, the Marshall Plan distributed $13 billion to war-torn Western European countries, over 90 percent of which was in the form of grants. Policymakers understood governmental aid to developing countries as part of the larger project of European recovery by providing outlets for European exports.[20] With European reconstruction largely complete, government-to-government assistance appeared less urgent.

In the wake of the decline of the Alliance for Progress, a fortuitous alignment of actors at Citi set the stage for novel forms of cross-border lending. George S. Moore, Citi's then-president, was particularly enthusiastic about Latin American expansion and Mexico in particular. Moore's wife was Spanish-American and kept a home in Mexico City, leading other Citi executives to worry that his "business judgement was clouded by his marriage to a Spanish woman and love for everything Latin."[21] But Wriston's most important partner

[20] Wood, *From Marshall Plan to Debt Crisis*, 29-34.
[21] Zweig, *Wriston*, 146.

when it came to expanding into Latin America was G.A. Costanzo. Before being recruited to Citi by Moore in 1961, Costanzo was the deputy director for the IMF in Latin America, where he "was largely responsible for transforming" the fund "from an ineffective institution" to one "that relied on tough austerity measures based on quantifiable performance."[22] While the kinds of policies Costanzo certainly foreshadowed the role the IMF would come to play in the debt crisis, in the interwar decades the kind of stipulations the IMF attached to loans were not nearly as far reaching and binding as they would come to be. Costanzo was an expert in balance-of-payments analysis, which Wriston recognized would be needed to evaluate the ability of foreign central banks to generate dollars to repay bank loans. By 1964, Costanzo became Citi's senior vice president in charge of Latin America.[23] While Moore, Wriston, and Costanzo worked to expand the volume and nature of Citi's overseas operations, a new type of financial market was emerging in London that would come to provide the perfect vehicle for new services.

Origin and Structure of the Eurodollar Market

The Eurodollar emerged in London in the late 1950s due to a confluence of regulatory factors. In line with the demands of the Bretton Woods system, the UK government committed itself to the establishment of current account convertibility. UK policymakers, however, continually responded to threats of inflation through tight monetary policy and direct capital controls. These two policy goals were somewhat contradictory in that convertibility was meant to liberalize trade and capital movement while controls were meant to mitigate the effects of the liberalization. This contradiction laid the groundwork for

[22] Ibid, 164.
[23] Ibid, 162.

"profitable innovation."[24] According to banking historian Catherine Schenk, the first Eurodollar deposit happened in 1955 at the Midland Bank in London. In the opening months of 1955, the Bank of England raised the Bank Rate (the rate paid to commercial banks for deposits at the central bank) to a postwar high of four and a half percent. Looking to take advantage of these high rate, the Midland bank was able to attract deposits of US dollars by paying one and seventh eights percent interest (seven eighths higher than the limit set by Regulation Q). The differentials between what the Midland Bank paid out to depositors of dollars and received from the Bank of England for deposits of sterling was great enough that the Midland Bank could sell their dollars for more sterling and then buy back the original dollars at a premium. What was so novel about the Midland Banks use of dollar deposits was that they "were attracted to solve specific liquidity constraints and in response to profitable investment opportunities in the U.K.."[25] This was not the more traditional kind of international banking undertaken to finance trade and was not converted through any central bank's foreign reserves. Rather it was an attempt at leveraging variations in national monetary policies and skirting around financial regulations to expand profits.

After 1955 the next boon to the euro-markets came in 1957, which is when most earlier accounts of the subject date the emergence of the Eurodollar.[26] In the wake of a balance-of-payments crisis, the British government-imposed restrictions on the use of sterling to finance foreign trade and international loans. To stay competitive overseas, many

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[24] Catherine R. Schenk, "The Origins of the Eurodollar Market in London: 1955-1963," *Explorations in Economic History* 35, no. 2 (April 1998): 221-238.
[25] Ibid, 226.
[26] See: Benjamin J. Cohen, *In Whose Interest: International Banking and American Foreign Policy* (New Haven: Yale University Press, 1986); E. Wayne Clendenning, *The Euro-Dollar Market* (Oxford: Claredon Press, 1970); W.P. Hogan and I.F. Pearce, *The Incredible Eurodollar* (London: George Allen & Unwin, 1982); Geoffrey Bell, *The Euro-dollar Market and the International Financial System* (New York: John Wiley & Sons, 1973;) Alexander K. Swoboda, *The Eurodollar Market: An Interpretation* (Princeton: International Finance Section, Department of Economics, 1968.)

more British banks took actions like Midland Bank in the 1955 by attracting deposits denominated in US dollars.[27] Dollar deposits therefore became a "substitute financing mechanism" for the more traditional areas of international finance. This development built on the foundations of 1955 because instead of just using dollars for a form of interest rate arbitrage, dollars were now fueling international trade outside of just the US. There was nothing inherently new about keeping deposit accounts denominated in US dollars outside of the US. In the past, however, those dollars were typically repatriated to the US money market instead of being used to fund new avenues of international trade and lending.[28] A strong factor driving US dollars out of their domestic market and into deposit accounts in London were the limits on interest paid on demand deposits stipulated by Regulation Q. European banks were willing to operate on lower interest margins than their US counterparts, thereby strengthening the flow of dollars into London and elsewhere.[29]

With a market for Eurodollars thoroughly established by the end of the 1957, the market rapidly expanded in size in 1958 with the "return to convertibility of the major Western currencies."[30] Specifically the UK "merged American-account and transferable-account sterling" while "Austria, Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, and Portugal" simultaneously moved "toward current account convertibility for non-residents."[31] Free convertibility meant that residents of these major European countries were relatively free to exchange their native currencies for others (such as US dollars) without restriction. This decreased barrier to entry made the Eurodollar market

[27] Cohen, *In Whose Interest,* 19.
[28] Ibid.
[29] Clendenning, *The Eurodollar Market*, 7.
[30] Swoboda, *The Euro-Dollar Market,* 2.
[31] U.S. Congress, Joint Economic Committee, *Economic Policies and Practices: The Euro-Dollar Market and its Public Policy Implications,* 79th Cong., 1st Sess., February 25, 1970, Paper No. 12, 3.

and even more attractive source of funds for multinational banks and savers looking for higher returns. Free convertibility, combined with the general success of the Marshall Plan and subsequent prosperity ensured that there were ample surplus funds that could be moved throughout the euro-markets.[32]

Throughout the rest of the 1950s and 1960s the Euromarkets expanded greatly—beyond just London and beyond just deposits denominated in dollars.[33] In light of this expansion, a 1970 congressional staff report on the euro-dollar market defined the market as such:

> Like the Holy Roman Empire, which was neither holy, Roman, nor an empire, the so-called Euro-dollar market is neither European nor a market for dollars. It is, rather, the market for bank deposits which are denominated in foreign currencies. In other words, the deposits are in the form of currencies other than that of the country in which the bank is located.[34]

So, while the Eurodollar market could therefore be more aptly described as a "Eurocurrency" market (and is in many sources) the overseas market for dollar deposits, thanks to the Bretton Woods backed primacy of the dollar, was largest and most dominant.[35] The largest players in the Eurodollar markets, moreover, were US commercial banks. Despite the role of British banks in developing the Eurodollar market, US commercial banks had the advantage of riding the coattails of predominant US multinational corporations into overseas markets. Through branches in London and across the world, the three largest US banks—Bank of America, Chase Manhattan, and Citibank—came to make up over one half of the total number of foreign branches of US banks.[36]

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[32] Cohen, *In whose Interest,* 19.
[33] Ibid.
[34] *Economic Policies and Practices,* 2.
[35] Clendenning, *The Eurodollar Market,* v.
[36] Cohen, *In Whose Interest*, 29-30.

The supply and demand sides of the Eurodollar market were made up of essentially the same actors. The three types of institutions that both provided and used Eurodollars included (1) official institutions such as central banks and state governments, (2) commercial banks, and (3) non-bank actors such as private corporations and individuals. Official sources of funds like central banks and governments turned to the Euro-dollar markets for a variety of political reasons. In the case of Eastern-European communist governments, the euro-markets provided a safer haven for their dollar deposits than branches located in the United States where assets could be seized.[37] In a general sense, central banks supplied dollars to the euro-market they had received through foreign exchange operations by loaning those same dollars to commercial banks. The banks would then move dollars to the euro-market or indirectly through the Bank for International Settlements.[38] Commercial banks and other businesses, for their part, were interested in depositing in the Eurodollar market as an outlet for short term funds when yields were higher than domestic options.[39] On the demand side, official institutions played a small role among the users of Eurodollars throughout the 1960s. Commercial banks, on the other hand, relied upon deposits and loans of Eurodollars received to increase liquidity. US commercial banks for example, could use Eurodollars to fund additional US lending given the limits of their ability to compete for deposits in the domestic market given Regulation Q interest caps. Non-bank business entities relied upon Euro-dollars as a source of financing for foreign trade operations. Given the primacy of US Dollars as tender in international transactions in the 1960s, euro-dollars were drawn from more heavily than other eurocurrencies.[40]

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[37] *Economic Policies and Practices,* 3.
[38] Ibid, 4
[39] Clendenning, *The Euro-Dollar Market,* 46.
[40] Ibid, 54.

The burgeoning Eurodollar market would gain limited attention throughout the 1960s from bankers and politicians in the United States as it related to a growing domestic debate over the US balance-of-payments. On July 18th, 1963, President John F. Kennedy introduced the Interest Equalization Tax as part of a larger balance-of-payments program designed to keep capital within the US and promote domestic investment. The tax, which was enacted by congress in September of 1964, was a 15 percent charge on any purchase of foreign securities by an American Citizen as well as on any loan made by a US bank to foreign borrowers.[41] The Eurodollar market, being outside of the US, was not within the jurisdiction of US regulatory authorities. As such, US bankers began to tap the Eurodollar market as a sort of "offshore segment of the New York Money Market."[42] In the words of one financial analyst, the Eurodollar market effectively became "a 51st state" for the US financial system, albeit one without the same regulatory demands.[43] Still, bankers were not happy about this development in global finance as a large amount of business that would otherwise be conducted in New York moved to London. In the view of Walter Wriston, the Interest Equalization Tax's boon to the Eurodollar Market set the US back "at least ten years in global financial competitiveness" and constituted a "denial of the global market."[44]

Commercial Banks and the Credit Crunch of 1966: Eurodollars to the Rescue

[41] Zweig, *Wriston*, 157.
[42] Benjamin Braun, Arie Kampf & Steffen Murau, "Financial Globalization as Positive Integration: Monetary Technocrats and the Eurodollar Market in the 1970s," *Review of International Political Economy* 28, no. 4, (March 2020): 802.
[43] Quoted in: William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon & Schuster, 1987,) 58.
[44] Zweig, *Wriston,* 158.

While the Eurocurrency market grew to 15.1 billion dollars in size by 1965, it was not until 1966 that American banks took serious interest in the market.[45] This change was the result of several years of the Federal Reserve struggling to effectively tighten credit conditions in the United States in effort to head off inflation. By the mid 1960s, amid the simultaneous strenuous financial commitments the Johnson administration was making to the escalating Vietnam War, the expansion of the Great Society welfare state, and the maintenance of the Bretton Woods international economic order, inflation emerged as a serious threat to the stability to the Golden Age of postwar capitalism. It was an era of "transition," according to the economic sociologist Greta Krippner, "from a period of easy abundance to an era defined by increasingly severe limits on the nation's prosperity."[46]

This novel challenge began in 1959 when, at the crest of an economic expansion, the Federal Reserve's tightening of monetary policy led to a dramatic outflow of capital from the banking sector in a process of "disintermediation." When Treasury bill interest rates rose above Regulation Q ceilings on time deposits, large New York City commercial banks dramatically lost many of their corporate deposits. Key to the Fed's policy strategy was the effective functioning of Regulation Q. In times of easy credit, going market rates remained well below the Regulation Q ceiling so they were not an object of much concern for bankers. When the Fed decided to reduce the money supply, interest rates on T-bills and commercial paper were free to rise above the Regulation Q cap while bank deposits were effectively stuck. Subsequently, depository institutions would have to halt new lending. In the "mild"

[45] Cohen, *In Whose Interest,* 21.
[46] Krippner, *Capitalizing on Crisis*, 64.

and “mercifully brief recessions of the 1950s the brunt of this of these credit freezes were borne mostly by thrift institutions and the housing market.[47]

In the depth of the 1960-61 recession, however, Citibank created a new secondary market for negotiable certificates of deposit (CDs) that enabled them to continue to bid for funds from corporate investors. Several Citi bankers claim credit for the invention of the CD, but in the words of one biographer, “Wriston was its principal promoter within the bank, and the individual most responsible for persuading top officers to adopt it.”[48] This new market in CDs meant, if only for commercial banks and their corporate clients, disintermediation could be reversed. Between 1961 and 1966, regulators sanctioned this new source of capital for commercial banks by raising the Regulation Q ceilings on CDs and other time deposits to stay competitive with market rates on four separate occasions.[49] Regulators had good reason to fear a possible dramatic sudden drain of funds from the banking system, as much of the New Deal financial system was designed to prevent the kinds of panicked bank runs that characterized Great Depression-era financial crises. Despite their good intentions, however, the complicity of regulators enabled a dramatic expansion of systemic risk in the banking system. Between the 1961 introduction of the Certificate of Deposit and the 1966 credit crunch, the proportion of investable funds in the commercial banking system rose precipitously. The popularity of CD’s had been responsible for bringing more and more money into the banking system, money which the big commercial banks had come to rely on.[50] Commercial banks even started to breach the New Deal fire wall between consumer and

[47] Ibid, 63.
[48] Zweig, *Wriston,* 141.
[49] Krippner, *Capitalizing on Crisis*, 66.
[50] Bell, *The Euro-dollar Market,* 55.

commercial banking by taking business away from thrifts through small-denomination CDs.[51]

In 1966, however, the Fed committed to holding the Regulation Q ceiling on time deposits firm, fearing that the excessive bank lending enabled by CD deposits was contributing to inflation. Without their usual support from the Fed, US commercial banks had to "turn elsewhere for funds."[52] Regulation Q stipulated that CDs and other large time deposits could yield no more than 5.5 percent, and by September of 1966 T-bills were yielding 5.36 percent while other money market investment options were yielding higher that 5.5 percent. This increased competition from more lucrative and safer investment options lead to run-off in C.D.s held at commercial banks. Looking to the Euro-dollar market to replace these lost deposits, US commercial banks borrowed dollars heavily from their own branches in London. By mid-1966, there were between $2.5 and $3 billion euro-dollars moving throughout the US banking system to help meet $3.9 billion coming due on CDs in June.[53]

Commercial banks use of the Eurodollar market to handle an acute episode of tight credit and lost deposits dissuaded any fears American bankers had of the euro-markets, leading them to turn increasingly to the markets as a source of funding as legitimate as any other. This newfound bridge between the US banking sector and the Eurodollar markets, as noted by the *New York Times*, "served to tie the world's markets closer together."[54] The Eurodollar markets served as a sort of valve through which US commercial banks could

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[51] Krippner, *Capitalizing on Crisis,* 66.
[52] Bell, *The Euro-dollar Market*, 54.
[53] Lee Silberman, "U.S. Banks Seek Euro-Dollars to Help Meet $3.9 Billion Due on CDs maturing in June," *The Wall Street Journal*, June 14th, 1966, 5.
[54] H. Erich Heinemann, "US Banks Active in Eurodollars," *New York Times,* May 16, 1966, 71.

release pressure from the domestic market by picking up borrowing overseas to maintain a certain volume of lending to the banks' customers. Banks could rely upon to the Eurodollar market to keep reserves in line with requirements set by the Fed to back up liabilities.[55] When first covered by Citi's internal economic newsletter in May of 1966, the Eurodollar market was celebrated as "among the most competitive and independent forces in international finance today."[56]

The 1966 annual report of First National City Bank (Citibank's predecessor) is demonstrative of this industry-wide shift towards a greater dependence on capital overseas for US commercial banks. In Citi's case, this turn towards the global is visible immediately on the cover of the annual report. In contrast with the aerial shot of New York City and the image of the inside of a bustling branch office which adorned the covers of the two previous annual reports, the 1966 cover is a diverse collection of country flags (see figure 1). Despite losing a significant amount of savings and time deposits due to competition with "high yields available on bonds and other investment media," Citi still booked $12.9 billion increase in total deposits— "a new high." "The growth in deposits at overseas offices reflects the continuing expansion of our established international business," the report explains, "and the continuing importance of the market for Eurodollars."[57] Thanks to the influx of Eurodollars, in 1966 Citi was able to book a 12 percent increase in operating revenue and expand their loan portfolio.[58]

[55] Bell, *The Euro-dollar Market*, 32-33.
[56] Economics Department, First National City Bank, "The International Capital Market," *Monthly Economic Letter*, May 1966, 56-57.
[57] *Annual Report 1966,* 8.
[58] Ibid, 3.

Figure 1. Cover of Annual Report 1966 *(New York: First National City Bank, 1966.)*

Just as Citi had led the expansion of money in commercial banking sector through pioneering the offering of domestic negotiable certificates of deposit in the early 1960s, Citi lead the turn towards Euro-dollars. Citi went as far as rolling out dollar-denominated CDs in the London market in May of 1966, a move that was followed by Bankers Trust Co. and Chemical Bank New York Trust Co. doing the same. For Citi and other major New York banks, seeking cash from Eurodollar deposits to pay out to domestic depositors withdrawing funds provided an effective stopgap measure to weather the credit crunch without taking

losses. Despite this infusion of liquidity into the US banking system, the level of systemic risk rose. In mid-1966, the amount of loans on the books of major New York Banks represented 74.3 percent of their total deposits. This figure was nearly 5 percent higher than in 1965 and more than 12 percent higher than 1964.[59] In other words, if in 1966 every one of these banks' depositors withdrew their money at once there would only be enough money on hand to pay them about 25 cents to the dollar.

Regulatory Challenges

A 1970 Congressional research report on the euro-dollar market described the market as "the freest sector of the international money market."[60] Naturally, the "freest" market for US dollars in an era of incessant balance-of-payment problems presented a significant challenge to US regulators. In the latter years of the 1960s as the Vietnam War intensified the Federal Reserve would continue to struggle to tighten domestic credit to stave off inflation and the Johnson Administration would struggle to contain the balance-of-payments problem. Against this backdrop of deepening economic concern, suspicious eyes turned towards banks like Citi that continued to expand loan portfolios at home and abroad through use of Eurodollars and other new sources of capital.

In 1969, the famous opponent of economic regulation, government spending, and social welfare programs economist Milton Friedman argued that observers of the burgeoning relationship between US banks and the Euro-dollar market had fundamentally misunderstood the source of the problem. Friedman summarized a common explanation for the source of euro-deposits coming from "partly" the "U.S. balance-of-payments deficits; partly, dollar

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[59] Silberman, "US Banks Seek Euro-Dollars," 5.
[60] *Economic Policies and Practices*, 3.

reserves of non-U.S. central banks; partly, the proceeds from the sale of Euro-dollar bonds." "No matter. How you try," Friedman says, "you cannot get $30 billion from these sources." The problem with these explanations, according to Friedman, was that they overlook the role of banks themselves in money creation. Namely, the structure of partial-reserve banking, which enables the major source of "both Euro-dollars and liabilities" to be "a bookkeeper's pen."[61] That is, through accounting practices, banks involved in the Euro-dollar market can create money when they book loans exceeding the amount of cash they hold against current deposits. Contrary to popular images of "piles of dollar bills being bundled up and shipped across the ocean on planes and ships—the way New York literally did drain gold from Europe in the bad—or good—old days at times of financial panic," Friedman asserts that no matter how many Euro-dollars US banks "borrow back" and repatriate, the total amount of Euro-dollar deposits increases.[62]

With a focus on monetary creation, Friedman demonstrated how the unique regulatory environment surrounding US commercial banks and the Euro-dollar market contributed to upward pressure on prices and an exacerbation of the burgeoning US balance-of-payments deficit. The most important regulation, in Friedman's formulation, was Regulation Q. Whenever Regulation Q interest rate ceilings were below the domestic market rate, Friedman explained, "Euro-dollar deposits, paying a higher interest rate, became more attractive than U.S. deposits, and the Euro-dollar market expanded."[63] On top of Regulation Q, "direct and indirect exchange controls," such as the interest-equalization tax and "the 'voluntary' controls on bank lending abroad and on foreign investment" had all further

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[61] Milton Friedman, "The Euro-Dollar Market: Some First Principles," *Federal Reserve Bank of St. Louis Review*, July 1971, 16-24.
[62] Ibid, 17.
[63] Ibid, 18.

enabled the rapid growth of the Euro-dollar market.[64]Another complicating factor was the fact that Eurodollar banks were not subject to legal reserve requirements that would require them to hold a certain portion of deposit liabilities in cash. Friedman stressed that the existence of only partial reserves is why images of dollar piling up are erroneous. A Eurodollar bank might not keep any cash at all as an asset against time deposits, Friedman explained, and instead turn all those deposits into loans that could be used to pay off depositors on maturity with additional profits for the bank to keep.[65]

From his strict monetarist perspective, Friedman saw the problem with the Euro-dollar markets not as a lack of proper regulation but rather in the functioning of extant economic regulations, namely Regulation Q. Whereas Regulation Q was meant to restrict risky competition between banks for deposits and subsequent speculative use of financial resources, Banks could use Euro-dollars to keep up just as much business and just as big of balance sheets when Regulation Q ceilings came into effect. When banks lost deposits after the 1966 CD runoff, they replaced those assets with loans from their European branches. The net effect was that banks had just as much cash to hold in reserve before and after the credit crunch, and therefore could keep up just as much lending while still adhering to the Fed's reserve requirements. "The Fed's insistence on keeping Regulation Q ceilings to levels below market rates has simply imposed enormous structural adjustments," Freidman summarized, "and shifts of funds on the commercial banking system for no social gain whatsoever."[66] Friedman correctly identified that all that really changed because of current regulations was the structure of bank's balance sheets – liabilities that were once owed to owners of CDs

[64] Ibid.
[65] Ibid, 20.
[66] Ibid, 23.

simply became liabilities that were owed to the Euro-dollar banks. Because this was all happening through the Euro-dollar markets, however, the total amount of dollars to business actors globally had also increased.

As opposed to the Friedmanite focus on the ineffectiveness of regulation to respond to the growing Eurodollar threat, Congressman Henry S. Reuss thought that stronger government intervention in the financial sector was appropriate. Specifically, Reuss called for the Federal

Reserve system to impose "guidelines immediately for a voluntary freeze on bank credit at present levels."[67] Reuss, a Democrat representative from Wisconsin, was the chairman of the international section of the Joint Economic Committee and a member of the House Banking Committee. A former Republican who defected from the party in 1950 in protest of McCarthyism, Reuss carried a healthy suspicion of the banking sector, and was consistently supportive of official foreign aid. In 1965 Reuss created and chaired the Subcommittee on International Exchange and Payments in response to the growing balance-of-payments issue.[68]

Before a 1969 conference of banking executives, central bankers, and regulators in Copenhagen, Reuss "called for a complete study and overhaul of the national banking laws."[69] Reuss elaborated that the Federal Reserve needed to take action to ensure that commercial banks would not expand their lending "over some base date." Reuss's suggestion revealed a shared understanding, between Friedman and other contemporary observers, that

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[67] John M. Lee, "Bank Credit Freeze Urged; Reuss tells Conference in Copenhagen System Should Issue Guides," *New York Times*, June 20, 1969, 55, 60.
[68] Henry S. Reuss, *When Government Was Good: Memories of a Life in Politics* (Madison, Wisconsin: University of Wisconsin Press, 1999,) 94-98.
[69] Lee, "Bank Credit Freeze Urged," 60.

monetary policy and Regulation Q were not effective in getting banks to curtail lending activity. Instead of getting rid of regulation all together, as Friedman advocated, Reuss instead called for more powerful direct federal controls over banking activity. In a panel on "Public Policy Questions in Banking and Financial Regulations" Reuss's suggestions received pushback from prominent members of the banking establishment. Walter Wriston of Citibank responded that "quantitative controls have never worked very effectively" and current regulatory control of the monetary system was so "tight" that banks were "out of money." Whereas Reuss hoped that a credit freeze would "prevent 'further exacerbation of bank credit, relieve strains in the Eurodollar market, pave the way for lower interest rates and give banks a valid and honorable excuse' for withdrawing loan commitments made some time ago," Wriston implied that these issues would work themselves out if the market were just given time to balance itself. "If we are just patient," Wriston explained, "the heat will go out of the fire in a couple of months."[70] For Wriston, problematically high interest rates were simply a product of market dynamics instead of the other way around. For congressmen like Reuss, interest rate hikes from the Fed and commercial banks were instead the cause of problems that could be better addressed through direct control and intervention in the financial sector.

Amidst this debate over intervention in the Eurodollar market, on August 13th, 1969, the Federal Reserve took action to disrupt US commercial banks' ability to rely upon Eurodollar borrowings to sidestep domestic credit restraints. The Fed required that commercial banks would have to hold a reserve of 10 percent against dollars borrowed from

[70] Ibid.

foreign branches.[71] So as opposed to 1966, when commercial banks could weather a drastic credit crunch without sacrificing the expansion of loan portfolios by drawing on Eurodollars to pay off depositors, banks would have to cut back on new lending to remain in compliance with reserve requirements. To combat inflation, the Fed had already dramatically raised interest rates and standard reserve requirements in December of 1968. By mid 1969, market rates climbed to unprecedented highs: the prime rate rose to 8.5 percent while investors found yields as high as 9 to 11 percent. Once again, just as in 1966, these rates were well beyond what banks were able to pay depositors under Regulation Q and $6 billion of funds left the banking system for greener pastures. Again, banks turned to borrowed Eurodollars to meet demands of current clients. Commercial banks were already paying a premium for Eurodollars, and the Feds' new reserve requirements in 1969 made that money even more expensive.[72]

To Walter Wriston, the financial turbulence and regulatory challenges of 1969 were an unfair impairment of the business of commercial banking. "We bankers were all successful, last year," Wriston said in a 1970 speech before the First National City Bank Correspondent Forum, "our success was so great that we failed."[73] The success, for Wriston, was bankers' ability to continue to "manage their liabilities under the greatest monetary pressure the Federal Reserve System has ever exerted." "In spite of a discriminatory Regulation Q," Wriston continued, "we were successful in hanging on to most of our customers by finding other pools of liquidity to tap."[74] Those other pools of liquidity were no

[71] E. Erich Heinemann, "Banks See Squeeze: Reserve Adopts Euro Dollar Curb," *New York Times,* August 14, 1969, 45.
[72] Zweig, *Wriston*, 266
[73] Walter Wriston, "Nothing Fails Like a Success: An Address," February 7, 1970, MS134.001.002.00008, Walter B. Wriston Papers, Tufts Digital Library, http://hdl.handle.net/10427/36017.
[74] Ibid.

longer just Eurodollars, but also commercial paper. In February of 1968, Citi set up the First National City Corporation as a one-bank holding company, which enabled them to evade New Deal regulations against banks selling securities.[75] The failure amidst this success for Wriston, however, was a political one. While Wriston saw banks' move to new pools of liquidity as "the cutting edge of government policy" it still brought down the "politicians' wrath down upon the banks."[76]

The political wrath that Wriston referred to was perhaps best personified in Texas congressman Wright Patman. As chairman of the House Committee on Banking and Currency, Patman was known for his populist distrust of bankers and a strong disdain for monopolies. As Nancy Beck Young describes, Patman was "marked as unique in Congress" by the "endurance" of his "hostility to big business."[77] The 1968 move towards one-bank holding companies, which the other major commercial banks soon followed Citi's lead, was in his view an attempt to exploit a "loophole" in the 1956 Bank Holding Company Act that allowed banks to engage in a host of non-banking activities that that Glass-Steagall and other New Deal legislation sought to prevent. In February of 1969, Patman introduced legislation to close this loophole in the 1956 legislation. For Patman the need for legislation was not only to prevent "unfair advantage" against "both bank and non-bank competitors" of the big commercial banks but also to uphold the "public interest."[78] The conflict was succinctly summarized in fiery headline in the *New York Times*: "The Furor in Banking: First National

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[75] Zweig, *Wriston,* 226.
[76] Ibid.
[77] Nancy Beck Young, *Wright Patman: Populism, Liberalism, and the American Dream* (Dallas: Southern Methodist University Press, 2000,) 7.
[78] U.S. Congress, House, Committee on Banking and Currency, *Bank Holding Companies: Report together with Prevailing Views, Additional Views, and Individual Views,* 91st cong., 1st sess., July 23, 1969, Report No. 91-387, 2.

City Found the Loophole and Now Washington Is Reacting to It."[79] What to the banks' opponents was a loophole, was to bankers like Wriston a necessary lifeline.

In his 1970 speech, Wriston astutely prophesied that the while the efforts of the Federal Reserve and Congress to reign in credit creation would be ineffective in stalling inflation, the presence of "tight money" would incentivize a proliferation of risk. High market interest rates meant that corporations were increasingly turning towards bond issues instead of bank loans, and that other lenders were having to find new ways to compete. "The result is more competition in all types of lending activities," Wriston explained, "and along with it, what are bound to be some greater elements of risk in our loan portfolios." The only thing not on the table, apparently, was a reduction in new lending. According to Citi's five-year plan, forecasted loan growth would require the bank to "more than double" their "dependence on money market funds, Eurodollars, negotiable CDs and other non-deposit liabilities."[80] Wriston's sentiments reveal how commercial banks had begun developing a structural dependence on foreign markets to fund their own expansion.

Two years later, in letter to Fed Chairman Arthur Burns, Wriston, along with twelve other chief executives of major commercial banks continued to insist on re-regulating US foreign economic policy to be more amenable to US banks' interests. Specifically, the bank heads called on Burns to "decontrol capital movements" by repealing Kennedy's interest equalization tax, removing the Fed's guidelines on bank reserves for Eurodollar holdings, and the complete ending of Regulation Q interest rate ceilings. Like Wriston's earlier reasoning, the bankers cited competitive pressure as rational for ending capital controls. If the ability of US banks to export capital was decontrolled, according to the bank executives,

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[79] H. Erich Heinemann, "The Furor in Banking," *New York Times,* Feb 20, 1969.
[80] Wriston, "Nothing Fails Like a Success."

the "attractiveness of United States money and capital markets to foreign bankers and investors" would be "enhanced."[81] The bankers' insistence on market forces served to naturalize the new capital mobility the Eurodollar markets offered. In the letter's rhetoric Capital appeared to already be mobile and foreign investors ready to move money into the United States.

Eurodollars Find the Developing World

Throughout the latter half of the 1960s, while Eurodollars had become an essential source of liquidity for US bankers and "Public Enemy Number One" in the eyes of inflation-fighting Fed officials, governments across the Global South discovered the Euromarkets as a lucrative source of development financing.[82] The Eurodollar market had become a massive pool of accumulated capital, exploding from approximately $12 billion in size in 1964 to $187.6 billion in 1973. The US balance-of-payments deficit provided continual fuel for the market's growth, and the lack of regulation attracted holders of US dollars from countries in the developing world seeking high returns. As both US and European banks followed Citi's lead in expanding overseas operations, competition between lenders made private loans a viable addition to official economic aid for leaders in developing nations.[83]

Nearing the end of the 1960s, a sort of vacuum for development resources was created by the deterioration of support for international aid programs like Kennedy's Alliance for progress.[84] In August of 1968, the *New York Times* reported that "developing countries"

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[81] Letter, A.W. Clausen et. al. to Arthur F. Burns, January 10, 1972, Folder 20, Box 55, Henry S. Reuss Papers, University of Wisconsin-Milwaukee Library Archives.
[82] Zweig, *Wriston*, 266.
[83] Robert Everett Wood, *From Marshall Plan to Debt Crisis*, 82.
[84] George C. Abbott, *International Indebtedness and the Developing Countries* (London: Croom Hem, 1979,) 42.

being encouraged by Western governments to "rely more on private business as a source of foreign credit and investment" was representative of a "fundamental change" in "the world pattern of economic aid to the developing countries."[85] What used to be a site of Cold-War competition between the US and Soviet Union to provide economic aid in exchange for ideological influence, was now giving way to a "climate of fatigue and disenchantment."[86] The growing cost of the Vietnam War along with pressure exerted by domestic "protectionist lobbies" pushed foreign aid further down the list of funding priorities in DC. With less budgetary resources being allocated for foreign aid, grant-based assistance to the developing world was being replaced by loans.[87] These decreases in total aid resources and transition to debt-financing over grants helped craft a new role for commercial banks in global economic development.

In May of 1973, several months before the First Oil Shock would kick off the ill-fated spiral of petrodollar recycling, concern over the viability of increasing bank lending to developing countries was emerging from the business press. "Rivers of easy credit," reported the *Wall Street Journal*, "are flowing out of international money markets into Africa, Asia and Latin America, and the outpouring is stirring deep misgivings among lenders and debtors alike." The base concern was that states in the global south were simply not credit worthy. Countries that were already carrying debts with official organizations such as governments or the World Bank were increasing their reliance on "private lenders" who were not as "able to wait for their money." According to the article, the problem for bankers was that they were having to compete in a "Eurodollar market" that was "awash with funds" with "200 or more

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[85] Seymour Topping, "Aid to Developing Nations Shifting to Private Sector," *New York Times*, 1.
[86] Ibid, 3.
[87] Wood, *Marshall Plan to Debt Crisis,* 77.

international banks…competing aggressively to attract borrowers.” This intense competition to build “capacity” in the international market was driving bankers into “doing things internationally that they wouldn’t dream of doing domestically.” [88]

Not all bankers were enthusiastic about the development. One Richard H. Cummings, a senior vice president of the National Bank of Detroit, complained of the “rapidly deteriorating situation in international credit standards.” The director general of the Union Bank of Switzerland, Guido Hanselmann presaged that the uptick in private lending carried “political risks.” Hanselmann, invoking an antisemitic trope, warned of the coming “Shylock Syndrome,” which “the friendly banker of the past is seen as bossy and is resented.” Irving S. Friedman, a former IMF staffer who was then an economist at the World Bank (and who in the mid 1970s would be hired as a senior vice president at Citibank), described the behavior in the private banking sector as “erratic” and forecasted “at some time in the 1970s” that the “servicing of external debt was preempting 50% or more of the flow of financial resources to the developing countries.”[89]

The source of this new wealth of debt finance for developing nations was of course the Eurodollar market. By the early 1970s, most of these new bank credits were unannounced to the public. Out of all “Eurodollar loans from private sources” that were publicly announced, however, 10 percent went to developing countries in 1970, 35 percent in 1971, and 40 percent in 1972. Bond issues in the Eurodollar market by developing nations had skyrocketed to $1.3 billion in the first quarter or 1973, up from $455 million in 1971. The Eurodollar market, whose growth itself was a product of regulatory conflict and US banks

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[88] Charles N. Stabler, “Uneasy Money: Outpouring of Credit to Developing Nations Seen Spelling Trouble,” *Wall Street Journal*, May 21st, 1973, 1.
[89] Ibid.

efforts to maneuver around domestic controls, had therefore by the early 1970s given birth to a whole new realm of financial risk and inter-bank competition. As illustrated in the *Wall Street Journal* piece, both the banks suppling Eurodollars to developing governments and officials of those debtor nations were aware of "storing up trouble for themselves." But through syndicated loans bankers were "shoveling out money" that government officials found it difficult to turn down.[90]

In late 1973, the *Columbia Journal of World Business* described the dramatic increase of Eurodollar loans to developing countries over the previous two years as a product of unique conditions in the competitive London market as well as stagnant investment opportunities domestically. Commercial banks had traditionally been wary of lending for terms longer than one year, but the steady stream of deposits available through the "totally free and unregulated" Euromarket allowed banks to expand into new, long-term loans. This new kind of business carried with it novel risks. "The rapid entry of banks into the market," the article summarized, "made it difficult for them to build a staff of experienced lending officers." These fresh staffers, inexperienced in assessing credit risk, found it possible to lend "significant sums in the public sector, where the need for credit analysis of any particular loan was minimal." Prophetically, the article expressed concern that in general Eurodollar lenders "have not created a reserve for loan losses." In the event of a "major failure," banks could stand to lose "a relatively large portion" of their capital base. These new private loans offered debtor governments a degree of autonomy that aid from official sources did not. The benefit to developing nations was access to new credit for shorter terms and "with less red tape and far fewer restrictions" than comparable World Bank loans. World Bank loans,

[90] Ibid.

which typically were made for a period of 10 to 30 years, were less than one percent cheaper than Eurodollar loans. The small cost premium developing borrowers paid for private loans from the Euromarkets was far outweighed by the benefit of an easier, more liquid source for development funding. Debtor governments would not have to abide the politics of official lending institutions, which often reflected US interests given American domination of the major international financial institutions.[91]

Peru's 1968 nationalization of the International Petroleum Company (IPC)—a subsidiary of the US-owned Standard Oil—is an illustrative example of this new autonomy in action. In response US froze all assistance programs to the country and blocked official loans from the Inter-American Development Bank. The expropriation of IPC was part of the larger political-economic program of the Peruvian military dictatorship which had just taken power by coup. Under President Juan Velasco, the Peruvian government nationalized key economic sectors, redistributed land, and instituted a progressive tax regime. Velasco's developmental vision was meant to be a "third way" between capitalism and communism which would promote equality through increased state intervention. Given the threat to US multinationals, the US State Department erected an "economic blockade" around Peru.[92] In 1972, encouraged by Peru's export promise, commercial banks began lending. By early 1973, Peru had made up a significant portion of the lost financing through loans from private bank syndicates operating through the Euromarket. In May of that year, after years of resistance, the US government approved new official lending to Peru. Private banks, ironically, funded Peru's successful confrontation with US foreign policy goals.[93]

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[91] Weinert, "Eurodollar Lending to Developing Countries," 34-36.
[92] Barbara Stallings, *Banker to the Third World: US Portfolio Investment in Latin America, 1900-1986* (Berkeley: University of California Press, 1987,) 267-268.
[93] Weinert, "Eurodollar Lending," 36-37.

By the time of the first oil shock in 1973, then, several important factors had come together to produce an increase in US commercial bank lending to Latin American governments. On the supply side of the market, US banks faced a domestic market with relatively limited avenues for new business. New Deal bank regulations confined banks to doing business within their home states or regions. The development of the Eurodollar market provided banks a source of new funds they could use to expand domestic and international loan portfolios. Competition between commercial banks and a new unregulated international financial market pushed bankers into the kinds of long-term lending that commercial banks had traditionally avoided. On the demand side, Latin American countries discovered that this new source of financing enabled them to fund development outside of the restrictions that official aid from the US and international financial institutions would permit. When loan volume expanded greatly in the 1970s it was not simply the result of the exogenous shock provided by the oil crisis. The framework to support LDC lending was built by endogenous factors of the international financial system in the late 1960s and early 1970s.

Import Substitution Industrialization, Foreign Capital, and Bretton Woods

In addition to the enhanced autonomy Euromarket loans offered Latin American debtors, demand was also pushed by momentum in economic development. By the early 1970s, countries in Latin America had enjoyed relative prosperity and economic growth since the end of WWII. In Mexico, for example, historians have described the period of rapid and expansive economic growth spanning the postwar quarter century as the "Mexican Miracle."[94] The Mexican economy grew at an average of 6.4 percent per year, driven by a

[94] Sarah Babb, *Managing Mexico: Economists from Nationalism to Neoliberalism* (Princeton: Princeton University Press, 2001,) 75.

growing industrial sector serving a burgeoning domestic market. The growing Mexican population became increasingly more urbanized—in 1940 64.9 percent of the population lived in rural settings as opposed to 42.2 percent in 1970. With the growing economy, quality of life indicators grew as well: the literacy rate nearly doubled, infant mortality fell by nearly half.[95]

In Mexico, economic growth was driven both by a strong state presence in the economy and an opening to private capital. In a program of import-substitution industrialization (ISI), the Mexican government promoted trade protectionism through high tariffs on foreign manufactured goods, promoting "practically any new industry that substituted imports."[96] With the power of a robust bureaucracy staffed by economists, the state became heavily involved in industries like oil and utilities and directly financed industrial development through a state-owned development bank, *Nacional Financiera*. To ward off inflationary spirals, under President Adolfo Ruiz Cortines in 1955, the Mexican government employed a policy strategy they called "stabilizing development" which sought to limit increases in prices and wages and thereby avoid excessive devaluations of the peso.[97]

The period of stabilizing development, lasting through 1970, witnessed the promotion of the private banking sector via lax regulations on reserve requirements and laws promoting the growth of investment banks. As Sylvia Maxfield has shown, this shift in Mexican postwar governing priorities was the result of a transition of political domination away from labor and peasant leaders and towards a "bankers' alliance" made up of business elites and

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[95] Juan Carlos Moreno-Brid and Jaime Ros, *Development and Growth in the Mexican Economy* (Oxford: Oxford University Press, 2009,) 262.
[96] Ibid, 95.
[97] Hector Aguilar Camín and Lorenzo Meyer, *In the Shadow of the Mexican Revolution: Contemporary Mexican History, 1910-1989* (Austin, TX: University of Texas Press, 1993,) 168-169.

their political allies.[98] While the bankers' alliance upheld ISI and domestic development priorities, they did so with a welcoming attitude towards foreign capital. Importantly, at first, this capital came primarily in the form of foreign direct investment and loans through official institutions like the World Bank.[99] By the mid-1960s, however, the successes of Mexico's developmental effort created contradictions that turned the government towards private borrowing. As domestic industry grew, growing foreign direct investment produced unfavorable competition between Mexican firms and multinationals. Consequently, commercial banks loans, accessed via the Euromarket, made up the difference.[100]

Mexico's experience with ISI was emblematic of that of other Latin American nations which would go on to become main actors in the debt crisis. In Brazil, trade protectionism and foreign investment led to steady GDP growth and the tripling of industrial output between 1949 and 1961. This growth spurt gave way to significant inflation, which in turn produced political instability which would yield a military coup in 1964.[101] More so than Mexico, the Brazilian government retained a very heavy presence in the economy throughout the postwar growth period, with the twenty-five largest corporations having been owned by the state. By 1969, to maintain government intervention and state ownership, Brazil had turned to the Euromarkets as well.[102] That same year, against a similar backdrop of political instability, foreign debt levels in Argentina began to rise precipitously as well.[103]

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[98] Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (Ithaca: Cornell University Press,1990,) 9, 64-66.
[99] Christy Thornton, *Revolution in Development: Mexico and the Governance of the Global Economy* (Oakland: University of California Press, 2021,) 145-148.
[100] Jeff Frieden, "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea," *International Organization* 35, no. 3 (Summer 1981): 407-431.
[101] Werner Baer, *The Brazilian Economy: Growth and Development* (Boulder: Lynne Rienner Publishers, 2014,) 65-73.
[102] Frieden, "Third World Indebted Industrialization," 421.
[103] David G. Erro, *Resolving the Argentine Paradox: Politics and Development, 1966-1992* (Boulder: Lynne Rienner Publishers, 1993,) 65.

As these examples demonstrate, the turn towards foreign commercial bank loans in the years before 1973 was the product of internal contradictions in ambitious development programs. The intellectual backbone of the ISI programs that Eurodollar loans were originally sought to maintain was an explicit desire to escape dependence on foreign capital. Through the United Nations Economic Commission for Latin America (ECLA), organized in 1948, Latin American intellectuals and policy elites developed a theoretical rebuke to the dictate of classical economic theory that a regime of international free trade would lead to shared prosperity between the Global North and South. Instead, the ECLA model argued that *laissez faire* international trade created a structural dependence on imports of finished goods from the "core" of developed countries that developing countries paid for through exports of primary commodities. As a corrective, the "periphery" of Latin American states would have to sever this dependence through active government protection of their domestic industrial sectors. One of the most famous proponents of this theory was Argentine economist Raul Prebisch, who first used the language of core and periphery before a 1946 meeting of Latin American central bankers held in Mexico City.[104]

The turn towards private debt in the late 1960s was not unprecedented—Latin American countries had borrowed heavily from foreign banks throughout the nineteenth century and during the interwar period.[105] During the Great Depression, many Latin American debtors began defaulting on their debts and completely suspending payments. By 1933, sixteen Latin American countries were in default. When Mexico stopped paying in 1928, US creditors had 2,800 claims against the Mexican government which were not settled

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[104] Babb, *Managing Mexico*, 76.
[105] See: Barry Eichengreen and Peter H. Lindert, eds., *The International Debt Crisis in Historical Perspective* (Cambridge, MA: The MIT Press, 1989); Max Winkler, *Foreign Bonds: An Autopsy* (Washington D.C.: Roland Swain Company, 1933.)

until 1941.[106] Peru, which declared a moratorium on all debt payments in 1931, did not reach an agreement with creditors until 1953.[107] In response to these confrontations, foreign banks ceased to do business in Latin America throughout World War II and the first two postwar decades. In their stead, official lenders filled the gap.

In the immediate postwar years, the character of and roles played by official lenders like the IMF and World Bank were different than what they would evolve to be in the Washington Consensus. Both organizations were born from the Bretton Woods conference of 1944 and were initially designed to uphold the Bretton Woods international political economic order. The World Bank was conceived of in 1944 as The International Bank for Reconstruction and Development (IBRD), and initially was meant to fund the rebuilding of war-torn Europe and Japan. The IMF, alternatively, was meant to provide short-term financing to member countries facing balance-of-payments disruptions. The original aim of IMF intervention was to help member countries maintain currency exchange rates compatible with the US dollar's peg to gold at $35 per ounce.[108] Between the two of them, the World Bank was envisioned as "junior partner" who would mostly work to guarantee loans from private sources.[109]While in their Bretton Woods conception both the IMF and World Bank were primarily concerned with the monetary affairs of the Global North, they both would develop a presence in Latin America well before the 1970s. In specific regards to the IMF, the stipulations attached to IMF loan agreements—known as "conditionality"—would slowly evolve in scope and reach throughout the 1950s and 60s.

[106] Camín and Meyer, *In the Shadow of the Mexican Revolution*, 105.
[107] Stallings, *Banker to the Third World,* 263.
[108] Daniel McDowell, *Brother, Can You Spare a Billion? The United States, the IMF, and the International Lender of Last Resort* (Oxford: Oxford University Press, 2017,) 24.
[109] Wood, *Marshall Plan to Debt Crisis,* 22.

The first IMF loan in Latin America was made to Peru in 1954. The loan agreement was only two pages long and did not contain any criteria for accessing the financing.[110] Four years later, Argentina signed its first loan agreement with the Fund. Argentina had been cooperating with the IMF since the fall of 1955 over trouble paying its debts to European creditor countries and a lack of foreign exchange to make those payments. As part of the agreement Argentina implemented a stabilization plan designed to rein in inflation. The Argentinean government agreed to reduce the number of government employees by 15 percent and delay completed public construction projects, among other measures. As Claudia Kedar has shown, in this early phase of IMF involvement in Latin American economic affairs, the Fund was not directly involved in imposing the liberalizing economic reforms. Rather, Kedar argues, by being admitted to the IMF as a member country, Argentinean elites slowly "internalized…the principles and working norms of the Bretton Woods institutions."[111] The first IMF loan to Argentina was only $75 million, but access to IMF funding was important as seal of approval that would incentivize more funding form other official institutions like the US Treasury and Export-Import Bank.[112] During the 1960s and early 1970s, political instability in Argentina caused the country's relationship to the IMF to fluctuate in terms of economic dependence. President Arturo Illia, during his term from 1963 to 1966, attempted to distance Argentina from the Fund and World Bank by refusing to sign any new loan agreements and resisting instituting organizational reforms of state enterprises on behalf of the World Bank. Still, the IMF and World Bank maintained a foothold in the

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[110] Sarah Babb and Ariel Buira, "Mission Creep, Mission Push and Discretion: The Case of IMF Conditionality," in *The IMF and the World Bank at Sixty* ed. Ariel Buira (London: Anthem Press, 2005,) 62.
[111] Claudia Kedar, *The International Monetary Fund and Latin America: The Argentine Puzzle in Context* (Philadelphia: Temple University Press, 2013,) 57-63.
[112] Ibid, 65.

country, and by 1972 the country was again seeking intensive funding from the IMF, World Bank, and private banks.[113]

For Mexico, similarly, the IMF and World Bank played an important role in development strategy during the 1950s and 60s. As part of Mexico's stabilizing development strategy, Mexican political elites came to rely on the IMF for advice on how to institute currency devaluations without causing undue social unrest. It was through these consolations with the IMF that Mexico remained in good graces with the World Bank. Through the World Bank, the Mexican own state development bank received loans for industrialization projects. Still, several World Bank loan requests were denied. Mexico's state-owned oil company, PEMEX was denied development funds because of then-World Bank President Eugene Black's disapproval of a public monopoly in the oil sector. It was because of conflict such as this, that Mexico began soliciting private loans which would offer more freedom in development usage. As Christy Thornton as has shown, it was not the existence of institutions like the World Bank and IMF that Mexican officials rejected, but rather just the indifference of these organizations to the specific needs of developing countries.[114] In the era of the Mexican Miracle access to IMF and World Bank funds was not as desperately needed as it would become decades later in the debt crisis. And with the advent of Eurodollar lending, Mexican officials had another more liquid and less politically invasive source of financing.

While in terms of sheer dollar amounts, the roles played by the IMF and World Bank in the pre-oil shock decades in Latin America were not all that significant, a framework was developed for the kind of conditionality and structural adjustment requirements those

[113] Ibid, 87-108; Erro, *Resolving the Argentine Paradox,* 67.
[114] Thornton, *Revolution in Development*, 157-164.

organizations would later come to impose. As Sarah Babb and Ariel Buira have argued, in the 1950s the IMF developed a "monetary approach to the balance of payments" whereby countries facing balance-of-payments issues were advised to tamp down domestic demand through restrictive monetary policy.[115] In the 1960s, as the work of political economist Jeffrey Chwieroth has shown, officials and intellectual elites at the IMF continued a gradual drift away from Keynesian economic doctrine towards the neoclassical and monetarist approach that would inform the IMFs approach to the global balance-of-payments issues in the 1970s and debt crisis in the 1980s.[116] One exemplarily IMF staffer from the period is Irving S. Friedman. As head of the IMF's Exchange Trade and Relations Department until 1964, Friedman claims to have invented annual consultations with debtor countries. Friedman had "twice threatened to resign from the Fund because [conditionality consultations] had tremendous opposition from the member countries." In instituting this oversight this measure at the Fund, Friedman became the self-described "father of conditionality."[117] The World Bank, similarly to the IMF, drifted away from the strict quality standards in the mainly infrastructure projects it would be willing to fund, and began to undertake more expansive lending programs with the presidency of Robert S. McNamara in 1968.[118] Both organizations then, had gradually become more ideologically amenable to

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[115] Babb and Buira, "Mission Creep," 63.
[116] Jeffrey M. Chwieroth, *Capital Ideas: The IMF and the Rise of Financial Liberalization* (Princeton: Princeton University Press, 2010,) 121-122.
[117] *Transcript of oral history interview with Irving S. Friedman held on December 11, 1985; and February 6, 28, 1986 (English)*, World Bank Group Archives oral history program Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/290831564605981637/Transcript-of-oral-history-interview-with-Irving-S-Friedman-held-on-December-11-1985-and-February-6-28-1986.
[118] Amy L.S. Staples, *The Birth of Development: How the World Bank, Food and Agriculture Organization, and World Health Organization Changed the World, 1945-1965* (Kent, Ohio: Kent State University Press, 2006,) 43-45.

liberalizing reforms that would eventually become a hallmark of the Washington Consensus, and had begun to develop the mechanisms to enforce those reforms.

Conclusion

By the time of the first oil shock, US commercial banks already had a firm presence in Latin America and the greater developing world. By 1973, headlines like "Why the Fast Spread of U.S. Banks Overseas?" were a common occurrence. Contemporary observers also well understood that the spread of US money-center banks overseas was largely motivated by a desire to undermine domestic financial regulations. As *U.S. News &World Report* reported in December 1972, US banks were "limited to operating in one State or even a single city" could now "expand abroad without such restrictions" thanks to the Eurodollar markets.[119] Aggressive banks like Citi took advantage of the political economic situation to build up larger loan portfolios, and offer higher interest rates on financial instruments like CDs, than the New Deal Order regulatory regime would permit. Through the Eurodollar markets, Commercial banks found an eager customer base consisting of Latin American governments who could continue domestic ISI programs with more flexible money than official, government-to-government sources would offer. Despite protests from regulators, Eurodollars remained largely unregulated and not subject to reserve requirements which only fueled the rapid supply of new dollars to the Euromarket. At the same time, international financial institutions like the IMF were already beginning to make a pivot away from limited balance-of-payments financing to the more invasive role that the Fund would come to play

[119] "Why the Fast Spread of U.S. Banks Overseas," *U.S. News & World Report,* December 4, 1972.

under the Washington Consensus. The advent of the Fund's conditionality requirements in the 1950s and 1950s reflected this change in the IMF's governing paradigm.

In sum, by 1973 several important preconditions for the development of the Washington Consensus were firmly in place: Capital was becoming internationally mobile thanks to the Euromarkets, developing countries in Latin America were turning towards private debt to fund domestic development, and the IMF had begun formulating the kind of conditionality requirements which would become hallmarks of Washington Consensus political economy. Bankers in the 1970s would go on to defend their aggressive marketing of loans to the developing world as a mere representation of financial markets providing a corrective force against the international imbalance in the global distribution of liquidity. As the late 1950s and 1960s demonstrate, however, the buildup of debt in the decade preceding the emergence of crisis in 1982 was not solely a product of exogenous shock. Nor was the financial crisis, when it did happen, just a matter of liquidity, as bankers also insisted. Rather, in the years preceding 1973, the dependence of banks on developing countries and developing countries on banks was produced endogenously. Banks needed overseas markets to fuel their growth in profitability, which would in turn give them more leverage over the makers of regulatory policy. Developing countries, on the other hand, found a pool of easily obtainable financing offered at generous terms which proved much more attractive than the going to official development institutions for what limited financing was available. After an era of economic "miracles" and rapid growth in the immediate postwar years, Latin American political elites were eager to keep growth rates high. The first oil crisis, then, was merely the spark that set fire to a sizable pile of kindling.

CHAPTER II

"AN ADDITIONAL PUBLIC ASSISTANT:"
THE OIL SHOCKS, PETRODOLLARS, AND THE EMPOWERMENT OF THE INTERNATIONAL MONETARY FUND IN THE 1970S

Beginning in March 1982, newly appointed Mexican finance minister Jesus Silva Herzog was making regular, secret trips to Washington D.C. To avoid alerting his fellow political officials in the lame duck administration of Mexican President Jose Lopez Portillo to what he was up to, Silva Herzog would leave Mexico City on a government plan late on Thursday afternoon and return to Mexico early enough on Friday for no one to realize he was gone. In Washington, Silva Herzog was discussing Mexico's rapidly deteriorating financial status with the executive directors of the International Monetary Fund and World Bank, the chairman of the Federal Reserve, and the US Treasury Secretary. Silva Herzog was particularly fond of the lemon meringue pie that Fed Chair Paul Volcker had made a Friday staple at the Fed cafeteria. Mexico was reeling from a softening of the oil market that the country had come to depend on for enough foreign exchange dollars to make loan payments in addition to a continuous capital flight putting further downward pressure on the peso. The US officials insisted that Silva Herzog go to the IMF to begin talks over an economic reform package. As Silva Herzog repeatedly replied to them, President Lopez Portillo would never accept any further assistance from the IMF given his rejection of the kinds of policy reforms that would come with any IMF funding. Any major reform package would have to wait until the beginning of the more capital-friendly Miguel de la Madrid administration in December. In the meantime, Mexico would have to keep borrowing from private banks to buy time.

Months later, Mexico would no longer be able to make those loan obligations, and the Latin American debt crisis would officially begin.[1]

In part, Mexico's financial troubles were a product of a series of economic shocks in the 1970s which had blown up the extant economic order, creating a structural imbalance in the distribution of global liquidity that commercial banks—operating through the Euromarkets—inserted themselves in the middle of. Shortly after Nixon's dismantling of the Bretton Woods system of fixed exchange rates, the first oil shock further challenged the global balance of economic power. These changes were felt most painfully in the international payments system. While a floating dollar created newfound uncertainty in exchange rates, the unprecedented spike in the price of oil after 1973 created a grave imbalance in the global balance-of-payments. Inflated oil prices lead to immense surpluses in most oil-exporting nations while simultaneously creating equally inflated balance-of-payments deficits for oil-importers. Facing these inflated import bills, both the eastern bloc and the so-called less developed countries (LDCs) of the Global South desperately needed sources for financing their deficits. Commercial banks were able to maneuver themselves squarely between these two parties. Taking deposits from the exporters, and making loans to the importers, commercial banks recycled so-called petrodollars to keep global trade afloat in the face of the disruption.

As explored in Chapter One, Latin American debtor countries like Mexico had already begun to turn towards private banks by the late 1960s for access to loans that would

[1] This anecdote is based on accounts of the meetings with Silva Herzog from multiple sources, see: Phillip L. Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown Publishers, 1995,) 750-751; James Boughton, *The Silent Revolution: The International Monetary Fund 1979-1989* (Washington D.C.: The International Monetary Fund, 2001,) 285; Paul Volcker and Toyoo Gyohten, *Changing Fortunes: The Worlds Money and the Threat to American Leadership* (New York: Times Books, 1992,) 199.

permit debtor states to continue domestic development programs with more political autonomy than loans from official lenders would permit. The near decade between 1973 and 1982, however, did much more than just add fuel to the fire. Between 1973 and 1982, the overall volume of international bank lending grew from $296.6 billion to $169.45 trillion, or 471 percent.[2] Between 1973 and 1979, meanwhile, LDCs were able expand their economies at triple the rate off the large industrial countries, given an expanded external indebtedness from less than $100 billion to $350 billion in 1979.[3] In addition to funding economic development efforts in the Global South, commercial banks also pitched themselves as providing an essential corrective to the international economic turmoil instigated by the precipitous rise in oil prices. By taking deposits from cash-rich oil exporting countries and loaning those dollars back to oil importing nations that were then able to pay for inflated import bills, bankers like Walter Wriston could defend their extensive loan profiles as necessary for keeping global commerce afloat. By becoming the primary vehicle which policymakers came to rely on for the recycling "petrodollars," as cash used in oil transactions was commonly known, commercial banks' foreclosed alternative policy measures that would not have added so much to the debt burdens of oil importing states.

The 1970s witnessed the expansion and empowerment of the IMF, which would later become a crucial factor for consolidating the Washington Consensus. Instead of bids from other international organizations like the OECD to become the primary recycler of petrodollars, policymakers in the United States ultimately gave their approval to the IMF's

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[2] Cohen, *In Whose Interest: International Banking and American Foreign Policy* (New Haven: Yale University Press, 1986,) 23.
[3] Penelope Hartland-Thunberg, "Causes and Consequences of the World Debt Crisis," in *Banks, Petrodollars, and Sovereign Debtors: Blood from a Stone?* eds. Penelope Hartland-Thunberg and Charles K. Ebinger (Lexington, Massachusetts: D.C. Heath and Company, 1986,) 3.

newly created "Witteveen Facility"—a supplementary pool of money that member states could draw from for balance-of-payments financing. While the amount of money committed to the Witteveen Facility was not enough to displace the role of commercial banks in the petrodollar recycling process, it was big enough for the IMF to continue to outgrow the limited role its founder's envisioned in the Bretton Woods era. The IMF, in the late 1970s, came to be an international lender of last resort, what one congressman referred to as "an additional public assistant."[4] Commercial bankers threw their support behind the IMF's expansion to offset the risk of their own loan portfolios. Debtor countries experiencing difficulties meeting their loan payments could go to the IMF to get money to keep paying the banks with. Thanks to its greater funding, in the 1970s the IMF gained the leverage it would need to impose increasingly strict austerity requirements attached to loans. The conditionality paradigm that had developed in the 1950s and 1960s became stronger owing to the increased funding support the IMF received from the US and other major creditor countries.

Importantly, support for the expansion of the IMF and of commercial banks was in no way unanimous among policymakers in the 1970s. Anxious observers in Congress, at the Federal Reserve, and in the Carter Administration raised red flags over the growing dependence of commercial banks on the LDC loans. Calls for capital controls from bodies like the Initiative Committee for National Economic Planning would have limited the ability of banks to freely import and export capital from the US and to do so with little money set aside in against the LDC loans. The defeat of these regulatory alternatives places the role of

[4] US Congress, House, Subcommittee on International Trade, Investment and Monetary Policy, Committee on Banking, Finance, and Urban Affairs, *U.S. Participation in the Supplementary Financing Facility of the International Monetary Fund: Hearings before the Subcommittee on International Trade*, *Investment and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs,* 95th Cong., 1st sess., September 20, 29, and 30, 1977, 152.

the commercial banks and the IMF in a larger process of the financialization of the US and world economy, whereby increasingly more profits were made through financial channels instead of productive ones. Without these developments, the outsized influence creditors held on debtor countries' economic policy making during the 1980s and era of the Washington Consensus may not have come to be.

Banks, Petrodollars, and the First Oil Shock

On the Jewish High Holiday of Yom Kippur, in late 1973, Egypt and Syria attacked Israeli military positions in the occupied Sinai Peninsula and Golan Heights, respectively, beginning the Fourth Arab-Israeli War. Egypt and Syria were both members of the Organization of Arab Petroleum Exporting Countries (OAPEC), a subset of the larger Organization of Petroleum Countries (OPEC). In retaliation for the United States and other Western countries support of Israel in the conflict, OAPEC proclaimed an oil embargo which would ultimately produce a quadrupling in the price of oil throughout 1974. By taking deposits from cash-rich OPEC nations and cycling those dollars back to oil-importing developing nations, US commercial banks were able to recycle "petrodollars." [5]

The banks eagerly recycled petrodollars not only because of the global need for credit, but also because of domestic economic conditions. As summarized in one history of the debt crisis, US commercial banks in the 1970s "had been losing their share of household savings to other types of intermediaries for decades" and expanded foreign lending operations as part of a "search for new markets and profit opportunities."[6] There was

[5] Federal Deposit Insurance Corporation (FDIC). Division of Research Statistics, "Chapter 5: The LDC Debt Crisis," *History of the Eighties: Lessons for the Future*. (Washington, DC: Federal Deposit Insurance Corporation, 1997,) 192, 198.
[6] Ibid, 195-196.

therefore a sort of push and pull that moved US commercial banks into the center of global finance. The abandonment of domestic financial commitments was also self-reinforced by the promise of overseas profits. In New York City, for example, where banks had for a long time happily rolled over the city's municipal debt and purchased its bonds, by the mid-70s banks had become more reluctant business partners. In the words of Kim Phillips-Fein, after "having begun to operate in a global context" big NYC banks "no longer saw their economics and political interests being inextricably tied to those of the city."[7]

As one financial journalist remarked, these new overseas markets were "lucrative" for commercial banks.[8] Citibank, led by Walter Wriston, was the American commercial bank with the largest overseas presence and most aggressive approach to international lending. It was hailed in the business press as "fat city." By lending to developing nations that had previously been underserved by private international finance, Citi took advantage of the lack of competition in developing markets to lend money at much higher interest rates than those of safer Eurodollar loans to borrowers in developed countries, where most other major commercial banks had concentrated their international portfolios.[9]

In March of 1975, *Fortune* magazine ran a ten-page article detailing Citi's success in overseas markets. The title page of the article featured a picture of Walter Wriston sitting casually in front of a large tapestry map of the globe that hung in his office. The picture itself, foregrounding a suited and serious-looking Wriston, seemed to foreshadow the outsized influence that Wriston's aggressive foreign lending would eventually exert over the operation of the global economy. The caption of the photo summed up Wriston's attitude

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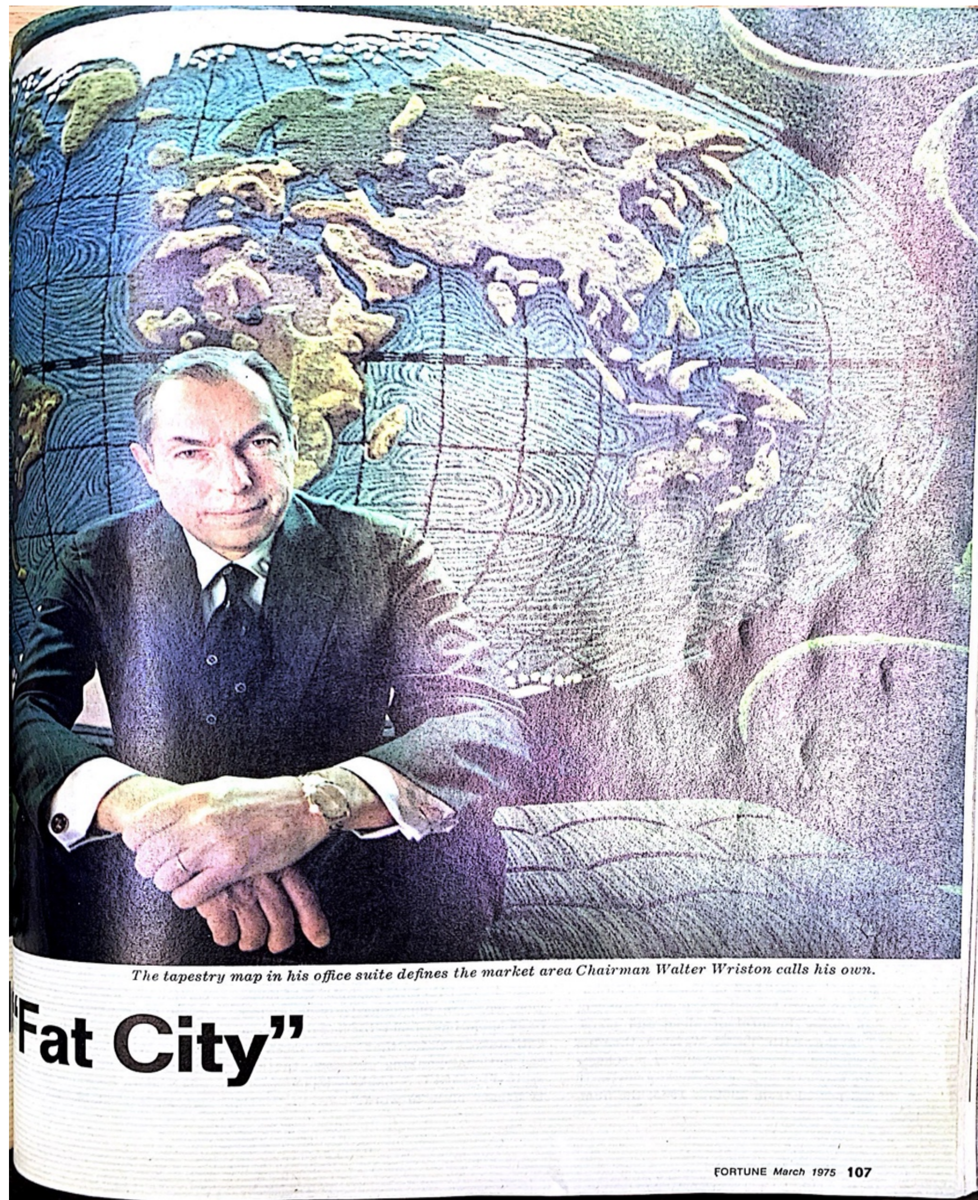
[7] Kim Phillips-Fein, *Fear City,* 87.
[8] Ibid, 196.
[9] Sanford Rose, "Why They Call It Fat City," *Fortune*, March 1975, 106-111, 164-167.

towards the international market succinctly: “The tapestry map in his office suite defines the market area Chairman Walter Wriston calls his own.” (See Figure 1) By prefacing an article on Citibank’s global operation with a picture of Wriston, the article also insinuated that Wriston himself was responsible for Citi’s turn towards international lending. Whether or not Wriston was responsible for pushing the business in that direction, *Fortune* magazine reflected a larger trend of using Wriston as a symbol of the US commercial banking industry in its entirety. Indeed, the article acknowledged it had “become popular to attribute Citibank’s outstanding record to the superb and aggressive management team put together by Walter Wriston.”[10]

[10] Ibid.


The tapestry map in his office suite defines the market area Chairman Walter Wriston calls his own.

"Fat City"

FORTUNE March 1975 107

Figure 2. Fortune Magazine, March 1975, p. 107

The *Fortune* article discussed the method by which Citi was able to extract so much profit from its international operations. Whereas other major banks focused their foreign lending efforts on safer Eurodollar loans, Citi held "between $3 billion and $4 billion" of its $15 billion loan portfolio in loans to "the poorer countries." "The profit margins on this end of the business are spectacular," the article elaborated, "they are so high, in fact, that Wriston is fond of saying: 'Around here, it's Jakarta that pays the check." The reason that lending to

the developing world was so lucrative was not so much because of market forces, but rather because of the lack of such forces. As the article described, "In the less developed world, the bank's regular interest earnings as well as its fee income are inflated by the absence of a vigorous competitive environment." In other words, Citibank may have taken a risk in expanding to markets that other US banks had not, but it was only because of a distinct lack of risk in those markets that the loans were so profitable. "The profits of local banks in many poor countries," the article explained, "are protected by cartel arrangements or else guaranteed by the government…. Although Citibank claims it does not actively collude with such associations, as a market participant it obviously benefits from such arrangements."[11] So while Wriston was preaching the virtues of free markets domestically, his bank was generating profits abroad through government-sponsored insulation from market forces.

From early on, however, the pronounced absence of more official forms of aid for developing nations needing to finance their balance-of-payments deficits started to highlight new challenges. A 1976 piece in the *Institutional Investor* trade magazine, for example, suggested that perhaps commercial bankers were painting themselves into a corner with their aggressive lending. As the piece explained:

> It goes without saying that the magnitude of the banks' loans to LDCs means that bankers feel duty bound to make increasing demands upon the LDCs that seek their funds. But carrying this to its logical conclusion conjures up age-old fears of domination of the Poor by the Rich, of renewed Dollar Diplomacy by the U.S., of exploitation of previous colonies by a host of Western nations – and a renewal of all the worst charges that have been heaped upon multinational corporations.[12]

In other words, to ensure the credit worthiness of the developing nations receiving loans, large US commercial banks were making demands of economic policy makers in creditor

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[11] Ibid.
[12] Harvey D. Shapiro, "Monitoring: Are the Banks Biting Off More Than They Can Chew?" *Institutional Investor*, October 1976, 140.

countries to produce an environment safe for investment. The *Institutional Investor* specifically cited a "drastic economic stabilization program" stipulated in a balance-of-payments loan "put together by Citicorp and a steering committee of five other major U.S. banks" made to the Peruvian government. Peru was required to maintain a devalued currency, charge higher prices on public transportation and electricity, and report periodically to the lender banks on "economic progress."[13]

The Peruvian case was especially unique in that it saw Citi pre-empting the powerful role of the IMF that would eventually be established, much to the chagrin of the IMF. In 1976, against the background of falling copper prices and economic crisis, Peruvian officials sought $400 million from private banks to pay principal and interest on the government's foreign debt, in addition to $200 million already requested from the IMF. Under the leadership of Citi executive Irving Friedman, a consortium of banks put together a $386 million assistance package for Peru. The conditions attached to the private loan, however, were significantly more far reaching than the IMF's. The banks didn't just want a devalued currency and culled budget, but also for leftist officials to be expelled from the government. The banks' authority could not stop the Peruvian government from spending money on Soviet fighter jets, however, and more severe austerity wouldn't happen in Peru until having to agree to a bigger IMF austerity program a year later.[14] This give and take between the IMF and the banks, with Citi at the head, was indicative of the larger process of building the debt restructuring and conditionality processes that would eventually characterize the Washington Consensus.

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[13] Ibid, 141.
[14] Phillip L. Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown Publishers, 1995,) 569-570.

The mounting anxiety over LDC loans was not limited to the financial trade press. While the trade publications focused more on the political risks commercial banks were taking in lending to possible recalcitrant debtors like Peru, more mainstream outlets were worried about the risks banks were imposing on the international financial system. In December 1976 the *Washington Post* ran a story on the LDC debt situation that characterized "the poorer countries' massive debt" as a "bomb that can go off at any time."[15] The article directly linked Citibank to the debt-bomb, noting that two-thirds of the US's share of the potentially bad debt was held by just six banks, with "First National City Bank" (Citibank) at the top of the list.[16] In contrast to the careful business calculation of risk that Wriston had suggested banks undertake elsewhere, the *Washington Post*'s bomb metaphor linked Citi's behavior to a sense of uncertainty. Aside from the uncertainty of when the "bomb" might go off, the article pointed to uncertainty over just how threating the debt situation was, noting that the "magnitude of the problem cannot be precisely measured."[17] Citing Chief Economic Advisor Alan Greenspan's concern that LDCs may have "just about reached the outer edge of their borrowing capacity," the article warned that renegotiations of LDC debt could produce "an adverse impact on that elusive element called 'confidence.'"[18] The *Post*'s criticism of US banks' lending activity was here premised on the threat uncertainty posed to the foreign exchange markets. The risk-taking that Wriston had championed, in the eyes of the *Washington Post*, threatened the productive operation of the very markets that Wriston notion of freedom was built upon. It would not be long until the same questioning attitudes emerged from Congress.

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[15] Hobart Rowen, "Other Countries Debt May Plague US," *The Washington Post*, December 14, 1976.
[16] Ibid.
[17] Ibid.
[18] Ibid.

Just a few months later, Wriston responded to the "recent…great deal of discussion about the less developed countries and their relation to the industrialized world and international capital markets" in a speech before the United Nations Ambassadors Dinner held in May 1977. As opposed to the "drumfire of criticism" from contemporary observers, the only uncertainty Wriston saw in the LDC debt situation was that produced by policymakers, not the market itself: "Whether [the] trend toward private financing will continue cannot be predicted with certainty, since no one can be sure what policies governments may choose to adopt. But to the extent that normal economic forces are permitted to operate, private international finance will undoubtedly become increasingly important to the LDCs." The distinction Wriston drew here between government policy and "normal economic forces" corresponded directly to the theoretical distinction between uncertainty and calculable risk. That is, while normal economic forces could be relied upon to act as predicted, the actions of policy makers could not be reliably anticipated. Therefore, Wriston's logic followed, if there was any possibility of LDC debt turning toxic, policymakers, not market actors, would be to blame.[19]

To further assuage doubts over the LDC debt situation, Wriston continued in the speech to invoke the economic history of the United States as a positive example of the role of the "foreign creditor" in a developing country. Citing the examples of a Dutch bond issue "to help build Washington D.C. and the "100% British" ownership of "the Alabama, New Orleans, Texas and Pacific Junction Railroad," Wriston assured the international ambassadors in the audience that "like every other developing country, the U.S. was built

[19] Walter Wriston, "Let's Create Wealth, Not Allocate Shortages," May 24, 1977, MS134.001.003.00015, Walter B. Wriston Papers, Tufts Digital Library, http://hdl.handle.net/10427/36036.

with borrowed money." Wriston said the "America experience" demonstrated that there was "nothing intrinsically wrong about carrying a large external debt" as long as foreign capital was "treated as an asset and not as an enemy."[20] By choosing to ignore the protectionist rhetoric of the nineteenth-century "American School" or the myriad financial crises of that period, Wriston's historical narrative emphasized that it was not indebtedness that generated uncertainty, but rather political decisions regarding foreign debt.[21] Wriston's advice to policymakers in developing countries to create a capital-friendly political environment would seem to confirm the very fears expressed in the *Institutional Investor* about American commercial banks assuming problematic, quasi-imperial political powers. In line with his emerging philosophy of risk, Wriston reified the notion that political actors should submit their own autonomy to the demands of credit markets. Wriston's use of language and historical narrative worked to mask pseudo-imperial power politics under the ambiguous guise of "normal economic forces."[22]

By "undertaking a role traditionally reserved to the international organizations such as the International Monetary Fund," Citibank seemed to be taking on some of the same regulatory powers that Wriston claimed to detest.[23] In a May 1975 editorial for *Newsweek* entitled, "An Economic Police State," Wriston railed against the newly created Initiative Committee for National Economic Planning (ICNEP), which he described as "pressing for a program designed to destroy the free-market system and with it our personal liberty."[24] The ICNEP was formed in October 1974 by a group of progressive intellectuals and labor leaders

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[20] Ibid.
[21] See: Martin J. Sklar, *The United States as a Developing Country* (Cambridge: Cambridge University Press, 1992.)
[22] Wriston, "Let's Create Wealth."
[23] Harvey Shapiro, "Are Banks Biting Off More Than They Can Chew," 141.
[24] Wriston, Walter B. "An Economic Police State," *Newsweek*, 5 May 1975.

including the economists Wassily Leontief, John Kenneth Galbraith, Robert Roosa, and the president of the United Auto Workers, Leonard Woodcock. The group advocated for the formation of an "Office of National Economic Planning" to be housed within the US executive branch that would be able to tackle the stagflation crisis through measures like credit controls, traditional tax incentives, and production targets for key industries.[25] While the kinds of policy changes pushed by ICNEP were not directly tied to banks' international lending, they nonetheless posed an alternative to the continual buildup of LDC debt on Wall Street balance sheets by suggesting measures that would have driven capital into domestic investment instead of foreign loans. It was the dissolution of capital controls in the first place which enabled the debt build-up to pick up steam, so those kinds of regulatory measures remained an alternative path not taken in the decade preceding the Latin American Debt Crisis.

Despite Wriston's public posturing, Citi's developing world profiteering had led the corporation to force economic planning on some of its sovereign clients, in the form of stabilization programs. The *Institutional Investor* also quoted Citi's Vice Chairman and head of international operations, G.A. Costanzo, seeming to recognize the nature of the situation at hand: "I don't think the banks can play the role of appearing to intervene in the affairs of a country…Whether they like or not, it could be considered Wall Street imperialism."[26] This instance of a Citi executive speaking the language of imperialism and acknowledging bank's possible complicity in the matter was indicative of the historical moment. In the wake of the

[25] The Initiative Committee for Economic Planning, "For a National Economic Planning System: The Initiative for National Economic Planning," *Challenge* 18, no. 1 (March-April, 1975): 51-53.
[26] Shapiro, "Are the Banks Biting Off More than They can Chew?", 142.

ending of the Vietnam War in 1975 and after over a decade of anti-imperial New Left activism, the charge of imperialism was not one to be taken lightly.

The Need for Order

In the mid-1970s, the International Monetary Fund was not yet adequately equipped to tackle the burgeoning developing world balance-of-payments problem. Born from the 1944 Bretton Woods conference, in the first two decades of its existence the Fund played a relatively minor role in global economic affairs. Until the unraveling of fixed exchange rates in the early 1970s, the IMF's main role was to provide financing to developed countries to support the fixed value of the US dollar. While the Fund had begun to develop a presence in Latin America in the 1950s and 60s, its official mandate was supporting the Bretton Woods exchange rate regime. Throughout the early 1970s, the fund had been undergoing an uncertain transition into supporting the new global system of floating exchange rates.[27] From the IMF's creation up to the present, the United States has been the single largest contributor to the fund and as such has had the greatest number of voting shares. In 1944, the US held a 32.5 percent share of the IMF's total contribution quotas and by the end of the 1970s held 21.2 percent.[28] By the time of the first global oil shock, the member states of the IMF did not provide the fund with enough resources to meet the ballooning financial needs of debtor states in the Global South. This need was instead met by private commercial banks that many

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[27] See: Margaret G. de Vries and Kenneth J. Horsefield, *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation* (Washington D.C.: The International Monetary Fund, 1969); James Boughton, *The Silent Revolution: The International Monetary Fund 1979-1989* (Washington D.C.: The International Monetary Fund, 2001).

[28] J.L. Broz, "The United States Congress and IMF financing, 1944–2009," *The Review of International Organizations 6, no. 3 (2011): 341-368.*

Latin American countries had already turned to for development financing by the end of the 1960s.

By 1977, federal regulators began to publicly tackle these questions regarding the stability of international finance. On April 12, Federal Reserve Chairman Arthur Burns gave a speech before the Annual Dinner of the Columbia University Graduate School of Business entitled "The Need for Order in International Finance." Burns, an economist and former Nixon advisor who had been heading the Fed since 1970, lamented that "strain and turbulence have, in fact, been so constant a feature of the international financial scene in recent years" that they had come to be "widely regarded as the normal state of affairs."[29] The strain and turbulence to which Burns referred was chiefly a result of global balance-of-payments deficits engendered by the dramatic rise in oil prices in the wake of OPEC's first oil shock. For non-oil exporting developing nations, for example, the aggregate year current payment account deficit stood at $36.3 billion and would grow to $38.9 billion for 1978. For those same developing countries, in 1977 debt servicing, ate up 25 percent of export earnings.[30]

The concern for Burns was that a large portion of the world economy relied upon heavy borrowing that was only getting larger. Burns forecasted, "if OPEC surpluses on current account should continue on anything like the present scale… the aggregate deficit of the remaining countries will still be larger." "Under such circumstances," Burns continued, "many countries will be forced to borrow heavily, and lending institutions may well be tempted to extend credit more generously than is prudent." As the global economy was just

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[29] Arthur Burns, "The Need for Order in International Finance," *Economic Quarterly (Federal Reserve Bank of Richmond)* 63, no. 4 (July-August 1977): 13.
[30] "Developing Nations Without Oil Exports Seen Facing Debt Rise," *The Wall Street Journal*, August 18, 1977.

then beginning to emerge out of the deep recession of mid-70's, Burns noted "a major risk" in the turn to private lending institutions. Namely that such an arrangement would "render the international credit structure especially vulnerable" in. the event of another downturn or shock.[31]

To address this emergent risk in international financial markets, Burns suggested several essential conditions that should be satisfied. Among them was a reduction in global balance-of-payments "imbalances… far more rapidly than currently observable trends imply," the abandonment of protectionist trade policies, the adherence to "high standards of creditworthiness" by "private financial institutions" (commercial banks), and the significant expansion of "official credit facilities" (the IMF). In essence, Burns was saying that the accumulation of large financial surpluses in oil exporting states and concurrent payment deficits in debtor states was unsustainable, and that the IMF was going to need more resources to address the problem. Throughout the rest of his speech, Burns emphasized that meeting these new challenges was going to require getting debtor countries in line with the policy prescriptions of the IMF. Burns insinuated that debtor countries had preferred private credit over IMF loans not only because of the obviously greater policy autonomy granted to them but also because of the limited resources available through the fund. Burns noted that the fund was "currently seeking resources of appreciable amount," and emphasized that member states would need to take action to provide those resources. With the ability to impel debtor countries to do the "painful things that must be done to restrain inflation and to achieve energy conservation," an empowered IMF could reduce the uncertainty inherent in the global debt situation. "The interests of the international economy and of private lenders

[31] Burns, "The Need for Order in International Finance,"14.

thus converge," Burns summarized, "and point to the need for a much more active role by the Fund."[32]

Burns did not mention the specific exposure of the U.S. financial sector to questionable debt or possible implications for the Federal Reserve. He only mentioned the Fed once in the entire speech – noting an ongoing "joint project with other central banks to obtain a much more complete size and maturity profile of bank credit extended to foreign borrowers, country by country." Burns only discussed the financial sector in general terms, suggesting in his final recommendations that "commercial and investment bankers need to monitor their foreign lending with great care."[33] While these restorative actions Burns laid out to address the debt issue were comprehensive, they placed the burden of correction more on debtor states than on lenders. In avoiding the details of the risks for banks and the Fed, Burns downplayed the risk of insolvency of the commercial banks should their LDC loans go bad. If the position of commercial banks were to deteriorate, it would be on central bankers to respond, likely through bailouts. Instead, Burns called on debtors to take political action to open their economies and stimulate growth which might produce more available revenue for debt service, while suggesting only that lenders take greater care in managing their portfolios. Burns' focus on debtor governments prefigured the unequal distribution of structural adjustment in the wake of the 1980s debt crisis.

Burns' prescription for handling the international financial situation was compelling enough to garner the attention of President Carter. Present in the audience for Burns' April 12th speech, afterwards Carter sent the Fed Chairman a handwritten note of approval. "Your entire speech was helpful to me," Carter said, "I've already seen the need for IMF type

[32] Ibid 14 -16.
[33] Ibid, 15, 18.

constraints and OPEC cooperation in an increased energy conservation effort."[34] Carter, just four months into the presidency, was connecting Burns' call for order to his administration's own troubled effort to create order out of the chaos of a post oil-shock world and the US public's use of energy resources. Burns' recommendations could have offered Carter a feeling of control over an otherwise chaotic political-economic environment in 1977. While Carter would not introduce any meaningful regulations over banks' foreign lending his term, he would oversee expansions in US contributions to the IMF. Passing legislation to increase IMF funding would be much easier than any kind of capital controls that the banks would oppose. This relatively easy apparent solution to the looming debt issue offered US policymakers some notion of control.

Citibank executives rejected the Burns approach, despite its moderation. They did not think their bank, or other private lending banks, had been involved with the "excessive risk" taking Burns condemned.[35] In a company-sponsored publication entitled *The Emerging Role of Private Banks in the Developing World*, Citi's chief economist Irving Friedman coupled the call for an empowered IMF with an endorsement of the role of private capital in the global economy. Friedman had plenty of previous experience with international finance, having held staff positions as at the World Bank and IMF before coming to Citi. Friedman explained that the "expanding role of international lending by private commercial banks to developing countries" was a sensible consequence of developing countries need of resources for development beyond what official government sources could provide. Friedman

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[34] Note, Jimmy Carter to Arthur Burns, April 12, 1977, folder "Debt Management 10/77," Box 435, (Council of Economic Advisors) International Financial and Economic Developments Subject Files, Jimmy Carter Presidential Library.
[35] "Loans Extensive: Big Foreign Lender Hedges Bets in a Risky Business," *The Washington Post*, April 24th, 1977.

concluded that the expanded role of international financial institutions would support private banks in making the most efficient use of international savings. As a potential lender of last resort, the IMF had a complementary role to private banks in ensuring that "the catastrophic conditions of the 1930s" are "readily avoided" by keeping international trade flows alive. Friedman acknowledged, however, that private banks did not require the same "safety nets" as national governments "to shield them from their own management decisions."[36]

Congressional Democrats expressed a much more urgent sense of alarm about the international debt situation than either Burns or Citi. Their position was encapsulated in a high-profile 1977 staff report sponsored by the Senate Subcommittee on Foreign Economic Policy, chaired by Idaho Senator Frank Church. The report emphasized the major American commercial banks growing multinational character and dependence on overseas profits over the course of the previous decade. As of 1977, for example, Citibank alone had an "overseas presence far larger than the U.S. government."[37] With American corporations like Citi dominating the global LDC debt market, the report estimated that up to a third of the entirety of the "public external debt of non-oil developing countries" was held by U.S. banks.[38] "There is every reason," the report commented, "for the U.S. Government to be concerned about the present debt buildup not only because of the large exposure of American banks, but

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[36] Irving Friedman, *The Emerging Role of Private Banks in the Developing World* (New York: Citicorp, 1977,) 4 – 5, 118.

[37] Lee Lescaze and Don Oberdorfer, "Big Foreign Lender Citibank Hedges Bets in a Risky Business," *Washington Post,* April 24th, 1977.

[38] US Congress, Senate, Subcommittee on Foreign Economic Policy, *International Debt, the Banks, and U.S. Foreign Policy: A Staff Report* 95th Cong., 1st Sess., August 1977, 5. US predominance in foreign lending in the postwar era was a product of the privileged position of the dollar. Between 1973 and 1975, on average, 10.7 US banks entered the international lending market annually which was far greater than any other major western creditor. See: Robert Devlin, *Debt and Crisis in Latin America: The Supply Side of the Story* (Princeton: Princeton University Press, 1989,) 86, 93.

also for its broader foreign policy implications."[39] Noting "a direct correlation between economic hardship and political repression in many countries" the report suggested that supporting "creditor demand for austerity measures" would be in conflict with the Carter Administration's "international human rights effort."[40] As phrased in the report, private financing was not enough to deal with the "international payments disequilibrium." More financing would be needed from the international financial institutions like the IMF. For liberal democrats, austerity and human rights were evidently negatively correlated, and such measures "may only be carried out at the expense of human rights."[41]

The Senate report was prescient in its frank analysis of the situation at hand. The report wrapped up its conclusions with the stern assessment that "the fact that the world is coping with financial disequilibrium… does not mean that it has come to grips with the ultimate economic, social, and political consequences of this massive transfer of resources."[42] As Senator Church emphasized in his forward to the report, the global debt situation was a "structural imbalance" that neither the Carter or Ford Administrations had fully recognized or addressed.[43] Other leading Democrats on the subcommittee, such as Illinois Senator Adlai Stevenson III echoed Church's focus on the imbalanced distribution of capital wrought by the oil crisis. In a hearing held on the debt problem shortly after publication of the staff report Stevenson emphasized that debt may have "enabled the world economy to survive escalating oil prices," but that bank loans were a "band-aid solution" that could only "buy time."[44]

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[39] Ibid, 7.
[40] Ibid.
[41] Ibid, 8.
[42] Ibid.
[43] Ibid, vi.
[44] United States, Congress, Senate, *International Debt: Hearings before the Subcommittee on International Finance of the Committee on Banking, Housing, and Urban Affairs,* 95th Cong., 1st Sess., August 29-30, 1977, 5.

The oil shocks had moved an unprecedented amount of the world's money to the governments of OPEC oil-exporting states. In turn, states in Latin America had become dependent on US banks who themselves were dependent on deposits from the oil exporters. It was the fragility of this situation that struck Church and other policy officials as a threatening structural imbalance. In 1977, there were five more years before those "ultimate" consequences would begin to rear their heads. Then, the ongoing discussion about the proper role of commercial banks and the IMF in the global economy would continue to cross and obscure traditional partisan boundaries.

The IMF Debate

The tentative consensus around the need for an empowered IMF that was emerging between Burns, commercial banks, and anxious policy makers came to a head in early 1978 with congressional passage of a bill increasing the US's contribution to the IMF's "Witteveen Facility." With a two-to-one majority, Congress approved a $1.7 billion US contribution to the $10 billion international fund.[45] The Witteveen Facility, named after the director of IMF who implemented it, was established in 1974 with minimal support from the US.[46] As a facility, the money set aside would allow debtor countries to draw on the fund continually, similar to a revolving line of credit. Witteveen imagined the facility as supplementary to the main role of private credit markets in recycling global liquidity, but necessary on the grounds that "the Eurocurrency markets do not provide a complete answer"

[45] Graham Hovey, "House Authorizes $1.7 Billion Outlay to Witteveen Fund," *New York Times*, February 24, 1978.
[46] Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994), 111-112.

to the balance-of-payments problems instigated by the first oil shock.[47] Officials in the US were originally opposed to the facility on the grounds of what Eric Helleiner has described as the US's "goal of changing the international financial system from a controlled public system to a more market-based one."[48] By 1978, however, with support from the Carter Administration and the Federal Reserve, the predominant attitude of US policymakers on the need for the facility had shifted. Opposition still existed from both conservatives and liberals who were concerned that more resources for the IMF was empowering an institution that the US exerted little control over and that the funds might sponsor human rights violations of oppressive regimes, respectively.[49] Given the scale of the emerging debt problem, though, this opposition was in the minority.

Before debate over the Witteveen Facility made it to Congress, the IMF had already overcome a challenge from the Organization for Economic Cooperation and Development (OECD) to become the main international financial institution handling the balance-of-payments crisis. On April 9, 1975, representatives from OECD member nations voted to approve the creation of a "Financial Support Fund" (FSF) earmarked for balance-of-payments loans to debtor countries. The FSF, at a planned $25 billion was significantly larger than the IMFs Witteveen Facility. Henry Kissinger was instrumental in the development of the FSF at the OECD and supported the fund as a way for Western nations to set up a rival, consumers cartel to OPEC. Despite initial enthusiasm, approval of the FSF did not make it through congress and was effectively abandoned by the beginning of the Carter Administration. US policymakers' apprehensions around the FSF were based in the fear that

[47] Edwin L. Dale, "Credits Pledged by Oil Producers: $2.75 Billion for a Special IMF Fund for Importing Nations is Disclosed," *New York Times,* May 7, 1974.
[48] Helleiner, *States and the Reemergence of Global Finance*, 112.
[49] Hovey, "House Authorizes $1.7 Billion Outlay," 1.

such a fund could challenge the authority of the IMF, which could compromise the Funds' abilities to impose conditionality stipulations in balance-of-payments loans. In the words of economist Fred Bergsten, testifying before the Senate Banking Committee in June 1976, the FSF would "weaken the International Monetary Fund, just at a time when the United States has a major interest in strengthening that institution."[50]

A series of congressional hearings held in advance of the Witteveen vote demonstrates how by the late-70s the prospect of an empowered IMF was no longer seen by bankers and liberal policy officials as a threat to private international capital markets, but complimentary to them. Irving Friedman, the same Citi official who wrote the Bank's report on the role of commercial banks in the developing world, testified to the committee that he was in strong support of the US's participation in the facility. "I would like to emphasize for this Committee," Friedman explained, "that lending to the developing countries has not constituted a threat to the US banking system."[51] Friedman said that bank financing in developing countries had so far helped those nations increase exports and thereby increase the health of their domestic economies. An enlarged IMF would be able to support the role of private credit by ensuring borrower creditworthiness through "conditionality," whereby any country that would make use of the Witteveen facility would only be able to do so "upon agreement between the Fund and the borrowing country of an economic stabilization program which the Fund considers adequate with its policies for use of the higher credit tranches." Friedman, himself a former IMF staffer before coming to Citibank, had played a significant part in the introduction of conditionality. As head of Exchange Trade and

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[50] Quoted in: Benjamin J. Cohen, "When Giants Clash: The OECD Financial Support Fund and the IMF," in *Institutional Designs for a Complex World: Bargaining, Linkages, and Nesting* ed. Vinod K. Aggarwal (Cornell University Press, 1998,) 179.
[51] US Congress, Committee on Banking, Finance, and Urban Affairs, *Supplementary Financing Facility*, 152.

Relations department from 1951 to 1964, Friedman instituted the first annual IMF annual consultations with debtor countries to monitor progress on conditionality stipulations.[52]

The role of greater resources for the fund and conditionality were both necessary to Friedman to enable the IMF "to play its appropriate role in sustaining and renewing confidence in the international monetary system." The challenge the IMF was facing was simply that its important role in preventing the inconvertibility of currencies and exchange restrictions had made the international economic system more "vulnerable to unexpected shocks," and that more resources were required to be able to respond to these imbalances. Friedman explained that for creditors like Citi, more governmental support of the IMF would be indicative of greater confidence on the part of member nations in the global financial system. The risk of not approving the facility, as Friedman presented, would be to decrease this confidence and possibility incentivize member countries to "run for cover" through trade and capital restrictions.[53] Friedman rejected the idea that IMF funding would represent a bail out option for private banks. He told Congress that fund conditionality would ensure that IMF funds could not go directly to paying off private bank loans. Covering his tracks, Friedman qualified that "all new lending augments the total foreign exchange availability of a country… borrowing from the Fund helps countries repay private banks—due to the fungibility of money—as well as meet all other external payments needs. Similarly, borrowing from private banks helps countries to repay the Fund by augmenting the foreign exchange available to a country."[54]

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[52] See: *Transcript of oral history interview with Irving S. Friedman held on December 11, 1985; and February 6, 28, 1986 (English)*, World Bank Group Archives oral history program Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/290831564605981637/Transcript-of-oral-history-interview-with-Irving-S-Friedman-held-on-December-11-1985-and-February-6-28-1986.
[53] US Congress, *U.S. Participation*, 153-154.
[54] Ibid, 177-178.

Among the banking committee members, Congressman John Cavanaugh was rather skeptical of Freidman's denial of the potential of the IMF to become a vehicle for bailouts. Cavanaugh was a freshman Democratic representative from Nebraska and would only serve in the house until 1981. Cavanaugh was by no means a political insider, having only served in the Nebraska state legislature for four years prior to coming to DC. As new house member from a midwestern state, Cavanaugh was relatively isolated from Wall Street posturing. Cavanaugh challenged Friedman's assurance that IMF money would not represent a bailout as being based on a "very restrictive…definition of bailout." Cavanaugh asked if what they were "really talking about" was simply whether or not the "international commercial financial system" needed "an additional public assistant" and if the system could stand to "benefit by that."[55] Cavanaugh's concerns were shared by the *Wall Street Journal*, who had previously editorialized that the expansion in IMF resources might be better called "The Bankers Relief Act of 1977."[56] To this criticism, Friedman responded that the amount of IMF financing that was available in total was simply not enough for full scale bailouts, or to make up for financing that might come from the private sector. "No private bank is acting responsibly if it acts on the assumption that someone" Friedman asserted, "whether it is the Monetary Fund or any public entity—will come to its rescue."[57]

Cavanaugh was not convinced, correctly identifying the apparent contradiction of banks asking for an expansion in IMF capabilities that would supposedly not affect their lending behavior and was "not needed in the capital market." Cavanaugh's critique captures succinctly the confusion inherent in the line that Citi was pushing through Wriston,

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[55] Ibid, 191.
[56] "The Witteveen Facility," *The Wall Street Journal*, September 26, 1977.
[57] US Congress, House, *U.S. Participation in the Supplementary Financing Facility of the International Monetary Fund,* 192-193.

Friedman, and other outlets. The narrative, as it appeared from the bank was that the oil shocks had caused a great disruption in the global allocation of liquidity, but that banks—operating through private capital markets—had successfully allowed the international economy to adapt and keep trade alive without having to resort to more serious government intervention. At the same time, however, more government resources were needed to allow the IMF to help countries navigate the same problem that banks were allegedly already solving. According to Friedman, the answer was simply about building a more robust international payments system that "encourages and enables stable growth, higher levels of employment and higher levels of international trade."[58] Friedman's reasoning here again fell upon the tropes of growth and shared prosperity. The conditionality of IMF funds would simply promote the kind of economic management that would produce greater creditworthiness. It wasn't the money that the IMF promised that mattered but the policy changes that the IMF could instigate.

The president of the smaller Philadelphia National Bank, also testifying before the committee, was more forthcoming about the benefits of the IMF funds to bankers. The Pennsylvania banker straightforwardly admitted that banks' credits to developing countries would be "enhanced" and "protected" thanks to the cover provided by the IMF fund. Cavanaugh clarified that he saw nothing "sinful" about banker's admitting to this, but just that they should admit it as a matter of course. While changes in the global economy could cause the need for rapid adjustments in countries' balance-of-payments positions, the IMF could benefit bankers by imposing "nonabrupt [sic] disciplined adjustment."[59]

[58] Ibid, 193.
[59] Ibid, 196.

Enthusiasm for the new facility was not limited to the banker's testifying before the committee, as multiple public officials echoed their same points. Speaking on behalf of the Federal Reserve Board in a prepared letter to the committee, chairman Arthur Burns endorsed US participation in the facility and stressed that it did not constitute a bailout for banks or struggling developing countries. "The fact that private and official interests happen to converge," Burns explained, "should not distract attention from the important public purpose that would be served by the Witteveen Facility."[60] Treasury Undersecretary for Monetary Affairs Anthony M. Solomon similarly downplayed concerns about the debt burdens of developing countries or the exposure of private banks to such debt. Private borrowing had been the main coping mechanism to global price disruptions because of "the private market orientation of the world economy," and in the "considered judgement" of the US treasury the "system as a whole" was not "in any such position of imminent danger."[61] From the State Department, the Undersecretary of Monetary affairs Richard N. Cooper responded to the concern that increased bank lending might be leaving the global economy prone to crisis by explaining that "in general, the lending standards of banks have been high." Like the other government officials, however, Cooper stressed that despite the capacities of the private market, the present economic situation still required an increased level of government coordination to handle new challenges. The Witteveen facility offered a method for doing that. From the perspective of the state department, moreover, accomplishing "foreign policy objectives" would require a "strong and healthy world economy, which in turn depends on a viable international monetary system." The Witteveen facility could counter growing sentiments that the international monetary system was not working, and in

[60] Ibid, 7.
[61] Ibid, 9.

Cooper's estimation, "impart a sense of hopefulness to other economic negotiations and to the political sphere as well."[62]

At the same time members of Congress were grilling bankers to admit their own interest in the creation of a backstop facility, then, the Federal Reserve, Treasury Department, and State Department were lining up to justify the expansion of IMF resources on loftier grounds. While the facility meant that banks could enjoy a sense of security around the protection of their loan portfolios, members of the economic and foreign policy establishments saw political utility in the installation of a greater sense of economic cooperation and a sounder international monetary system. As the policy officials iterated the alignment of public and private interests in the matter was no cause for concern and was simply a happy coincidence brought on by a shared need for new tools to help navigate the post oil shock global economic landscape. The international political economist Philip C. Wellons has argued that the flow of loans and debt in the 1970s demonstrates how international banking offers a clear linkage between politics and economics. The debate over the Witteveen facility certainly confirms this. For Wellons, however, it is not that "banks force weak home governments to create a favorable banking climate" and instead "that climate reflects complicated bargaining among many players at the national level."[63] The exchange in this Congressional hearing indicates that the bargaining may have not been that complicated. Officials from the foreign and economic policy establishment accepted the alignment of their interests behind those of the large banks, and at times to the chagrin, but not outright rejection, of suspicious legislators.

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[62] Ibid, 27-29.
[63] Phillip A. Wellons, "International Debt: The Behavior of Banks in a Politicized Environment," *International Organization* 39, no. 3, Summer: 1985, 446.

With the expansion of the Witteveen facility secured on the domestic front, the Carter administration turned towards shoring up support for the initiative among the developed countries. In advance of a summit of the G7 countries to be held in Bonn, Switzerland in July 1978, confidential memos passed between the President's Council of Economic Advisors (CEA) reveal the importance of the IMF in the administration's economic agenda. In putting together the briefing papers for the president, the Witteveen proposal and future expansions to IMF resources were front and center in the administration's objectives. The first objective listed for the president in international financial issues demonstrated this priority:

> Strong support for a plan being developed by the Managing Director of the International Monetary fund to increase IMF resources so that the Fund could give more balance of payments support to countries prepared to take the steps needed to stabilize their economies and preserve their credit standing, emphasizing that this reduces the damage of trade and payments restrictions.[64]

The key detail in the CEA's approach was the emphasis on the IMF's ability to get debtor countries to adopt policy changes. While banks are not mentioned directly, the end goal of preserving country credit standings served to benefit them. Keeping debtor countries in good credit ratings meant keeping bank shareholders happy and, for the time being, keeping bank balance sheets healthy. The second objective underscored this point: "Support for the linking of most IMF credit to the adoption of policies by borrowing countries which can be expected to reduce their external deficits to a sustainable level."[65] This linking of IMF credit to adoption of policies was exactly the "conditionality" that Citibank's economist had touted before congress as a reason for enthusiasm over IMF resource expansion.

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[64] Memo, Henry Owen to Charles Schultze, "Presidential Briefing Papers for the Bonn Summit," folder "[Bonn Economic] [3], Box 7, Council of Economic Advisors, Charles Schultze Series, Jimmy Carter Library.
[65] Ibid.

The link of these objectives to the interests of the banks was made most obvious in the memo's stated goals for the joint declaration between the G7 members that was to come out of the summit:

> We want the Declaration to… support IMF role in encouraging and assisting countries to adjust their balance of payments positions through linking of credit to the implementation of appropriate stabilization measures which enable countries once again to borrow on private markets to finance any remaining current account deficit.[66]

What is made explicit here that was implicit elsewhere, is that the point of the conditionality measures was to facilitate the reliance of debtor countries on private credit markets. The IMF was not in itself solving the imbalance in global liquidity and balance-of-payments issues in the developing world, but rather it was ensuring that private credit could continue to serve as the primary recycler of global liquidity. It was the job of private capital to enable debtor countries to continue to fund development programs despite disruptions to international commodity markets, and to do so profitably through unprecedented forms of sovereign lending. As opposed to alternatives solutions to the balance-of-payments crisis—like more government-to-government lending through the OECD—the IMF allowed policymakers to address the crisis without compromising the role of private banks. Through conditionality stipulations, the IMF would ensure for creditor commercial banks that their client borrowers remained a safe credit risk.

According to the same confidential memo, almost all the rest of the G7 countries were equally enthusiastic about the Witteveen facility and a stronger IMF. The Germans were in support of the conditionality attached to IMF lending as means of "imposing discipline on deficit countries." Canada supported expansion, but like the Germans, favored strict conditionality and the fund to only be a last resort after private credits had been

[66] Ibid.

exhausted. The British were enthusiastic of higher quotas as way to ensure that troubled countries could finance deficits without having to "restrain domestic demand" and could continue to import goods from Britain and other developed countries, and as such favored a "weaker conditionality" to IMF loans. France, similarly, saw IMF loans as a hedge against protectionism. Italy, as a large borrower itself, supported expansion to ensure their access to the higher credit tranches at the fund. The only member country with serious reservations was Japan, who feared the Witteveen plan could "cause the government political embarrassment domestically" given that the Japanese legislature, despite internal resistance, had just voted to endorse the OECD's Financial Support Fund for the same purpose.[67]

What all these positions shared with the US was a desire for the same kind of order to be instilled in international finance that Arthur Burns had called for. As some of the most developed economies in the world, the G7 had a shared interest in disciplining developing countries so as to ensure continued access to export markets for Western finished goods, in addition to the imports of cheap primary commodities that G7 members depended on the Global South for. In the mid-1970s, many policy makers myopically focused on the oil shock despite the root cause of this need for order being the growing debt burden that borrower countries had accumulated through private capital markets. The focus on the exogenous shock of the oil crisis obscured the fact that banks were already lending heavily to developing countries prior to 1973. In the mid-1970s, as in the 1960s, US banks were lending to LDCs not just to address the balance-of-payments crises but also because lending in the developing world was more profitable, especially on a short-term basis than investing in domestic economic growth. Alternative visions of responses to inflation, like that of the

[67] Ibid.

Initiative Committee for National Economic Planning, could have imposed stronger credit and capital controls to keep so much money from flowing into speculative lending.

The Second Oil Shock & The Gospel of Risk

Following the Iranian revolution in 1978, the global supply of oil once again declined precipitously in early 1979.[68] Consequently, oil prices were pushed even higher and oil-importing nations in the Global South needed even more loan money to make up the difference. Between 1979 and 1982, the total debt held by developing nations in Latin America "more than doubled, increasing from $159 billion to $327 billion."[69] Mirroring this tangible increase in the already worrisome amount of US investment capital at risk in the developing world, throughout 1979 Wriston had become much more explicit about his philosophy of risk. That is, instead of simply evoking the role of calculated risk-taking for bankers or the threat of uncertainty from errant policymakers, Wriston began to tout the virtue of risk in and of itself.

In a speech before the Wharton School Club at the University of Pennsylvania, Wriston took on "the media" for the continuous use of "the word 'risk' as pejorative." As Wriston explained: "Almost daily, we read solemn words about a 'risky' foreign policy move by the President, or 'risky' investments or 'risky' loans, just as if these phrases were not as redundant as talk in about one-story bungalows."[70] In response to this animosity towards the presumed risky behavior of Citi and other developing-world creditors, Wriston looked to the words of contemporary business intellectual and management guru Peter Drucker. As

[68] FDIC, "LDC Debt Crisis," 199.
[69] Ibid, 200.
[70] Walter Wriston, "Wriston—Wharton," March 20, 1979, MS134.001.003.00031, Walter B. Wriston Papers, Tufts Digital Library, http://hdl.handle.net/10427/36093.

Wriston saw it, Drucker revealed "that true productivity increases are generated by people who will take a risk, make a judgment and reap the rewards or pay the penalties." "It is not always an easy task," Wriston added, "to persevere in a society where some commentators associate being controversial with being wrong."[71] By describing risk-taking as "controversial," Wriston was simultaneously acknowledging the marginality of his own ideas in mainstream political conversations while also touting himself as a maverick. If invoking Peter Drucker's commercial wisdom was not enough to sell the business students in the audience on the necessity of risk, Wriston quoted scripture for good measure: "… life itself is a risk, and indeed the Scriptures tell us that 'whosoever would seek to save his life will surely lose it.'"[72] With this rhetorical flourish implying that risk was the nature of life, following Wriston's narrative to its logical conclusion would mean seeing the anxieties of risk-averse Senators over structural deficiencies in global political economy as unnatural. Wriston contended that both politicians and bankers should operate under the same logic of risk: "The plain fact is that all policies, all loans, and all investments are based on faith in the unknown future. This is as it should be."[73]

Wriston's comments before the Wharton School Club illustrate an important development in his counter-narrative to the structural assessment of the LDC debt situation. Whereas the predominant structural narrative as articulated by congressional democrats had emphasized a systemic international economic dysfunction that banks could only temporarily ameliorate, Wriston's narrative of risk emphasized individual behavior and norms. In his concluding remarks to the Wharton audience, Wriston even claimed that individual risk-

[71] Ibid.
[72] Ibid.
[73] Ibid.

taking was the root of the Founding Fathers' vision of democracy: "Democracy itself is the ultimate risk because its survival rests on the courage and the imagination of the individual, of free men and women who are willing to innovate, to stand up and be counted, to take a chance and to live with the results of their own efforts."[74] For Wriston, evidently, the unique material and economic circumstances posed by the oil price-induced distribution of global surplus investment capital was not so much the problem as was the behavior of the individual. "If we as a nation ever opt for a safe, stagnant tomorrow," Wriston warned, "our economy will sink to the sluggish levels of the planned societies which are even now dragging down the general level of world prosperity."[75]

Nearly half a year later, Wriston gave a slightly longer version of what was essentially the same speech but this time before the Economic Club of Chicago. Wriston's rhetoric in the October speech, entitled "Risk and Other Four-Letter Words," had expanded, however, to emphasize even more urgent danger regarding societal attitudes towards risk. Building upon his Founding Fathers anecdote, Wriston proclaimed that despite the American nations' mythical historical enthusiasm for "political adventurers and fighters who did not hesitate to sign a document pledging 'our Lives, our Fortunes, and out sacred Honor'" that contemporary popular discourse in the United States suggested that "the descendants of these bold adventurers should be sheltered from risk and uncertainty as part of our natural heritage."[76] Again, without discussing any specific economic conditions of the contemporary world, Wriston sought to enshrine risk as a central tenet of a mythic American ideal. Instead of directly responding to the structural critiques of commercial bank lending activity from the

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[74] Ibid.
[75] Ibid.
[76] Walter Wriston, "Risk and Other Four-Letter Words," October 25, 1979, MS134.001.004.00004, Walter B. Wriston Papers, Tufts Digital Library, http://hdl.handle.net/10427/35114.

mainstream press, Wriston chose to build his narrative from a completely different set of assumptions and cultural signifiers. Wriston's extension of free-market rhetoric into the realm of risk, moreover, was indicative of the thematic process of risk commodification which had characterized the history of American capitalism in the nineteenth century. As the historian Jonathan Levy has demonstrated, nineteenth century attempts at "corporate risk management" repeatedly "manufactured new forms of uncertainty and insecurity" in a self-perpetuating cycle.[77] Wriston's assertion that commercial banks' assumption of risk contributed to economic growth and general prosperity therefore echoed a larger, contested history of commodified risk. Wriston's insistence on risk, moreover, reflected the influence of neoclassical economics advocates like Milton Friedman and Alan Greenspan—both of whom Wriston would later serve alongside as part of President Ronald Reagan's Presidential Economic Policy Advisory Board.[78]

As Wriston was steadily developing this risk-centered narrative of economic life, both international and domestic economic conditions grew grimmer. By 1980 the U.S. inflation rate had ballooned to 13.3 percent, higher than any year in the previous decade.[79] Domestic political developments, concurrently, indicated that certain elements of Wriston's free-market rhetoric were in fact breaking into the mainstream of political discourse. Paul Volcker replaced William Miller as the head of the Federal Reserve in August 1979. Wriston had personally recommended Volcker to President Jimmy Carter on the grounds that he was well known in the international financial community. Even though Carter and Wriston were

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[77] Jonathan Levy, *Freaks of Fortune: The Emerging World of Capitalism and Risk in America* (Cambridge: Harvard University Press, 2012,) 6.
[78] Zweig, *Wriston*, 708-709.
[79] Federal Reserve Bank of St. Louis, *FRED: Economic Data,* Inflation—consumer prices for the United States, https://fred.stlouisfed.org/series/FPCPITOTLZGUSA.

certainly not political allies, Carter sought Wriston's opinion as part of an effort to make sure members of the banking establishment would support the president's nomination.[80] Wriston reportedly told Carter: "You have to get someone who foreign central bankers don't say 'Who Dat?' [sic] The guy whose name they know is Paul Volcker."[81] It was telling that Wriston's main concern with the Fed appointee was Volcker's rapport with the international banking community.

Seeing the chairmanship go to someone with his personal approval must have been rather significant to Wriston, given the influence that the regulatory institution had previously had in shaping the structural narrative of the LDC debt situation. Arthur Burns, who served as Reserve Chairman until 1978, had called for "order in international finance" and implored American bankers to "monitor their foreign lending with great care," as late as 1977.[82] If Volcker's appointment had been an improvement for Wriston, the 1980 Presidential election was a momentous victory. Ronald Reagan's landslide victory over Jimmy Carter effectively signaled that the federal government, at least the executive branch, was no longer Wriston's staunch adversary. Wriston secured an appointment to President Reagan's Economic Policy Coordinating Committee, confirming the level of Reagan and Wriston's agreement on the economic role of government.[83]

In the face of worsening international economic conditions, the IMF once again proposed a greater increase in member quotas in September of 1980. As oil prices had once again spiked and exacerbated balance-of-payments deficits, the heads of the IMF endorsed an

[80] James Freeman and Vern McKinley, *Borrowed Time: Two Centuries of Booms, Busts, and Bailouts at Citi*, 202-205.
[81] Zweig, *Wriston*, 635.
[82] Arthur J. Burns, "The Need for Order in International Finance," 13-18.
[83] Philip L. Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown, 1995,) 569.

increase in borrowing limits for member countries to up to 600 percent of their IMF quota contributions. As explained by the Nigerian finance minister, increased lending capability through the IMF was “a matter of survival.” To fund this expansion in lending, the IMF boosted its member quotas by fifty percent. The quota increases at hand raised questions about influence over the IMF, given that it presented an opportunity for OPEC and developing nations to challenge the US’s command of twenty percent of fund voting rights—correspondent with its largest fund quota.[84]

The Carter administration, for its part, had been pushing for another increase of the US’s quota since February. The House banking committee held hearings on a bill to increase the US IMF allocation by $5.5 billion between February and April. On behalf of the administration, Treasury Undersecretary Solomon underscored the importance of maintaining the US share of IMF quotas. “Given the continuing large role of the U.S. economy and the dollar in the international monetary system,” Solomon said to the committee, “maintenance of an appropriate U.S. share and influence over decisions on the system is particularly important.” This maintenance was especially important given “strong competition for increased quota shares.” What Solomon was getting at was that the US needed to ensure that the current period of grave financial uncertainty would not compromise American leadership of the international economic system. Unlike the hearings held in 1977 and ’78, Solomon didn’t feel the need to downplay the possibility of IMF expansion constituting a bailout for commercial banks. What was implied, instead, was that the interests of the US financial sector and foreign policy agenda were one and the same.[85]

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[84] Kenneth H. Bacon, “IMF Approves Sharp Expansion of World Credit: Certain Developing Nations May Increase Borrowings from Agency Threefold,” *Wall Street Journal*, September 29, 1980, sec. 1.
[85] US Congress, House, Subcommittee on International Trade, Investment, and Monetary Policy, Committee on Banking, Finance, and Urban Affairs, *To Amend the Bretton Woods Agreements Act to Authorize Consent to an*

Citibank vice president Harold Van B. Cleveland also testified before the committee, and as with the earlier hearings, expressed the Bank's support for a stronger IMF. As opposed to the earlier discussion, Cleveland was quite open about the importance of the IMF as an international lender-of-last-resort and the protection that might offer banks. This need for such a lender came into play when economic conditions had severely eroded confidence in the financial system and the "unalloyed discipline of the marketplace could be too harsh for the public good because a panic might ensue" and possibly burden banks with "serious deflationary consequences." But to dampen fears of untenable debt burdens faced by LDC countries, Cleveland resorted to the Citibank party line that the debt levels were first, statistically not threatening and second, that increased lending was indicative of the financial sector successfully keeping the world economy afloat in the face of oil-induced price distortions. As Cleveland explained, "now the 2 years, 1979, 1980 have of course, a lot in common 1974-75… in sum, there are reasonable grounds to assume that the debt burden of the developing countries that do most of the borrowing to remain manageable."[86]

By 1980 the movement of capital into aggressive foreign lending through an unprecedented remaking of the practice of commercial banking was established and nearly taken for granted. That is not to say that concerns did not abound surrounding the risk presented by an ominous level of international debt, as Wriston's persistent defense of Citi and other banks activities demonstrates. But still, by 1980 the debates around the empowerment of the IMF had come to condone the position of commercial banks in the middle of the balance-of-payments crisis. Neither Solomon or Cleveland, representing the

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Increase in the United States Quota in the International Monetary Fund: Hearings before the Subcommittee on International Trade, Investment, and Monetary Policy of the Committee on Banking, Finance, and Urban Affairs, 96th Cong., 2nd sess., 1980, 6.

[86] Ibid, 269-270.

administration and the banks respectively, bothered to acknowledge how much banks stood to benefit from the IMF effectively backstopping the solvency of their balance sheets. By 1982, for example, Citibank would have 89.7 percent of its total capital tied up in loans to Brazil and Mexico alone.[87] Instead, they focused on the need for the IMF to help protect lenders and borrowers from the vagaries of the market. The most important piece of protection the IMF could offer, they argued, was compelling debtor countries to make the necessary adjustments to keep loan payments flowing to commercial banks. Cleveland's comment on the need to cushion the "unalloyed discipline of the marketplace" through the lender-of-last-resort role the IMF could play was only a cushion for commercial banks as the IMF could keep their risky loans from going sour. For debtors the unalloyed discipline of the marketplace was not cushioned, but instead was harshly imposed. Solomon's call to maintain the US's voting power at the IMF reveals the expansive marketization of the international monetary system carried a threat to the American hegemony, and that expanding the IMFs role in the global economy was a way to preserve US interests.

Despite consensus offered from both the banking industry and government that IMF support was the soundest way of addressing the present crisis, Congressman Cavanaugh still questioned the bankers if another way was possible. In Cavanaugh's view it was possible that the ample amount of credit made available to deficit countries was providing a perverse incentive for OPEC countries to continue raising oil prices. In Cleveland's view, bank-backed petrodollar recycling was simply the best available option that the market could facilitate. The fact that Cleveland insisted this on the basis that the oil prices set by the OPEC countries were a matter of "high politics" also entailed a sort of contradiction from his earlier

[87] Calculated based on data in: Freeman and McKinley, *Borrowed Time,* 211, 215.

comments. In Cleveland's reasoning, the politics of oil prices were in a different realm from the economics. Interfering with these politics could result making "more complicated the process of [petrodollar] recycling." Cleveland claimed that such interference could result in OPEC nations digging in their heels and even holding prices the same while cutting back on production.[88]

Cavanaugh used Cleveland's insistence on the appropriateness of bank intermediation of petrodollars to bring up the recurrent issue of risk with mounting LDC debt. Cavanaugh was responding to a point made by Cleveland that implied that bank lending was a better option than issuance of bonds on the behalf of debtor nations. These bonds could conceivably be bought by the OPEC nations with payment surpluses, but Cleveland insisted that that those securities would not be attractive to investors – given the risk. If "the risk of lending to LDC's" was so "unattractive to OPEC," Cavanaugh inquired, "how can the risk be justified by a bank such as Citibank?" In response, Cleveland insisted on the importance of Citi's "enormous portfolio of assets," that an official lending body would not be able to cultivate. Citibank's explosive growth, thanks to LDC loans, essentially validated the continuance of that lending. To Cavanaugh, this behavior constituted a subsidization of these loans by the bank. Debtor nations were being enticed by lower interest rates than they otherwise would receive because of the size and relative economic power of the big banks. The more of the loans that could make, at least from Citi's perspective lowered the risk of any one of those loans going bad.[89] What Cleveland did not mention, and Cavanaugh did not ask about, was what could happen if a large portion of those loans were to go bad at once.

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[88] Ibid, 356.
[89] Ibid, 357 – 358.

Despite the closer alignment of the political establishment with Wriston's culture of risk, doubts over commercial banks' behavior did not go away. The unprecedented levels of exposure of LDC debt shared by the major US banks was simply too much for regulators and the business press to ignore. In June of 1981, *The American Banker* – an industry trade journal – informed its readers that the "nine largest banks in the United States have loans outstanding to nonoil-producing developing countries that are more than double the banks' total capital base."[90] The *American Banker* article paraphrased comments made before a meeting of Bankers Association for Foreign Trade by Henry C. Wallich, a member of the Federal Reserve Board of Governors. Wallich, the *American Banker* reported, "questioned whether such lending may carry too high a risk, given the intense uncertainty of financial and political systems in developing countries."[91] Whether or not Wallich himself had used the words "risk" and "uncertainty" in his speech, *The American Banker's* summary of Wallich's comments reveals that attitudes towards risk and uncertainty were still central in the contesting narratives assigned to the LDC debt situation. Comments made by a Citibank representative present at the meeting affirmed that Citi still saw economic policy makers as the most disruptive source of uncertainty. The Citi representative, according to the article, rejected the notion that "large banks find it difficult to reduce such loans in an 'interlocking global economy'" and argued that "statistics such as Mr. Wallich's raise fears of large defaults and make it harder for banks to sell debt of any kind."[92]

While Wallich and Citibank may have disagreed on the level of threat posed by LDC loans, Wallich's apparent understanding of the division between risk and uncertainty may not

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[90] Gary M. Hector, "Bank LDC Exposure Worries Wallich," *American Banker,* June 3, 1981, 1.
[91] Ibid.
[92] Ibid.

have been completely incompatible with Wriston's narrative. Wallich seemed to agree with Wriston's comments from prior years that politics and the behavior of politicians were a significant source of uncertainty. Wallich conceded that the "risk resulting from portfolio concentration in a diversified group of developing countries is a good deal less than the risk resulting from concentration in any particular country," but he expressed concern that "the large amount of lending to developing countries" had led to "higher concentrations in individual countries."[93] So while Wallich may have disagreed with Wriston about the sustainability of the LDC situation, the two would perhaps agree that risk was an integral part of economic life. The problem was not whether economic risk should be better mitigated by regulation, as Wallich's comments suggested, but whether the level of risk was appropriate. Both Wallich and Wriston, then, understood bankers to be operating in a world of knowable, quantifiable risk.

At the end of 1981, the major credit rating agencies Standard & Poor's and Moody's downgraded Citibank's Long-Term Debt rating to Aa1, one step below its previously top-tier Aaa rating.[94] Such a change indicated that Wallich's anxiety over the long-term health of US commercial banks had, by the end of the year, spread from government officials and journalists to the major credit rating agencies. The credit rating agencies' lack of confidence in the financial health of Citi could carry significant consequences in investment markets, given that many large institutional investors used credit ratings to determine where to direct investment capital. Shares of Citibank stock, however, did not experience any significant decline in price following the credit-rating downgrade.[95] These contradictory external

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[93] Ibid.
[94] FDIC, *LDC Debt Crisis,* 202.
[95] Ibid.

measures of confidence in Citibank's performance demonstrated a sense of uncertainty in financial markets on the eve of the debt crisis's eruption.

The Road to Crisis in Mexico

While bankers and policymakers debated the debt situation in the US, debtor countries in Latin America continued to borrow. By the mid-1970s, Mexico was well on its way to becoming the first Latin American country to threaten default. Under the administration of President Luis Echeverria from 1970 to 1976, Mexico's debt had grown from $4 billion to $20 billion, and the Mexican central banks' foreign currency reserves had fallen from $1.2 billion to $177 million.[96] Echeverria's turn towards massive borrowing in the 1970s was motivated by a desire of Mexican officials to continue, as Christy Thornton describes, "leadership of a global effort to challenge international inequities in distribution and representation," as well as a "foreign-capital-friendly developmentalism."[97] Like other Latin American debtors, Mexico had turned towards foreign borrowing before the first oil shock, and had continued borrowing throughout the 1970s for reason separate from the inflated cost of oil imports. The first oil shock added fuel to the fire, but it was not the sole factor generating demand for loans. As demonstrated earlier, debates between policymakers and bankers in the US tended to ignore this complicating factor in the debt situation. As such, the insistence of bankers that their foreign lending activities were a helpful corrective to the

[96] Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (Ithaca: Cornell University Press, 1990,) 122; Paul V. Kershaw, "Averting a Global Financial Crisis: the US, the IMF, and the Mexican Debt Crisis of 1976," *The International History Review* 40, no. 2 (May 2017,) 292.
[97] Christy Thornton, *Revolution in Development: Mexico and the Governance of the Global Economy* (Oakland: University of California Press, 2021,) 166.

post-oil shock maldistribution of liquidity held more sway and precluded discussions on the structural factors at hand.

In August 1976, Echeveria began talks with the IMF, US Treasury, and Federal Reserve. Before formal negotiations could even begin, the IMF told Mexican officials, the peso would have to be devalued. In response, the Mexican Finance Ministry allowed the value of the peso to float, ending the peso's longstanding fixed exchange rate to the dollar. Consequently, the value of the peso fell 38 percent. The US treasury then provided the Mexican government with $600 million worth of bridge loans until an agreement with the IMF over an additional $1.2 billion was reached in mid-September. The Mexico-IMF agreement, in additional to continual devaluation of the peso called for an austerity program consisting of budget cuts and reducing funding for public subsidies. As Paul Kershaw has shown, Echeverria attempted to resist going to the IMF and accepting an unequal burden of adjustment between debtors' and creditors. Eventually, Echeverria accepted the IMF package as a political tactic to ensure continued access to international credit markets, which would allow Mexico's "capacity to industrialize" and maintain "high rates of private and public investment."[98]

The role the IMF agreements would play as seals of approval enabling debtor countries to continue to access foreign capital only grew throughout the 1980s and become a central factor in creating the Washington Consensus. The same fear that Echeverria had of losing access to foreign capital to continue economic development programs would eventually be leveraged by the IMF to maintain a case-by-case approach to the debt crisis. The carrot of additional foreign loans would be enforced by the stick of potential financial

[98] Kershaw, "Averting a Global Financial Crisis," 297-299.

isolation. In 1976, conditionality agreements were not yet far reaching enough to cut off the possibility of Mexico continuing its ISI program. This moment of possibility in the Mexican case represents a road not taken, whereby financing from the IMF and Banks would continue to allow debtor states to pursue development programs with a greater sense of autonomy.

Jose Lopez Portillo, Echeverria's successor chose to focus on developing Mexico's capacity to export oil through investment in the state-owned oil firm, Pemex. Increased oil production would grant Mexico more leverage in future loan agreements, given the promise of potential export earnings. By 1977 interest rates were still relatively low given the inflationary environment, and Mexico stood to gain access to cheap foreign exchange dollars both through new loans and oil exports. In the eyes of Lopez Portillo, this would enable continued domestic economic growth. This oil driven development strategy allowed the Mexican administration to avoid continued relations with the Fund, at least until 1981. By then, the effect of the Fed Chairman Paul Volcker's dramatic increase of global interest rates had slowed inflation at the cost of economic growth and a fall in demand for the oil that Lopez Portillo had hinged his development program on. Consequently, in November 1981, Mexican officials once again entered consultations with the IMF over Mexico's adherence to the IMF adjustment measures.[99]

The IMF was disappointed by the November consultations and concluded that the "prospects for adjustment were limited." The Lopez Portillo administration was slated to be replaced in December of 1982, and the political uncertainty cast doubts on Lopez Portillo's willingness or ability to impose IMF conditionality requirements. In February 1982, the Mexican government did allow the value of the Peso to fall precipitously but, just a month

[99] Boughton, *Silent Revolution*, 285.

later and to the IMF's chagrin, authorized a 20 percent wage increase for the public sector to offset the effect of the currency devaluation on working-class Mexicans' consumption levels.[100] At the same time as the wage increase, Lopez Portillo authorized his economic advisors to come up with policy options to deal with the escalating debt problem. Capital flight caused by rich Mexicans moving their bank accounts offshore or converting them to dollars was a continually exacerbating the level of Mexico's economic difficulty, and the advisors consequently recommended nationalizing the banks as a possible option that would cut off this flow of money out of the country. By August 1982, capital flight had reached unprecedented levels, and by the end of the month Mexico would not have enough foreign exchange left to meet its upcoming loan obligations. Mexico's threat of default in August would kick off the Latin American debt crisis and begin the "lost decade" of economic contraction across the continent.

Conclusion

Reflecting on the emergence of the Latin American debt crisis in the fall of 1982, one financial writer has reflected that for "mega-bankers" like Walter Wriston, the crisis came as surprise: "In the Spring of 1982, the notion that [LDC borrowers] would all wind up as economic basket cases within months of each other was a worst-case scenario that was never even contemplated."[101] The political debates surrounding the lending boom in the 1970s would seem to indicate otherwise. Many observers—in Congress, at the IMF, in the Press—knew that the imbalanced distribution of liquidity was a structural problem that needed to be addressed. In the 1970s, the arrangement whereby the IMF would impose economic policy

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[100] Ibid, 285-288.
[101] Zweig, *Wriston,* 748.

requirements on debtor countries to ensure continued payments to the commercial banks was not a given. Instead, expanding the IMF was one solution out of several others—such as the possibilities offered by an OECD lending facility or more robust capital controls—which policymakers in the US passed up. The IMF-based solution, however, was attractive in that it ensured that petrodollar recycling would remain the purview of private commercial banks.

For laying the path to the Washington Consensus, the near decade between the 1973 oil crisis and the 1982 debt crisis was crucial for two reasons. First, the largest US banks had expanded their LDC loan portfolios to greater than 100 percent of their total capital and reserves.[102] With those loans now on the precipice of default, the banks were staring down potential insolvency. The expansion of the international financial markets had come to threaten the stability of the world's financial system. Second, the amount of funding and capacity of the IMF had grown immensely. Through piecemeal increases over the decade, the IMF had developed from its limited postwar role into an institution capable of playing lender-of-last-resort to the international financial system. Faced with a new intrusion of the market into the structure of global economic life, policymakers—with the support of the bankers themselves—had crafted a virtually new institution that could safeguard the flow of capital and international trade. The conditionality policies attached to the rescue financing the IMF could now provide would over the next decade provide the groundwork for the prescriptions of the Washington Consensus.

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[102] FDIC, "LDC Debt Crisis," 191.

CHAPTER III

"FINANCIAL PEARL HARBOR:"
THE EARLY DEBT CRISIS, ECONOMIC FIREFIGHTING, AND NATIONAL SECURITY

On August 12, 1982, the United States Treasury Secretary Donald Regan received a call from the Mexican Finance Minister Jesus Silva Herzog. Herzog informed Regan that, without help, Mexico would be unable to meet its near $8 billion in scheduled loan payments coming due over the next three months. Herzog, known by American officials—given their discomfort addressing him as "Jesus"—as "Chucho," also made separate calls to Federal Reserve chairman Paul Volcker and the managing director of the International Monetary Fund (IMF) Jacques de Larosière reporting the bad news. Secretary Regan, Chairman Volcker, and Director De Larosière would scramble through the next few days meeting with central bank officials from creditor nations, executives from large commercial banks, and Mexican officials to provide Mexico with the necessary bridge financing to qualify for rescue loans from the IMF. While Mexico was saved from default, the debt payments exacted a heavy toll on the economy. The continued interest payments instigated a downward cycle of negative growth and inflation that lasted until the 1990s." In the months following Mexico's threat of default, both Brazil and Argentina needed to negotiate similar rescue packages to continue servicing their debts.[1]

With Herzog's phone call, the Latin American debt crisis had begun. By the end of 1982, "approximately 40 nations" across Latin America and the greater developing world

[1] This anecdote has been reconstructed from: James Freeman and Vern McKinley, *Borrowed Time: Two Centuries of Booms, Busts, and Bailouts at Citi* (New York: HarperCollins, 2018,) 207-215; Paul A. Volcker and Christine Harper, *Keeping at it: The Quest for Sound Money and Good Government* (New York: Public Affairs, 2018,) 131-132; Joseph Kraft, *The Mexican Rescue* (New York: Group of Thirty, 1984,) 1.

would be behind on interest payments to global money-center banks.[2] As discussed in Chapter One, Latin America became the epicenter of this sovereign debt accumulation owing to trend of governments in the region financing domestic import substitution programs by borrowing money abroad in a process of "indebted industrialization."[3] In the midst of post-war prosperity, Latin American states had sought to decrease dependence on developed economies for manufactured goods and for a while were able to fund industrialization programs with revenues from the sale of primary commodities. As explored in Chapter Two, by the 1970s in many Latin American countries, demands for public spending had simply outpaced government revenues. In the case of Mexico, for example, the turn to foreign debt was simply easier than carrying out tax reform or grappling with other structural factors to make up the gap.[4]

Given the effects of rapid inflation on loan interest rates, external financing became had also become increasingly attractive to industrializing Latin American countries throughout the approximate decade between the first oil shock and the emergence of the crisis. With the value of the dollar in steep decline, money borrowed today could be expected to be easier to pay off with inflated revenues tomorrow. The average external debt as a percentage of GDP in the fourteen most heavily indebted countries had grown from twenty percent to over fifty.[5] From the very outset of the crisis, contemporary observers commented that over-lending to Latin America was by no means a new phenomenon, and the most recent concentration of Western bank lending in Latin America reflected a "long history of lending

[2] FDIC, "Chapter 5," 191.
[3] Cohen, *In Whose Interest,* 205.
[4] Hector Aguilar Camín and Lorenzo Meyer, *In the Shadow of the Mexican Revolution: Contemporary Mexican History, 1910-1989* trans. Luis Alberto Fierro (Austin: University of Texas Press, 1993), 170-171.
[5] Boughton, *The Silent Revolution*, 270.

frenzies in the Americas—the sorry cycles of boom and bust that had characterized financial relations with Latin republics almost from the moment of their birth."[6] Fueled by OPEC deposits, US banks had built up a total exposure of $82.5 billion throughout Latin America by the end of 1982. The threat of default from the three biggest borrowers alone (Mexico, Argentina, and Brazil) would mean a loss of over 100 percent of the capital of leading American banks including Citi, Bank of America, and Chase Manhattan.[7] As of late 1982, the threat to the health and stability of the international financial system was great enough for one Citibank executive to later describe the crisis as "financial pearl harbor."[8]

In the years following the threats of mass and widespread default in late 1982, the specific policy tenets of the Washington Consensus would begin to emerge, cobbled together in a piecemeal process. The consensus did not materialize straight from the foreheads of IMF technocrats as the best path towards market development for struggling countries in the Global South or as the inevitable result of progress in the science of economic development. Rather, the Washington Consensus was a reflation of a series of decisions made by policymakers to avoid financial panic, protect price stability, and therefore privilege the needs of US commercial banks while also grappling with the Cold War imperative of staving off the kind of leftist political agitations that debt-induced instability could potentially yield. The early years of the Latin American debt crisis represent an interregnum period between two distinct international political economic regimes in which Reagan Cold War foreign policy and neoliberal economic reform mutually constructed one another. Just like the Reagan administration's covert funding the Nicaraguan Contras and other military proxies in

[6] Cohen, *In Whose Interest,* 207.
[7] Freeman and McKinley, *Borrowed Time*, 211-219.
[8] William R. Rhodes, *Banker to the World: Leadership lessons from the Front Lines of Global Finance* (New York: McGraw Hill, 2011,) 182.

Central America, the administration's approach to the sovereign debt issue was molded by the Cold War desire to keep leftists out of power in Latin America.[9]

This first emergency-management phase of the crisis, lasting from fall 1982 through 1983, established several key components of the Washington Consensus. First, the process of IMF expansion—both in funding and in capacity—which had begun during the buildup of LDC debt in the 1970s continued at an accelerated pace. Under managing director Jacques de Larosière, the Fund took a much more proactive role in its negotiations with debtor countries and commercial banks. In late 1982, the Fund spearheaded a new strategy of "involuntary lending," as it was then known, whereby commercial banks were forced into extending new money to troubled debtors to pay off old loans while longer-term, structural solutions could—at least theoretically—be devised. The IMF would only release funding to debtor countries after agreements had first been made with the banks, and the debtor country had made firm commitments to austerity. To ensure that the IMF had enough money to lend out to troubled debtors, the Reagan administration worked throughout 1983 to secure even greater IMF funding from Congress.

Second, despite being coerced into greater debt exposure through involuntary lending, the banks ensured that the burden of adjustment would shift almost entirely onto debtor countries. New money loans were made with terms that were profitable for banks and burdensome for debtors. To negotiate with debtor countries, the banks created advisory committees made up of representatives of major creditors, led by William R. Rhodes of Citibank. Rhodes and the advisory committees he chaired would become significant in the later years of the debt crisis as the vehicle by which banks enforced the terms of their new

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[9] On Reagan's Cold War in Latin America see: Sean Wilentz, *The Age of Reagan: A History 1974-2008*. (New York: Harper Collins, 2008).

lending and restructuring of old debts through. Banks were also granted protection via regulatory forbearance granted by both the Federal Reserve and Federal Deposit Insurance Corporation (FDIC). Had they been forced to set aside reserves early on, or declare Latin American loans as non-performing, the health of commercial banks' balance sheets would have been compromised enough to threaten a global financial panic. Whether intentional or not, the lax treatment regulators gave to commercial banks ensured that the banks would be shielded from serious financial consequences, and that economic recovery from the early 1980s recession could continue in the US while Latin American economies experienced severe contractions.

Rescuing Mexico

Within twenty-four hours of his distress calls, Chucho Herzog was in Washington for negotiations. It was Friday the 13th no less, and Herzog had spent the night prior staying at the Watergate hotel. Accompanied by Angel Gurria, his counterpart at the Mexican treasury, Herzog's first meeting was with De Larosière at the IMF. Despite President Jose Lopez Portillo's known antipathy for the fund, Herzog made clear the Mexican administration's willingness to begin talks on an austerity program. In an hour-long meeting, De Larosière informed the Mexicans that as part of any agreement that the Mexican Government would have to publicly announce it was seeking IMF assistance, cease moves towards implementing exchange controls, and coordinate all relief actions with the commercial banks. Again, it was important to De Larosière that Mexico openly acknowledge its use of IMF funds because of President Lopez Portillo's history of holding a nationalist confrontational attitude towards the international financial institutions. Importantly, the Mexican government would have to stay

current on their interest payments and reach an agreement with the creditor banks before any IMF funds could be disbursed. Da Larosière was particularly concerned because this was going to require a severe adjustment program in Mexican economic policy, at the time when the Mexican presidency was soon going to behanded off from Jose Lopez Portillo to his successor, Miguel De La Madrid, on December 1st. De Larosière wanted any adjustment plan to be supported by both the outgoing and incoming administrations, so as to avoid any implication that the policies were being imposed on the Mexican government without its consent.[10]

Herzog's next stop was at the Fed, to meet with Paul Volcker. Herzog's main message was that Mexico needed emergency financing from the US Treasury, the Fed, and other central banks to buy the Mexican government the time it needed until an agreement with the IMF could be finalized. Volcker, like De Larosière, was worried about Lopez Portillo and possible issues that could arise before the hand-off of power to De La Madrid. Volcker's main concern, however, was the stability of the US banking system. The sheer size of Mexico's total sovereign debt—$80 billion—was over three times greater than that of Poland, the most recent major country to threaten default in 1981.[11] Mexico's total debt owed to US commercial banks accounted for 44 per cent of the capital of the nine largest US banks.

While Volcker and bank executives understood that Mexico would have to delay payments on principal temporarily, it was critical that the Mexican government keep making

[10] Boughton, *Silent Revolution*, 291; Joseph Kraft, *The Mexican Rescue* (New York: Group of Thirty, 1984,) 5-7; Roger S. Leeds and Gale Thompson, *The 1982 Mexican Debt Negotiations: Response to a Financial Crisis* (Washington D.C.: Foreign Policy Institute, 1987,) 14.
[11] See: Fritz Bartel, *The Triumph of Broken Promises: The End of the Cold War and the Rise of Neoliberalism* (Cambridge: Harvard University Press, 2022.)

interest payments. If interest payments were to stop, according to US accounting regulations the banks would have to declare their Mexican loans as "non-accruing" which would greatly weaken banks' balance sheets. The panic this possibility could ignite in financial markets had the potential to turn the Mexican debt crisis into a global one. To address the bank issue, Volcker handed Herzog a list of the personal phone numbers of top executives at the major US banks where they could be reached even on the weekends. On the topic of emergency financing, Volcker estimated the $1.5 billion could come from creditor countries' central banks, with the Fed willing to put up half. After the meeting, Volcker phoned central bankers in Britain, Canada, France, Germany, Switzerland, and Japan and arranged a meeting to be held at the Bank for International Settlements in Basel in the coming weeks.[12]

To make it through the weekend, the Mexican government was still in need of approximately $2 billion which would have to come from the US federal government. As such, Herzog's next meeting was with Treasury Secretary Regan. Representatives from various US federal government agencies were in the room, but the Treasury staff led the discussion. The $2 billion was to come from two sources: a $1 billion agricultural credit that Mexico could use to import US food and the rest from a $1 billion advance payment on Mexican oil imports. The latter measure was contentious, according to Joseph Kraft, because "selling oil to the Colossus of the North at cut-rate prices" was "a sensitive subject with radical nationalists."[13] The first two suggestions on the oil deal that the Treasury floated to the Mexican delegation were unacceptable to President Lopez Portillo. The first idea was to have Mexico pay back the $1 billion dollar loan in $1.3 billion worth of oil, carrying an interest of roughly 35 percent. In response to the second suggestion—a $100 million

[12] Kraft, *Mexican Rescue*, 9.
[13] Ibid, 14.

“negotiation fee” on the loan—prompted Lopez Portillo to tell Herzog over the phone: “Let Rome burn.”[14] For his part, Paul Volcker later reflected that the first two deals came with interest rates that were “egregiously high,” and a consequence of the myopic views of the “Budget Bureau and Energy Department officials” who had no sense of the “larger issues at stake.”[15] By mid-day Sunday, August 14th. Herzog and the Mexican delegation left back to the Mexican embassy without settling a deal.[16]

The stalemate was finally broken when Regan’s undersecretary Richard McNamar called Regan to report the news. Regan had left the negotiations Sunday morning to play golf with President Reagan and several Congressman. Secretary Regan asserted to President Reagan that significant action needed to be taken on the Mexican issue. Reagan agreed that if more action could be taken to help Mexico, it should be done. Secretary Regan flew back to DC and Herzog was summoned back to the Treasury just as he was on his way out the door back to Mexico. After three hours of negotiations, Treasury officials and the Mexican delegation hammered out a deal for the US to purchase $1 billion worth of oil at steep 20 percent discount per-barrel. In effect, this meant Mexico would be paying 30 percent interest on its rescue money to the US government.[17]It is important to underscore that this rescue money from the US government was not rescuing Mexico from crisis. This emergency $2 billion dollars was only meant to enable Mexico to keep making interest payments on loans held by US commercial banks through the weekend. Such a relatively small, but important, infusion of cash came with an interest cost barely lower than the 35 percent that Paul Volcker found to be egregious in earlier offers. The cost of the oil deal prompted one of Herzog’s

[14] Ibid, 15.
[15] Volcker and Gyohten, *Changing Fortunes*, 201.
[16] Kraft, *Mexican Rescue,* 15-16.
[17] Kraft, 16.

aides to later reflect that Regan had “screwed Mexico at a time of its worst need.” Regan, a former investment banker, had allegedly said regarding the deal that he wanted to “deliver to American taxpayers the same [returns] he delivered to Merrill Lynch shareholders.”[18] As this was emergency money from the federal government, it came with no direct conditionality stipulations. But again, the purpose of the funding was to hold over the Mexican government until conditions could be negotiated on new and restructured loans from the IMF and the banks.

On August 18th, Jesus Herzog flew from Basel to New York City to begin meeting with heads of Mexico’s main commercial bank creditors the next day. Herzog had been in Basel securing another $1.85 billion in emergency funding at the BIS—half to come from the Fed. As noted in one prominent history of Citibank, it had been hard to reach these top bankers over the weekend when most were “playing golf, fishing, or relaxing at their summer residences.”[19] Citi’s Walter Wriston, though vacationing in Connecticut when he got the call, recognized the seriousness of the situation and had called Secretary Regan to emphasize the gravity of the issue. At the outset of the crisis, Citi’s exposure to Mexican debt was nearly half of its capital.[20] Given its outsized exposure, and sway within the banking sector, Volcker appointed Citibank and Bank of America to head a fourteen-member restructuring committee representing the banks in their negotiations with Mexico.[21]

After a day of informal meetings held at the New York Fed, a formal meeting was called for Friday, August 20th. That morning, in a smaller meeting with Wriston and the heads of Chase, Manufacturers Hanover, and Chemical Bank, Herzog assured the bankers

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[18] Quoted in: Zweig, *Wriston*, 758.
[19] Zweig, *Wriston,* 757.
[20] Freeman and McKinley, *Borrowed Time*, 211.
[21] Zweig, *Wriston*, 759.

that Mexico would do whatever necessary to stay current on interest payments but asked for an extension of principle maturities for one to two years. On Wriston's objection, they agreed to not postpone any principal payments for more than 90 days. Later, in a larger meeting with 115 bank representatives (800 were invited) as well as the representatives from the IMF, Herzog affirmed Mexico's commitment to adjustment. The meeting ended with a general agreement that Mexico's creditor banks would uniformly allow a 90-day extension on principal payments while Mexico finalized its adjustment agreement with the IMF. Near the end of the month, Herzog reached a tentative agreement with the IMF that would have Mexico cut its budget deficit from 15 percent of GDP down to 8 percent.[22]

Jose Lopez Portillo's Last Stand

The concessionary and conciliatory attitude that Herzog brought to these early negotiations with the banks and IMF was, as of fall 1982, not shared by the rest of the Mexican political elite. On September 1st, just days after Herzog's unofficial austerity agreement with the Fund, Mexican President Jose Lopez Portillo nationalized the country's banks in a fiery State of the Union address. Much to the IMF's dismay Lopez Portillo laid responsibility for the crisis directly at the feet of the Fund, property-holding Mexicans, and foreign private banks.[23] In the speech, Lopez Portillo described how a significant portion of Mexico's external debt and balance-of-payments problems had been driven by Mexicans converting pesos into dollar-denominated foreign banks accounts as well as purchases of US real estate. Lopez Portillo estimated this amount of "Mexdollars," as he referred to them, to be $12 billion, on top of $20 billion dollars "generated to pay for mortgages" and

[22] Boughton, *Invisible Revolution,* 299.
[23] Ibid, 300.

"maintenance of [foreign] property and taxes." "I can assert that in a few, recent years, a group of Mexicans," Lopez Portillo continued, "headed, counseled and aided by the private banks, have withdrawn more money from this country, than all of the empires that have exploited us from the beginnings of our history."[24] To attack this offshoring of Mexican currency, Lopez Portillo also took the chance to introduce foreign exchange controls.

As to be expected, Lopez Portillo's provocation drew strong reactions from creditors, and even within his own government. The Mexican central bank head resigned in protest of the nationalization, and Herzog was kept on board after Lopez Portillo refused to accept his resignation.[25] Lopez Portillo's nationalist last stand against foreign creditors, while extreme it its rhetoric, did not represent a substantial alternative to direction that negotiations were heading. By nationalizing the banks, Lopez Portillo turned the country's private debt into public debt—in effect consolidating all the foreign loans into the government's sovereign debt. For Mexican banks in trouble, as reported in the banking trade press at the time, the only other route the Mexican government could have taken would have been to bailout the banks, which would have been politically unacceptable.[26] The nationalization, moreover, only applied to domestic Mexican banks which meant that Citibank—the only US bank with branches in Mexico—would be left untouched.[27]

While Lopez Portillo explicitly invoked the image of imperial oppression in his speech, his policy maneuvers only went so far in resisting foreign economic demands placed upon Mexico. Still, the resistance that came within his own administration was a testament to

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[24] Quoted in: Camín and Meyer, *Shadow of the Mexican Revolution*, 215-216.
[25] Rhodes, *Banker to the World*, 86.
[26] Robert E. Norton and Teresa Carson, "Mexico Nationalizes its Banks; US Branches there Left Untouched," *American Banker*, September 2, 1982.
[27] Zweig, *Wriston*, 763.

the level of change that was occurring within the PRI. Lopez Portillo made the announcement as a lame duck, with De La Madrid slated to succeed him in December. Ivy League-trained economists like Lopez Portillo would find a much more welcoming environment in the De La Madrid administration, who was himself a holder of graduate degree in policy from Harvard.[28] As Sylvia Maxfield has argued, the nationalization represented only a "temporary comeback for the national populists." Despite the efforts of Lopez Portillo and his allies, capital flight was not significantly diminished. In taking on private sector debts, the move only added to the public sector's financial burden.[29]

During these early days of the crisis, an important factor that would shape the negotiations for the rest of the decade was the advent of the bank restructuring committee, with Citibank at the helm. To head the new committee, Wriston tapped William R. Rhodes, a "cigar chomping forty-seven-year-old international banker" who had worked in Latin America since joining Citi in 1957. In the coming years, Rhodes would come to be the bank's top diplomat in debt negotiations, described variously as the "man on whose shoulder the Third World debt crisis would optimally fall" and "the field marshall of the debt crisis.[30] Previously, Rhodes had served as Citibank's negotiator with the left-wing Sandinista government after they had taken power in culmination the Nicaraguan Revolution in 1979 over the foreign debt inherited from the dictatorial regime the Sandinistas had overthrown. It was then that Rhodes first met Jesus Silva Herzog, as Mexico had served as an advisor to Nicaragua in the negotiations. In the middle of negotiations, as a favor to the new Nicaraguan

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[28] On the transition in PRI leadership towards foreign-trained economists see: Sarah Babb, *Managing Mexico: Economists from Nationalism to Neoliberalism* (Princeton: Princeton University Press, 2001.)
[29] Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (Ithaca: Cornell University Press, 1990,) 146-162.
[30] Zweig, *Wriston*, 758; Rhodes, *Banker to the World*, 181-187.

president, Rhodes met with Fidel Castro—who had repudiated Cuba's debt to the US upon taking power in—to advise him on how to restructure his debts with European banks. By the time of Mexico's crisis, then, Rhodes already had experience talking adversarial government into debt agreements. In his memoirs, Rhodes reflected that the nickname given to him by Castro and the Sandinistas, "Comandante Gucci," conferred on him "comandante credentials." As a testament to the negotiation skill he had developed by 1982, Rhodes was the reason that the bankers' committees were officially called "advisory committees" instead of "restructuring committees"—he felt that the original name sounded "too menacing" Rhodes spoke Spanish and was familiar with Latin American political negotiations.[31]

The significance of the personalities of elites like Rhodes and Herzog is the outsized influence they held during the debt crisis and therefore in the economic fates of creditor and debtor countries. In the chaotic negotiations following the bank nationalization, Rhodes could not get a hold of Herzog to affirm that Mexico would not pull out of conditions attached to further deals for new money loans. Rhodes became concerned enough to fly to Mexico City to get to the bottom of the situation. As Rhodes later explained, Herzog was crucial to negotiations because bankers had come to trust him:

> We had come to trust Silva Herzog, yet nobody could explain why he had disappeared. Without him, that trust was on the verge of vanishing. The Members of the banking committee were getting antsy. They threatened to end the negotiations and go home.[32]

Eventually, Herzog called Rhodes to explain that his absence was due to an emergency appendectomy, and that he had not informed any of the creditors because of his "fear on the impact of the markets."[33]

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[31] Rhodes, *Banker to the World*, 183.
[32] Ibid, 87.
[33] Ibid, 88.

This anecdote is significant in that it reveals just how fragile the political-economic situation was in the immediate aftermath of the emergence of the Latin American debt crisis. Not only was the absence of a single Mexican financial official enough to potentially thwart negotiations, but Herzog's condition also was enough to possibly induce financial panic. The Mexican banking system had indeed come close to collapse days after the nationalization announcement. On September 7, or "Black Tuesday," enough panic reached the interbank market to nearly cause the nationalized Mexican banks to default on their debts.[34] The precarity of the banks' position in the 1980s debt crisis threatened global financial crisis and economic depression on the scale of the 1930s. By preventing such a crisis, the IMF, commercial banks, and creditor governments, ensured that the economic cost of adjustment would be borne solely by debtor governments. The depression that followed the lending frenzy of the 1970s was contained to the borrower countries. The emergency negotiations in 1982 therefore foreclosed the alternative scenario where the burden of the crisis would have been shared more equitably between borrowers and lenders.

Another important development that came out of the early months of the crisis was the IMF becoming increasingly more proactive in pushing both the creditor banks and debtor countries into agreements before granting any IMF financing. Mexico finalized its initial agreement with the IMF in early November. The agreement came only after weeks of deadlock over how severe Mexico's austerity commitment would have to be for 1983. Finally, the Mexican negotiators accepted a "compromise" of cutting their fiscal deficit by 50 percent.[35] Crucially, the IMF would release to Mexico in 1983 the maximum amount permitted by the Fund's "rules of access," $1.3 billion, only after the banks had committed to

[34] Boughton, *Silent Revolution*, 301.
[35] Ibid, 306.

at least $5 billion in new loans to Mexico, equal to seven percent of the banks' extant exposure. The pressure that the IMF was now putting onto the banks was "unprecedented."

This model of "concerted," more often referred to as "involuntary" lending would become the norm for at least the opening phase of the debt crisis. The new money from the banks was intended to pay off the interest on old loans, while macro-economic adjustment could be worked out in the debtor countries. While bankers may have felt coerced, this new lending came with plenty of incentives. To help get the US banks to play along, the Federal Reserve promised that loans made to support IMF adjustment programs would be spared regulatory scrutiny. When Mexico did reach a deal with its US creditors on December 8, 1982, in the words of IMF historian James Boughton, "the terms were harsh for Mexico and highly profitable for the banks." The loans carried healthy spreads and would cost Mexico about $800 million in fees. [36] In February 1983, the banks and IMF struck similar deal with Brazil, which was followed by more concerted lending in agreements in Argentina and the other major Latin American debtors.[37] With the first emergency phase of financial negotiations concluded and major debtor default avoided, it was established that the burden of adjustment would fall on debtor governments. While banks may have been pressured by the Fed and IMF into increasing their debt exposure, the cost of that exposure was pushed onto debtors through austerity commitments and inflated costs for new loans.

In the weeks following Mexico's reaching its new money agreement with the banks, internal documents from within the US Treasury reveal how the Treasury department rhetorically validated this unequal distribution of the debt burden. In talking points regarding the ongoing Brazilian debt negotiations, Secretary Regan stressed the need for Brazil to reach

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[36] Ibid, 306-307, 310-311.
[37] Krugman et. al, "LDC Debt Policy," 694-695.

an agreement with the IMF before the US committed any more official funding.[38] A memo to Regan from the US's IMF executive director, Richard Erb, stressed that the government of Mexico was responsible for its current crisis. In stark contrast to President Jose Lopez Portillo's diagnosis of the crisis, Erb claimed that Mexico "probably would have avoided the severe financial squeeze" which precipitated the crisis if the government had "reigned in the growth of government expenditures" and fiscal deficit in 1980 and 1981. "The IMF did not impose austerity," Erb explained regarding Mexico's recent austerity agreement. Erb continued: "The policies recommended by the IMF are designed to reverse the sharp deterioration in Mexico's economy and restore the conditions for domestic economic growth, import growth, and external financial stability."[39]

Assessing the Threat to the US Economy

In the immediate aftermath of the crisis's emergence, Citibank chairman Walter Wriston tried to ease anxieties over the drastic consequences of a decade of exuberant international lending by assuring the public that the present situation was merely a temporary issue of "liquidity, not insolvency."[40] Wriston had spent the years leading up to the crisis cultivating a persona as the public spokesman for the American banking community. It was under his leadership that Citi had led American commercial banks "up the primrose path" in expanding developing world lending into a profit center, all the while Wriston was making regular appearances in opinion columns and public speaking events to preach the gospel of

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[38] Memo, Donald T. Regan to William P. Clark, December 13, 1982, Box 104, Folder 4, Donald T. Regan Papers, Manuscript Division, Library of Congress, Washington D.C.
[39] Memo, Richard D. Erb to Secretary Regan, "Mexico and the IMF," December 23, 1982, Donald T. Regan Papers, Manuscript Division, Library of Congress, Washington D.C.
[40] Walter Wriston, "Banking Against Disaster," *The New York Times*, September 14th, 1982.

risk.[41] In a notorious 1982 *New York Times* op-ed Wriston declared that no matter what financing problem a sovereign state may face, balance-of-payments or otherwise, that the "country does not go bankrupt."[42] Criticism of Wriston's op-ed was widespread, and not limited to either side of the political spectrum. The economist and former member of the Kennedy administration Robert Roosa described the article as "just plain cotton candy." *The Wall Street Journal* editorial page summed up Wriston's argument as "sovereign nations never die; they just roll over."[43]

Wriston's ultimate point was that in the case of sovereign debt, the problem could not be structural in nature. All debt-addled countries needed, therefore, was additional cash aid in the form of new loans from banks, governments, and the IMF. For Wriston, commercial banks' recycling of petrodollars was not a band-aid solution but proof that the market could effectively "absorb the shock."[44] Wriston also pointed to New York City's 1975 fiscal crisis as time when observers "warned… that the nation's banks might be in deep trouble" but were proved wrong.[45] Wriston's particular interpretation of the major economic events of the 1970s looked to bank's survival and the health of financial markets, as opposed to plight of debtors, as indicators of stability.

Much like New York in 1975, to access the emergency liquidity which Wriston implied was readily available indebted Latin American states were beginning to have to drastically cut back on public spending. In addition to the Mexican agreement, in November 1982 the Costa Rican government had also received a total of $170 million in new loans from

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[41] Benjamin J. Klebaner, *American Commercial Banking: A History* (Boston: Twayne Publishers, 1990,) 208. Also see: Walter Wriston, *Risk and Other Four-Letter Words* (New York: Harpers Row, 1986.)
[42] Wriston, "Banking Against Disaster."
[43] Both quoted in: Zweig, *Wriston*, 765-766.
[44] Ibid.
[45] Ibid.

the IMF and United States "conditional upon IMF approval" of a national austerity program. As reported in the *New York Times*, Costa Rica "sharply raised electricity, gasoline, water, and telephone rates… promised to cut spending, decree new taxes and increase domestic interest rates" in accordance with the IMF agreement. The Costa Rican government was compelled to accept the terms of the austerity agreement not only for emergency IMF funding, but also to aid in negotiations with their bank advisory over the terms of a $3.1 billion debt owed to the commercial banks.[46] By the end of the year, nine other Latin American nations has opened similar negotiations with the IMF.[47]

On November 7th, 1982, in an address given before the Organization of American States (OAS) Secretary of State George Schultz reflected on the ramifications of the emerging debt crisis for the shared prosperity of member nations. In Schulz's rhetoric, borrowers and creditors had an equal responsibility to adjust the terms of their loan agreements to stave off economic disaster. The ultimate risk at hand was the possibility of closing off vital networks of world trade, and thus plunging the world into "the kind of disaster that engulfed the world in the 1930s."[48] "It would be equally devastating," Shultz continued, "if debtors and creditors were to fail to find those mutual accommodations that will permit borrowing countries to have sustained access to financial markets."[49] So from Shultz's point of view, and that of the US foreign relations establishment, the financial relationships between creditors (the US and other Western industrial countries) and debtors

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[46] Alan Ridings, "Costa Rica Plans Debt Talks as Austerity Program Gains," *New York Times*, December 9, 1982, D15.
[47] Jackson Diehl, "Latin America Looks for Way Out of Deep Dark Tunnel: Massive Debt Saps Economies, Forces Austerity, Unemployment," *The Washington Post*, January 9, 1983, H2.
[48] George P. Shultz, "Reflections Among Neighbors," November 17, 1982, folder "Trip of President Reagan to Brazil, Colombia, Costa Rica, and Honduras, 11/30/1982-12/14/1982 (Notebook) (1)-(5)," Box OA 19325, William Henkel Files, Ronald Reagan Library.
[49] Ibid.

(Latin America) carried very high stakes for the economic health of the world. It wasn't that the stability of the US financial system was hinged on the assets provided by Latin American debt. Instead, what seemed to worry Shultz about the debt crisis was a much loftier concern about avoiding a repeat of the international retreat to protectionism that characterized the Great Depression and had put the world on the road to World War II.

The implication of Shultz's reasoning was that creditors and debtors had an equal burden to share in navigating the crisis. "Just as borrowers must cut their current account deficits, raise domestic interest rates, and keep exchange rates realistic," Shultz explained, "so lenders should in some cases be ready to restructure or, in exceptional cases, reschedule." In implying that the steps needed from lenders and borrowers was equal, Shultz performed a small rhetorical sleight of hand. For borrowers, cutting current account deficits meant having to extract capital from their domestic economies to make up for the missing capital that had previously been imported. For lenders, restructuring debts carried no real consequences for their greater domestic economies. In fact, rescheduling debts (as opposed to writing portions of the debt off or otherwise lowering the total obligation) worked in banks favor by allowing them to keep the loans on their books as assets, as opposed to the potential insolvency that writing down the debts or even default might instigate.

The other obligation Shultz put onto banks was supplying new credits, which would help to ensure the success of IMF stabilization programs. What Shultz failed to mention, however, was that those very stabilization programs might reverse the economic growth many Latin American nations enjoyed throughout the 1960s and 1970s. "Beyond the adjustment," Schultz concluded, "comes the recovery. The US economy is now poised for

just that."[50] How that recovery might be extended to Latin America, however, Schultz failed to mention.

Schultz's particular interpretation of the crisis at hand differed substantially from the picture that emerged just one month earlier from a meeting of Latin American and US state officials in San Jose, Costa Rica. In a document entitled "Final Act of Foreign Ministers of Countries Interested in the Promotion of Democracy in Central America and the Caribbean," the officials in attendance laid out the stakes of the debt crisis as it related to the continuance of democratic state-building throughout the region. Specifically, they discussed the negative economic and political ramifications of the crisis for debtor states that Schultz omitted. The officials "noted that the current world economic crisis produces phenomena such as disproportionate foreign indebtedness, a deterioration of the international financial system, and an increasing imbalance in the terms of trade among states."[51] They elaborated that these problems could and would result in "unemployment" as well as "political, economic, and social conflicts which are exploited by totalitarianism for the purpose of destabilizing the democratic way of life and government." In response to this fear, the present officials jointly made an "appeal to the industrialized countries to step up their cooperation with the democratic countries of the area by implementing bold and effective initiatives to strengthen the recovery and economic and social development efforts of the various interested countries in the area."[52]

[50] Ibid.
[51] Statement, "Final Act of the Meeting of Foreign Ministers of Countries Interested in the Promotion of Democracy in Central America and the Caribbean," October 4, 1982, folder "Trip of President Reagan to Brazil, Colombia, Costa Rica, and Honduras, 11/30/1982-12/14/1982 (Notebook) (1)-(5)," Box OA 19325, William Henkel Files, Ronald Reagan Library.
[52] Ibid.

In the United States, some voices in the mainstream press acknowledged the role of the banks is contributing to the severity of the debt problem. In early 1983, *Time* magazine devoted a feature story to "The Debt-Bomb Threat." Readers were given cause for alarm by the illustration of a large, menacing bomb hovering over earth with its lit fuse being fed by streams of U.S. dollars and other national currencies featured on the January 10th cover (see Figure 1). The enthusiasm for private bank's funding of global development from just a few years earlier had been replaced by apocalyptic anxiety over the consequences of a decade of "go-go lending." With the kickoff of petrodollar recycling after the first oil shock, "bankers awoke to the delights of international lending… young loan officers fell over one another knocking on the doors of finance ministers from Warsaw to Kinshasa." The *Time* feature depicted LDC lending as a thrill-seeking venture rather than a noble effort to aid needy countries. As one banker quoted in the article reflected: "Bankers like travel and exotic locations. It was certainly more exciting than Cleveland or Pittsburgh, and an easier way to make money than nursing along a $100,000 loan to some scrap-metal smelter."[53]

[53] Jay Palmer et. al., "The Debt-Bomb Threat," *Time*, January 10, 1983, 50-59.

Figure 3, Cover of Time *Magazine, January 10, 1983.*

Just a week after the publication of the *Time* piece on the alarm over global debt, the Subcommittee on International Economic Policy of the Senate Foreign Relations Committee held hearings on the emerging debt crisis. In his testimony before the committee, Robert Solomon, an economist from the liberal Brookings Institution classified the crisis as being precipitated by factors outside of the control of debtor countries and therefore necessitating increased international support for the IMF. As Solomon explained to the committee, “the recent difficulties of the major debtors have, to a large degree, been thrust upon them as the result of the recession and high interest rates in the industrial countries” and were not

reflective of "generalized overborrowing."[54] As opposed to *Time's* characterization of exuberant go-go lending fueling the crisis, Solomon's point of view was less concerned with the banks themselves and more with the macro-economic environment in which both creditors and debtors were acting.

Solomon's statement was indicative of the normalized buildup of debt across Latin America throughout the 1970s and pointed to inflation and recession as the key factors fueling trouble. "It goes without saying that growing external debt is a normal condition for developing countries," Solomon explained. By adjusting the data on the increase of long-term debt for all non-OPEC developing countries to account for inflation, Solomon claimed that "debt and the debt burden have not increased alarmingly." While the total amount of debt across non-OPEC developing countries quintupled between 1973 and 1982, in real terms the debt expansion was roughly 10 percent per year. Export proceeds from debtor countries, moreover, had "rose almost as fast as debt." The proportion of those export proceeds that had to be used to pay interest on the debt rose from four percent in 1973 to 9 percent in 1983. Solomon continued to acknowledge that debt to commercial banks was highly concentrated among developing countries—Brazil and Mexico accounted for nearly half of all debt by mid-1982. But again, according to Solomon, for these countries the ratio of interest payments to exports and of debt levels to GNP revealed that the amount of debt itself did "not appear to be an overwhelming burden."[55]

Rather than the level of debt itself, Solomon's statement argued that the primary instigator of trouble was the combined effect of reduced export earnings and skyrocketing

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[54] Statement of Robert Solomon, "International Indebtedness, 1950s—Global Debt," Subject File, Walter S. Salant Papers, Dwight Eisenhower Presidential Library.
[55] Ibid, 4.

interest rates that had a deleterious effect on the variable-rate loans held by debtor countries. Because of "stagnation or recession in the industrial countries," Solomon explained, "the food and raw materials exported by many developing countries experienced a falloff in demand and their prices dropped by more than 25 percent from mid-1980 to mid-1982." So even while many debtor countries were able to increase exports in in the opening years of the decade, the revenues those exports generated increased much less. While export revenues were falling between 1980 and 1982, the real cost of debt was increasing exponentially. While interest rates had been climbing for a while, continued inflation meant that those rates were often marginal in real terms. An 8.85 percent increase in the LIBOR rate in 1978, for example, was just a 1.5 percent increase in the context of a 7 percent rise in consumer prices in the developed countries. Between 1980 and 1982, however, inflation was finally beginning to fall making high interest rates even more punishing. In response, Solomon observed, large debtor countries had to "restrain economic growth" and "impose restrictions on imports." The cutting of imports by developing countries was especially alarming to Solomon, given that it could worsen the recession in the industrial countries. As Solomon warned, "we are in the presence of a vicious circle reminiscent of the early 1930s."[56]

In the face of the grave economic threat, Solomon saw that the US had an urgent interest in expanding the resources and strength of the IMF. Namely, the US needed the IMF to ensure that developing countries continued to receive financing from both commercial banks and public sources. The non-OPEC developing countries that were bearing the brunt of the debt crisis represented one-third of all US exports, and "considerably more than we sell to the European Economic Community" Solomon elaborated. In just the "first ten months

[56] Ibid, 5-6.

of 1982," US exports to Latin America declined 20 percent, to Mexico alone declined 21 percent, and to Brazil alone declined 9 percent. For Solomon, international economic recovery hinged on debtor countries maintaining the imports and "sustaining the world economy."[57] For Solomon, the charge that the IMF would be merely "'bailing out' the banks" was "patently incorrect." Rather, the IMF was "bailing in" the banks by "requiring them to increase their loans to the countries to which [the IMF] is lending."[58]

A Reagan White House memo from a few months earlier reveals that Solomon's emphasis on importance of an empowered IMF was in line with the view of officials within the administration. The memo, dated November 12, 1982—shortly after the initial onset of crisis in Latin America, was from Treasury Secretary Regan to the President. "An increase in the resources of the IMF" the memo reported, "is a central part of our efforts to resolve current international debt and financial difficulties." While an increase in IMF resources had been under discussion "for some time," because of the recent emergence of financial difficulties, "we and other major countries have agreed that the timetable should be accelerated." This would not just be an expansion in the quotas of contributions to the fund by member countries, but also "at US suggestion" the "establishment of special arrangements among major countries for lending to the IMF in extraordinary circumstances that pose a threat to the international financial and economic system." [59]

A month after the appearance of the *Time* expose, the Subcommittee on International Finance and Monetary Policy of the Senate Banking Committee held a series of hearings on the topic of "International Debt." The central policy question which shadowed over the

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[57] Ibid, 7.
[58] Ibid, 8.
[59] Memo, Donald Regan to Ronald Reagan, November 19, 1982, WHORM: Subject File, International Organizations, Box 10, Ronald Reagan Library.

debates was whether commercial banks should be granted a bailout vis-à-vis an expansion in IMF funding. Over the course of three days in mid-February, representatives from the Reagan administration including Treasury Secretary Regan, executives from major lender banks, and regulators such as Fed Chairman Volcker and FDIC Chairman William Isaac testified. In his opening statement to the hearings, Subcommittee Chair and moderate Republican Senator from Pennsylvania John Heinz elucidated a nuanced pro-market view of the debt situation while also being critical of banks behavior. In Heinz's view, as "the leading economic power by far in the free world" the US had an obligation to concern itself with the "stability of that world." The health of developing countries was especially important given the size of the export market for US goods that they represented. A "swift and effective resolution" of the emergent debt crisis was therefore "essential to our welfare and to our future economic growth." While some funding for Latin American balance-of-payments problems was necessary to keep these markets open through the oil-fueled inflation of the 1970s, however, Senator Heinz was "convinced that the current situation would not have fit the description of a crisis had our Nation's banks acted more conservatively and more prudently!"[60]

Heinz's preoccupation with the responsibility of American banks colored the entire shape of the hearings, specifically what role the IMF should play in charting a way out of the crisis. Of particular concern was whether an expansion of the government's fiscal commitment to the IMF would constitute a bail-out for the big banks. For certain business

[60] U.S. Congress, Senate, Subcommittee on International Finance Monetary Policy, Committee on Banking, Housing, Urban Affairs, *International Debt: Hearings before the Subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing, and Urban Affairs on Proposals for Legislation to Increase the Resources of the International Monetary Fund,* 98th Cong., 1st Sess., February 14,15, and 17, 1983, 1.

conservatives like Heinz, any pressure applied to the US budget on behalf of the IMF had to be matched with "legislation that will prevent a recurrence of the current kind of debt crisis that has so involved the world, but most specifically, US banks."[61] In his testimony before the subcommittee, Treasury Secretary Regan directly addressed "widespread concern that an increase in IMF resources will amount to a bank bail-out at the expense of the American taxpayer." For Regan, however, the idea that banks bore sole responsibility for the crisis was "dangerously misleading." Regan stressed three points: that IMF sponsored adjustment would necessarily be accompanied by increased lending commitments from the banks, that the US had a responsibility to the IMF to allocate resources in proportion to the country's nineteen percent share of voting rights, and that the "banking system as a whole" had "performed admirably over the last decade, in a period when were widespread fears that the international monetary system would fall apart for lack of financing in the aftermath of the oil shocks."[62] The contrast between Heinz's and Regan's interpretations of the crisis reflected a pervasive uncertainty throughout the hearings over what the proper shape of the post-1973 global financial order was to be.

The Security Concern

Inside the Reagan White House, the National Security Council (NSC) was grappling with the same questions over the appropriate response to the international debt crisis, albeit with a very different set of concerns. In the immediate aftermath of the emergence of the crisis, top secret memos on the debt situation began circulating through the NSC containing updates from the CIA on the stakes of the international debt situation. A heavily censored

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[61] Ibid, 2-3.
[62] Ibid, 71-73.

memo dated September 16, 1982, for example, noted that a CIA estimate of what had previously been a “surplus” of liquidity in the OPEC countries was then a $17 billion deficit. So as opposed to the situation of the 1970s with surplus petrodollars fueling new credits to debtor countries, OPEC countries would be extracting “from the world’s liquidity pool” rather than growing it. This lack of free liquidity was thereby exacerbating the world debt situation by making it harder for debtor countries to find liquidity with which to service their debts. The memo also noted an uncertainty about “Brazil’s ability to service its debt” and reported that Mexican companies, both public and private, were falling behind on payments.[63] The uncertainty and alarm which the memo revealed to be permeating the US national security establishment is indicative of how uncertain the world’s economic future in the early days of the crisis. The actual CIA reports on the situation in Mexico and Brazil that were attachments to the memo, unfortunately remain classified. Another memo which circulated two weeks later, however, noted that Brazil was having to pay a much higher interest rate spread between the loans it was making payments on and the loans it was borrowing to make those interest payments.[64]

In the wake of a wave of debtor countries seeking to reschedule their extant debts in late 1982, a confidential report in the files of Reagan’s NSC dated September 30, explored the possible consequences of these possible new arrangements. Looking to the emerging crisis in both Latin America and in Eastern Bloc countries, the report noted the 18 countries that had “announced or indicated that they will reschedule,” including Argentina and Mexico, represented “one fourth of the total external debt of the developing countries and Eastern

[63] Memo, Norman A. Bailey to William P. Clark, September 16, 1982, folder “International Debt Situation, 5/82-9/28,” Box 41, Executive Secretariat, NSC: Subject File, Ronald Reagan Presidential Library.
[64] Memo, Norman A. Bailey to William P. Clark, September 23, 1982, folder “International Debt Situation, 5/82-9/28,” Box 41, Executive Secretariat, NSC: Subject File, Ronald Reagan Presidential Library.

Europe." In addition to the 18 rescheduling countries, many other countries, including Chile and Peru, were attracting attention from the international financial community as potential problems in the future. Brazil posed the most immediate threat, as its "sudden difficulty in obtaining foreign loans raises the prospect of a serious foreign exchange crisis."[65] The early months of the crisis, as the urgency of the report revealed, raised very serious questions.

The biggest threat all these considerations posed, according to the confidential report, was how they might affect "the willingness of commercial banks to continue to expand lending." "Just as individual bankers took comfort from and joined in the expansion of lending in the 1970s," the report hypothesized, "now they may draw back or limit the growth of exposure in union. In addition, banks that were the heaviest lenders in the 1970s are finding their ability to continue lending is being constrained."[66] Of primary importance to observers in the security establishment was ensuring that the flow of new credits was not dramatically cut off. From a security perspective, banks needed to continue the cycle that had picked up during the previous decade and allow debtor countries to pay off the interest on old loans with the proceeds of new ones. The report noted how the possible restructuring of loans due in 1982 into longer-term assets would lead to a decrease in banks' liquidity and therefore a potential "loss of investor and depositor confidence" in banks "heavily exposed" to troubled debtors. But if banks were to slow the growth of lending too much, debtor countries would be forced into adopting "austerity measures to compensate for reduced foreign exchange availability" that, "at the extreme… could lead countries to stop payment on external debt and could result in changes in governments."

[65] Report, "International: Implications of Debt Rescheduling," September 30, 1982, folder "International Debt Situation, 5/82-9/28," Box 41, Executive Secretariat, NSC: Subject File, Ronald Reagan Presidential Library.
[66] Ibid.

A motif in these security documents was emerging already by the end of the 1982. That is, the sudden disruption in the cycle of international lending that had developed in the previous decade had introduced serious risk to both the global economy and security balance. A huge volume of bank assets was now up in the air, meaning that a possible decline in confidence in the solvency and liquidity of major money center banks could cause panic throughout the world financial system. On the other hand, the steps that banks might take to handle this new risk including a reduction of new loans to debtor countries would require those countries to halt their development programs and economic growth, thereby introducing the possibility of political agitation and regime change.

On March 14, 1983, the NSC issued National Security Study Directive Number 3-83 (NSSD-3). The directive instructed the Senior Interdepartmental Group on International Economic Policy (SIG-EP) to complete a comprehensive review of the international debt situation and its potential political and economic consequences. SIG-EP presented their review in an April 25th report entitled "Approach to the International Debt Problem: A Policy Overview." The report covered four key topics including the general scope of the debt problem for the United States, possible "implications" for international trade, domestic policy considerations, and finally "political and security considerations." [67] With the issuance of this official directive, the NSC was further codifying its stance on the debt crisis as an issue with serious security concerns that could not be easily disentangled from the economic issues at play.

For Reagan's NSC, the uncertainty over how international debt would be handled in the long term was most concerning. The SIG-EP report summarized that "although the first

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[67] Memo, William P. Clark to Ronald Reagan, June 1, 1983, folder "International Debt Situation NSDD," Box 3A, Richard Darman Files, Ronald Reagan Library.

phase of the international debt situation on the whole has been successfully dealt with"—the first phase being the successful sidestepping of any major defaults in Mexico, Brazil, and Argentina—there were still "major difficulties" to be expected as "debtors implement adjustment plans and as external financing difficulties reach crisis stages in additional countries." The problem, specifically, was that banks were finally becoming hesitant to keep offering new financing to pay the interest on old loans. "The combination of internal adjustment and loss of financing," the report explained, could lead to a "contraction of debtor country imports and consequently of U.S. exports." According to SIG-EP this difficult economic situation would "require difficult U.S. policy decisions" that would force choices between federal bailouts to ensure domestic financial stability and granting leniency to politically troubled Latin American nations. Policymakers would soon have to decide if the federal government should "meet further requests for significant bilateral emergency financial assistance."[68] The debt crisis was calling for more federal intervention, but policymakers would have to decide who to privilege in their intervention.

The need for additional emergency financing would rely on "continued cooperation from other governments, central banks, and the private banking system" which could not be guaranteed indefinitely. The SIG-EP report expected that "governments" would "have to increase their assistance in the face of reluctance of banks to maintain their high relative share of financing." Given the number of concerns within the situation, the report reflected that "there seems to be no good alternative to handling problems such as these on a flexible, country-by-country basis." In each debtor country, the key was to maintain "the ability to resume economic growth" dependent on "a rapid expansion of exports, which in turn will

[68] Ibid.

depend on the strength… of their internal adjustment programs." Ensuring export growth was ensuring that economic recovery from recession continued in the industrialized countries.[69]

In its conclusions, the report emphasized the significant amount of uncertainty as to how the debt situation might continue to play out. The best bet for the United States, "in cooperation with other major industrial countries," was to "closely monitor evolution of the international debt problem." "The operation of this strategy in the near term"—that is handling each debtor country on a case-by-case basis while conducting close monitoring—"was likely to be turbulent." In the "medium term" prospects were better, so long as growth "in the industrialized countries" was sustained. The final appendix of the report included a set of "alternative proposals" in place of the current case-by-case approach. The alternatives included a "one-year grace 1983 debt," granted for both private and public creditors. Several other alternatives reflected concerns with the position of commercial banks within the debt situation. A "large scale debt restructuring" option, for example, would include "a new international institution" buying up "commercial bank credits to developing countries" at a discounted price. A "buyout of small creditors" option was listed as a way to use "official sources of finance to pay off small regional banks anxious to withdrawal from foreign markets." A "Safety-Net for Commercial Banks" option would require banks to "contribute amounts equal to a small percentage of foreign loans to a central fund, to be drawn on if a loan goes bad and the bank encounters financial difficulties as a result."[70]

In his memo forwarding the results of the report to President Reagan, NSC Chief William P. Clark summarized the main points of concern as: "(1) the possible need for increased bilateral governmental assistance to the debtor countries, (2) risks to the

[69] Ibid.
[70] Ibid.

international trading system, and (3) the possibility of social and political unrest." In addition to the main findings of the report, Clark noted that successful handling of the debt situation would require certain "principal elements" including an "International Monetary Fund adequately equipped to help borrowers design adjustment programs and provide balance of payments financing on a temporary basis while adjustment programs take effect." As such, Clark called for "priority attention" given to "securing prompt Congressional approval of proposed U.S. participation in the agreed expansion of IMF resources."[71]

By the summer of 1983, all three of Clark's points of concern were coming to fruition. Jose Lopez Portillo's bank nationalization and the ripples it sent throughout the Mexican political establishment, for example, exemplified the threat of political retaliation to austerity demands. In López Portillo's adversarial speech announcing the new measures, he "took pains to underline Mexico's fierce nationalism and independence." López Portillo charged that "the United States wants to treat us as if we were an underdeveloped economy without any chance to argue back."[72] Mexico had a history of aggression towards US capital—during the Great Depression President Lazaro Cardenas had expropriated US oil companies' operations in Mexico.[73] In Brazil, a week of anti-austerity riots in Sao Paulo threatened the Brazilian government's ability to comply with the IMF agreement they had reached in February. These political developments could not have been far from the minds of Reagan's security advisors.

On June 16, 1983, the heads of the NSC and the CIA's Chief of Global Issues gave a summary presentation on the international debt situation to President Reagan. The purpose of

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[71] Ibid.
[72] Christopher Dicker, "Mexico Takes Control of Private Banks," *The Washington Post,* September 2, 1982.
[73] Camín and Meyer, *Shadow of the Mexican Revolution*, 151.

the meeting was not only to "provide a comprehensive briefing" of the origins the crisis and the US stakes within it but also "to stimulate a discussion" which would result in Reagan's "tasking" the NSC chief William Clark and Treasury Secretary Don Regan with putting together "a set of contingency measures to cope with plausible 'worst-case' scenarios."[74] As the briefing memo accompanying the presentation indicated, those within Reagan's NSC were aware that the international debt crisis was far from resolved. As the presentation would indicate, the debt was not only a problem for debtor states and their various lenders, but for domestic economic stability in the US.

As summarized in the presentation, "the crux of the problem for the United States is to enable troubled debtors to adjust to the reality that they cannot continue to finance deficits by borrowing as they did in the past."[75] Given the recent threats of default, LDCs could no longer expect to be able to pay the interest on old loans with new ones from the same set of private banks. The coming adjustment "both by borrowers reducing their needs and by lenders minimizing risks to their loan portfolios" had to be "gradual." If creditor were to suddenly cut off debtor nations, a rapid decline in "living standards" could "cause a backlash against western governments and financial institutions." Additionally, the presentation noted that "debtors' financial problems could slow the pace of the economic recovery that is just underway. In the United States…because of its adverse impact on trade."[76]

To explain to President Reagan how and why the international debt crisis mattered for American interests the presentation summarized four key points. First, the possibility of economic adjustment contributing to the growth of "radical movements" in debtor countries.

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[74] Memo to William C. Clark from Roger W. Robinson, June 16, 1983, National Security Council Meeting Files, Executive Secretariat, NSC 00081-00090, Box 9, Ronald Reagan Library.
[75] Ibid.
[76] Ibid.

“Populations used to continuous growth,” the report explained, “are now subject to declining standards of living and will be for some time.” As evidence of the kind of insecurity that such decline in economic conditions could render, the report mentioned riots that had erupted in major Brazilian cities as well as a considerable uptick in the movement of undocumented Mexican migrants into the United States. Second, the possibility that country defaults could have “a substantial negative impact on the rate and solidity of the economic recovery in the third world.” Of particular concern was the threat to American exports, as 37 percent of all American “goods and services” sold abroad in 1981 were sold to developing countries, which was a ten percent increase from 1970. Mexico, the report noted, was the United States second largest export market in the world. Because countries like Mexico were having to extract resources from their domestic economies to pay off debt service, they were having to cut back on imports from the US. Third, was the “major stake” held by American commercial banks in the “debtor countries.” “Our banks are most heavily exposed in Latin America,” the report warned, “where the situation is most disturbing.” The nine largest US commercial banks had lent 140 percent of their total capital to Mexico, Brazil, Argentina, and Venezuela alone and “over three times” their capital and reserves to all LDC borrowers. Not only were the largest American banks all overleveraged in their exposure to potentially toxic LDC debt, “hundreds of medium to smaller U.S. banks” had “lent billions to the major debtor countries.” Lastly, given the increasing concentration of “risk exposure” throughout the American financial system to questionable debt, there was a possibility that the US would have to offer “rescue packages” to larger vulnerable banks which would mean that the risk

would become "assumed to a greater extent by the government and thus indirectly by the U.S. taxpayer."[77]

Raising the IMF Quota

On February 10, 1983, the IMF interim committee decided to increase member subscriptions by 47.4 percent. IMF subscriptions, also referred to as IMF quotas, are the amount of money member countries must pay to join the IMF. This increase came on top of earlier increase in the IMF's general agreement to borrow (GAB)—an additional pool of money at the Fund set aside specifically for emergency borrowings by members in economic distress. For the United States, this meant sending an additional $8.4 billion in contributions to the IMF.[78] The almost fifty percent increase was significantly less than the doubling or tripling for which some member nations had allegedly sought. Regan had stated to the press in January that fifty percent was the hard ceiling that the Reagan administration would be willing to accept. Still, while testifying before the House Banking Committee Secretary Regan and Chairman Volcker faced opposition from GOP deficit hawks as well as Democrats who would typically be amenable to foreign aid contributions.

As reported in the *Washington Post*, congressional Democrats were "understandably annoyed at being asked by President Reagan to approve more money for the IMF at the same time as further cuts for domestic programs." The *Post* coverage specifically brought up the risk to financial stability that IMF funding could help curb as outweighing moral qualms about shielding banks from the risk their own lending generated:

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[77] Ibid.
[78] Memo, Donald T. Regan to Ronald Reagan, "IMF Quota Increase Agreement," February 11, 1983, Folder 3, Box 154, Donald T. Regan Papers, Manuscript Division, Library of Congress, Washington D.C.

> There are good reasons to oppose a bank ‘bail-out’ that leaves banks unscathed but public institutions carrying the risks, and to examine the need for new and better controls on bank lending. However, financial collapse and bank failures would hurt more than the shareholders of the individual banks involved. The ill effects would spread rapidly across the U.S. economy and all lending would be squeezed.[79]

As is on full display in the *Post*’s reasoning, the magnitude of the risk-shift that the response to the debt crisis was generating was not lost on outside observers. The threat of an enormous bank panic allowed the banks to effectively hold the global financial system hostage. If the banks were not bailed out, an international financial crisis could erupt. The *Post* went as far as to describe the cost imposed on developing countries as “much less dramatic” than this possible nightmare scenario.[80] What was conspicuously not included in the *Post* piece, was the irony of the Reagan administration increasing the US deficit to enable the IMF to force debtor countries to dramatically reduce deficit spending.

When selling the president on going to bat for the increase, Secretary Regan offered a much more nuanced diagnosis of the problem than either the Reagan administrations outward messaging or press coverage would imply. In his talking points for a February 17 meeting with President Reagan, Secretary Regan stressed the role of bigger economic forces like the oil shocks and “rapid disinflation” (brought about by the Fed’s restrictive monetary policy) in generating the debt crisis rather than just “poor country management” or “imprudent bank lending.” Regan also stressed that without additional financing, debtor countries could devolve into the kind of “economic chaos” that would threaten economic growth in the “industrialized countries” and possibly incentivize the creation of a “debtor cartel.”[81] Regan’s assessment of the crisis indirectly demonstrates a growing contradiction at the heart of the

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[79] Caroline Atkinson, “IMF Quota Boost May Help U.S.,” *Washington Post,* February 10, 1983.
[80] Ibid.
[81] Donald T. Regan, “Talking Points: International Monetary Fund,” February 17, 1983, Folder 3, Box 154, Donald T. Regan Papers, Manuscript Division, Library of Congress, Washington D.C.

response to the debt crisis. US policy makers had an interest in promoting the kind economic growth and political stability in debtor countries that the heavy austerity requirements imposed by the IMF could preclude. At the very least, the US needed continued access to exports from debtor countries as well as the import markets those economies offered.

In the months following the February IMF decree, the Reagan administration worked continuously on securing enough votes in Congress to approve the higher US contribution. President Reagan sent identical personal letters to both Democratic and Republican leadership in the Senate, urging Republican Majority Leader Howard Baker, Jr. and Democratic Leader Robert C. Byrd to support the bill. Reagan explained that global leaders who had recently attended a G7 summit in Williamsburg, Virginia were eagerly seeking "early ratification" of a "proposed increased in IMF resources." Dealing "with the world debt situation" through this expansion of resources, Reagan added, would mean doing so in "a manner strongly supportive of U.S. economic, foreign policy, and security interests." According to the note, Reagan believed that "this legislation should warrant…the broadest bipartisan support in the Congress" and such he urged "its prompt approval by the Senate."[82]

On November 18th, the Reagan administration got its way, and Congress approved the $8.4 billion increase in US funds for the IMF. As the urgency that Reagan's personal pleas to congressional leaders would suggest, the approval came only after "months of uncertainty and partisan bickering." The vote ratified an accord, designed to dramatically increase the IMF's ability to respond to the spiraling debt crisis, approved by another eighty-three IMF member states. The bill also included $7.5 billion for struggling "regional banks" which had been caught up in over lending to LDC states. To overcome congressional Democrats'

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[82] Letter, Ronald Reagan to Chalmers P. Wylie, May 5, 1983, ID#232999, IT04, WHORM: Subject File, Ronald Reagan Library.

skepticism over aid to troubled banks, the Reagan administration accepted their bill for a "$15.6 billion authorization for housing and community development funds." Both President Reagan and Treasury Secretary Regan were publicly vocal with their support—Reagan praised congress for avoiding "an economic nightmare that could plague generations to come."[83]

The distribution of votes in the bills passing, however, reveals how politically peculiar the Reagan administration's stance towards the international debt crisis was. In the house, where the bill passed 226 to 186, more Republican congress people voted *against* the bill than for it. The Republican opposition to the bill was led by Jack Kemp—one of the administrations favored disciples of supply-side economics—and California representative William E. Dannemeyer. For them, in "a world awash with debts…another step away from monetary discipline."[84] For these dissenting Republicans, a return to the gold standard was the reasonable route out of the crisis. "Only by getting honest money in the United States," Dannemeyer said, "can we rein in the runaway politicians."[85] Outside of Congress, libertarian economist Milton Friedman was also vocal about his opposition to the IMF quota increase, going as far as describing the IMF as an organization with "no real function " that "ought not to exist."[86] So while Reagan's security advisors saw imminent threats to Cold War geopolitics, the health of the global financial system, and the imperative of maintaining export markets, other Republicans held fast to more archaic economic views about the importance of sound, specie-backed money as a cure for inflation.

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[83] Clyde H. Farnsworth, "Congress Approves I.M.F. Aid: Ex-Im Bank Authorization Also Backed," *New York Times*, Nov 19, 1983.
[84] Ibid.
[85] Ibid.
[86] Milton Friedman, *Politics and Tyranny: Lessons in the Pursuit of Freedom* (San Francisco: Pacific Institute, 1984,) 37.

Aside from the expansion of IMF resources, another key factor in shaping the course of debt crisis in following years was policy makers response decision to grant regulatory "forbearance" to commercial banks after the first wave of default threats. That is, throughout the debates in the immediate aftermath of the crisis, commercial banks were never even required to set up reserves to hold against restructured Latin American debt. For the Federal Reserve, Comptroller of the Currency, and the Federal Insurance Deposit Corporation (FDIC), the threat of financial panic which could follow major US banks having to build reserves on LDC debts that were, on average, more than double their extant aggregate capital and reserves was simply too great. In the words of former FDIC chairman William Seidman, the loans made to Latin American countries "were so formidable that they had placed the world's largest banks in jeopardy. US bank regulators, given the easy choice between creating panic in the banking system or going easy on requiring our banks to set aside reserves for Latin American debt, had chosen the latter course."[87] Taken in the context of the security concerns present in the debt situation, the forbearance granted to banks was even more significant. The granting to commercial banks a reprieve from regulatory constraints was, in the eyes of policy makers, a road not only financial stability, but geopolitical stability as well.

Conclusion

By the end of 1983 the US government had managed to stave off both debtor default and creditor collapse through emergency financing of an expansion in IMF capabilities throughout Latin America and the developing world. Commercial banks could still collect

[87] L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and other Washington Sagas* (New York: Times Books, 1993,) 127-128.

interest payments on questionable loans, and their shareholders could rest easy. As described by Jeffrey Sachs, the crisis of 1982-83 presented US policy makers with “two crises: a crisis of U.S. banks, which had lent too much… and a crisis of the developing countries who had borrowed too much. Until 1988 concern over the banks took precedence.”[88] Citibank stock, for example, appreciated continuously from $28.65 per share at the beginning of 1983 to a peak of $83.23 per share just before announcing that the bank would begin to build up reserves against its Latin American Debt in March of 1987.[89] The level of urgency which characterized emergency debt negotiations throughout late 1982 and 1983 would, at first look, make the continued growth of money-center banks throughout the crisis years somewhat surprising. But to policymakers grappling with the financial predicament which came to a head in 1982, financial stability was ultimately a more important objective than economic growth. By building up such outsized debt exposures, banks effectively pushed regulators into a corner by ensuring that if the needs of banks were not prioritized in debt negotiations the level of financial panic could possibly be catastrophic. By undoing New Deal financial controls in the years preceding the debt crisis, moreover, banks closed off the kinds of growth-oriented policies employed in the 1930s in response to financial crisis.

As of the end of 1983, then, a new era of financialized international economic relations was beginning to take shape and would continue throughout the rest of the decade. This international economic paradigm, importantly, was not borne from an idea and did not come down from the worlds’ development economics departments. Rather, the driving factor in the response to the debt crisis, especially in the early years, was the need to shore up large

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[88] Jeffrey Sachs, “Making the Brady Plan Work,” *Foreign Affairs* 68, no. 3 (Summer 1989): 87-104.

[89] Calculations made based on data available from: “Citigroup – 47 Year Stock Price History,” Macrotrends, accessed February 15, 2023, https://www.macrotrends.net/stocks/charts/C/citigroup/stock-price-history.

commercial banks which would otherwise be insolvent. The austerity pushed onto debtor governments was not for the purpose of reforming their economies so much as it was to reverse the flow of capital from the developing world to the developed. The discussions happening within the Reagan administration's national security team reveal that the privileged position held by the banks was not inevitable and carried possible geopolitical consequences in addition to economic ones. Security officials accurately predicted that the kinds of demands placed on debtor governments which the needs of the banks necessitated would lead to social unrest. In the early crisis, policymakers ultimately accepted this risk. To ensure that the IMF as an institution had the leverage and capability to enforce austerity conditions, the Reagan administration pushed through further increases in IMF funding, despite the lip service Reaganites paid to balanced budgets. These costs, in addition to the regulatory forbearance granted to the commercial banks, was an early example of the too-big-to-fail mindset that policymakers would return to in subsequent periods of financial crisis.

The Washington Consensus would not have been possible without the critical expansion of IMF funding and functional capacity in 1982 and '83. The rigid austerity programs that have become synonymous with the IMF and were described by Williamson in 1989 as part of the "fiscal discipline" point of the Washington Consensus, were made possible by expanding the amount of funding that the Fund could offer debtor countries. The disproportionate distribution of the burden of adjustment which became codified in the Washington Consensus was secured in 1982 by privileging the needs of banks over those of debtors. Austerity, and indeed political unrest, were the price that Latin American governments paid to ensure healthy financial markets in the Global North.

CHAPTER IV

IN THE SHADOW OF THE "DEBTORS' CARTEL:" THE MULTIYEAR RESCHEDULING AGREEMENT, THE BAKER PLAN, AND THE THREAT OF DEBTOR COOPERATION

On the last Monday of April in 1984, soldiers of the Dominican army opened fire on crowds of protestors on the streets of Santo Domingo. By the end of the altercation sixty people lay dead, 200 more were wounded, and upwards of 4,300 demonstrators were arrested. The people of the Dominican Republic took to the streets in protest of the Dominican government's recent capitulation to the International Monetary Fund. Days before the uprising, to meet the dictates of the IMF program, the government had devalued the Dominican Peso drastically enough to double the price of select food products and triple the price of other imports, including medicine. Anger against the IMF in the Dominican Republic had been brewing since the country's first agreement with the Fund in 1983, as indicated by the appearance of anti-IMF graffiti in the poorer neighborhoods of Santo Domingo.[1]

Dominican leadership was forced into the IMF agreement by an $80 million US loan (part of $430 million three-year deal) being temporarily withheld by the Reagan administration until the Dominican government implemented a set of economic reforms dictated by IMF conditionality. In addition to the $80 million of 1984 funds, the rest of a three-year $430 million loan agreement, as well as any new money from commercial banks were all going to be withheld until an IMF agreement was in place. The head of the Dominican central bank, Bernardo Vega, defended the move by framing it as a form of economic helplessness: "We had no alternative but to accept the IMF's conditions…but the

[1] Margot Hornblower, "Price Riots Imperil Dominican Government," *The Washington Post*, April 30, A1.

issue is to what extent are these arrangements hitting the limits of social peace," he said in response to the outbreak of violence. In the eyes of one US diplomat, alternatively, Dominicans had no one to blame but themselves—the loans that the country was now having trouble paying back were used "to subsidize an unrealistic standard of living for the lower and middle classes." The "unrealistic standard of living" to which the diplomat referred was a result of the Dominican government failing to lower the exchange rate of the Dominican Peso, thereby allowing the populace access to "subsidized" imports. Despite their allegedly inflated standard living, 60 percent of Dominicans were unemployed or overemployed at the time of the price rises.[2] The American diplomat's comments, however, speak to the importance of devalued currencies as part of the developing Washington Consensus.

The US position generally echoed this sort of victim-blaming for the adjustments, which then allowed the Reagan administration to position itself as savior by releasing the funds to the country that it had effectively been holding hostage. In his press talking points on the subject, Treasury Secretary Don Regan described the crisis as "traceable to long overdue adjustment in economic policy" in consequence of that adjustment happening too rapidly. In the aftermath of the crisis, then, Regan could proudly tell the press about the US's "opportunity to demonstrate its friendship for the Dominican Republic."[3] Regan's condescending attitude was also deployed by the IMF which, in later negotiations, "gave their condolences" to Dominican officials over the crisis their policies instigated.[4]

The "no alternative" sentiment present in the Dominican experience in early 1984 was indicative of the dynamics to come over the next few years. Of course, in no sense, was

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[2] Ibid, A15.
[3] "Dominican Republic," April 30, 1984, Box 102, Folder 7, Donald T. Regan Papers, Manuscript Division, Library of Congress, Washington, D.C.
[4] Hornblower, "Price Riots Imperil Dominican Government," A15.

there really no alternative. Between 1984 and 1985, three alternative paths through the crisis did appear. One was the possibility of actions taken collectively by debtor nations—a sort of "debtors' cartel" as bankers and western officials described it—made possible through the formation of the "Cartagena Group" of debtor nations in June. Another was a political challenge Argentina made against IMF orthodoxy by suggesting that conditionality should promote economic growth instead of meeting debt obligations at all costs.[5] Last, and perhaps most frightening for the banks, was Fidel Castro urging countries to stop debt payments all together.[6] Working in concert, the IMF, leading commercial banks, and the Reagan administration cut these possibilities off through a relentless divide-and-conquer campaign where countries who played by the rules would be given easier payment terms and countries like Argentina would be isolated and ostracized.

The defeat of these alternative paths proved critical to the construction of the Washington Consensus. By eliminating alternatives, Western governments and banks created the illusion that the only way towards survivable debt payment terms, access to new money, and even access to international capital markets in general was through the IMF. As would become the norm, banks and governments refused to give new money until IMF agreements were worked out. As opposed to primarily a lender of last resort, as was envisioned when the IMF was first being expanded in the 1970s, by mediating access to credit markets the IMF became a kind of gatekeeper to the international financial system. If debtor countries wanted access to international credit markets, they had to be on good terms with the IMF. In the mid-1980s, moreover, debtor country's commitments to the IMF became longer term and more

[5] Claudia Kedar, *The International Monetary Fund and Latin America: The Argentine Puzzle in Context* (Philadelphia: Temple University Press, 2013,) 158-159.
[6] Benjamin Cohen, *In Whose Interest: International Banking and America Foreign Policy* (New Haven: Yale University Press, 1986,) 225.

invasive. Through the advent of the Multi-Year Rescheduling Agreement (MYRA) and "enhanced surveillance" granted to the IMF, the tenets of the Washington Consensus became even more binding. Scholars and bankers have referred to this move towards longer-term thinking as the "second phase" of crisis management.[7]

After the initial phase of financial firefighting and emergency management in the first two years of the Latin American debt, the struggle between debtors and creditors moved towards competing visions over what a longer-term structural resolution to the crisis would look like. By 1984, through rescue packages from the IMF, US Treasury, and the banks, debtors had been saved from the looming threat of default. Through the continued loan payments those rescue packages ensured, in addition to lax enforcement of capital reserve standards from regulators, the banks had themselves been saved from the threat of insolvency. Through these protections afforded to the banks, panic had been kept from consuming international financial markets and Latin America's debt crisis was prevented from becoming a true global crisis. Still, the political economic security that these measures provided was incredibly fragile, and contingent upon the deterioration of living standards across Latin America. Between 1984 and 1986, political elites in debtor countries offered visions for a new paradigm that would share the burden of reform more equitably between debtors and creditors. The IMF, commercial banks, and the Reagan administration foreclosed these more equitable alternatives by offering small concessions while leveraging the threat of economic isolation. Along the way, these institutions codified the long-term dependency on and invasive surveillance capabilities of the IMF and World Bank which would come to be a defining feature of the Washington Consensus.

[7] See: Paul Krugman, Thomas O. Enders, & William R. Rhodes, "LDC Debt Policy" in *American Economic Policy in the 1980s* ed. Martin Feldstein (Chicago: University of Chicago Press, 1994,) 691-739.

The Cartagena Group: An Alternative Consensus

The first instance of debtor cooperation in 1984 was a $300 million loan made to Argentina, not from any of the usual creditors, but from the combined resources of Mexico, Brazil, Venezuela, and Colombia. Officials in Argentina were worried that banks would refuse to reschedule the $500 million in interest payments coming due at the end of March and sought the $300 million from fellow debtors to help meet the upcoming payments. The Argentinian president, Raúl Alfonsín, was concerned enough to summon the esteemed economist Raúl Prebisch to Washington to try and work through the situation with IMF staff. Prebisch was famously instrumental in the development of dependency theory, by describing in a 1950 study the pattern whereby underdevelopment was maintained in Latin America through the reliance on imports of manufactured goods from the developed countries in the imperial core to help generate the primary commodities that Latin American countries would then export back to the core.[8] Prebisch's theories helped spawn the import-substitution-industrialization (ISI) programs that many Latin American countries originally turned to overseas borrowing in order to maintain in the 1970s. In his letter to Prebisch briefing him on the situation, Alfonsín stressed that too excessive of an adjustment program could lead to "economic, social, and political consequences" which could not be ignored.[9] Prebisch

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[8] See: Raúl Prebisch, *The Economic Development of Latin America and its Principal Problems* (Lake Success: United Nations Department of Economic Affairs, 1950.)
[9] Letter, Raúl Alfonsín to Raúl Prebisch, March 21, 1984, Box 102, Folder 7, Donald T. Regan Papers, Manuscript Division, Library of Congress, Washington D.C.

ultimately spent over a week in Washington "generally trying to calm the situation as best as he could."[10]

While Prebisch was in Washington trying to save face with the IMF, at a meeting of the Interamerican Development Bank Argentinian officials were consulting with other debtor governments on how to avoid default should banks refuse to reschedule the upcoming payments. Stressing that a collapse in Argentina's relationship with its creditors threatened the financial stability of the entire region, Mexico's Jesus Silva Herzog convinced his fellow finance ministers from the co-sponsoring countries to get behind the $300 million loan.[11] Just months earlier, Argentine president Raul Alfonsín was lobbying across Latin America to make a cartel of debtors that could negotiate with creditors collectively.[12] While countries lending Argentina the money intended to avoid just that kind of situation, the loan demonstrated the potential of debtor cooperation and the benefits of more intentional regional integration among Latin American countries, despite their more conservative motivation.

The loan arrangement was enough to convince the US treasury, also present in the negotiations, to extend another bridge loan of $300 million intended to last until an IMF agreement could be worked out. Members of both houses of the US Congress, however, were suspicious of the Treasury's motivation. Both the Senate and House held hearings on the Argentinian situation in May. Testifying before the Senate, Treasury Undersecretary Anthony Solomon explained that US banks were interested in Argentina given their having to publish their balance sheets with the SEC by the upcoming end of the first financial quarter. If Argentina's interest payments were to continue to go unpaid by the end of the

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[10] James M. Boughton, *Silent Revolution: The International Monetary Fund, 1979-1989* (Washington D.C.: International Monetary Fund, 2001,) 389.
[11] Ibid.
[12] Kedar, *The International Monetary Fund,* 154.

quarter, banks would no longer be able to report the unpaid interest as income. In response, Republican Georgia Senator Matt Mattingly questioned the timing of the treasury's assistance: "Was it Argentina's democracy or Citibank's profits that were most at risk at the end of March?"[13] While the economic policy elites of Mexico, Brazil, Venezuela, and Colombia hoped to shore up regional economic stability through their cooperation, Senator Mattingly's question reveals how the stability they sought was contingent on the profit reporting of commercial banks. As with the Dominican Republic, a theme was emerging in Latin American economic policy making—government officials were making consequential decisions, weather consciously or not, in the interest of the US banking system as opposed to any democratic imperative.

Still this kind of regional cooperation in Latin America threatened the primacy of private economic interest. Weeks after the Senate hearings, the presidents of Argentina, Brazil, Columbia, and Mexico met in Buenos Aires in response to the 50 basis point rise of the of the prime lending rate two weeks prior, from 12 percent to 12.5 percent.[14] With rising interest costs, according to the *New York Times* coverage of the meeting, total Latin American debt rose "by an estimated $4.5 billion." The four presidents issued a joint statement declaring that they could no longer accept the "hazards" to democracy posed by the extant repayment terms on their debts. Most Latin American loans were floating rate, meaning that the cost of repayment moved along with market pressure and monetary policy in the US. The statement, responsively, called for lower interest rate spreads between creditor

[13] U.S. Congress, Senate, Subcommittee on International Finance and Monetary Policy, Committee on Banking, Housing, and Urban Affairs, *The Argentinian Debt: Hearing before the Subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing, and Urban Affairs, on Details and Implications of U.S. Government Involvement in Both the Argentinian and the Larger Latin American Debt Crises*. 98th Cong., 2nd sess. May 3, 1984, 2, 18.

[14] "Bank Prime Loan Rate," Interest Rates, Federal Reserve Economic Data, last modified February 1, 2024, https://fred.stlouisfed.org/series/DPRIME.

and debtor borrowing costs, longer payment grace periods, and "greater allowances for their exports to industrialized countries." While western observers felt that the statement was relatively moderate, the action was still able to instill fears of a coming union of debtor nations that would threaten the preferred case-by-case approach. As one anonymous banker told the *Times*, the action of issuing the statement "could lead almost anywhere."[15]

Bankers' fears of a looming "debtors' cartel" were stoked further when just a month later, representatives from the countries behind the earlier statement met along with officials from seven other Latin American debtor nations met in Cartagena, Columbia. The tone of the two-day conference painted the debt crisis as a continuation of a centuries-long exploitation of the Latin America by western imperial powers—exactly the kind of sentiment the big banks wanted to avoid. The Colombian minister of foreign affairs went as far as to point out that in 1870s the Italian navy surrounded Cartagena to force the city to pay its debt. The "Cartagena Group" of debtor governments, as the attendees came to be known, issued a statement proclaiming that structural adjustment on the part of debtors was not enough to solve the crisis, and that the responsibility was shared between debtor governments, creditor banks, and the IMF to find a more comprehensive solution. The Cartagena Group called for lower debt costs—meaning more new money extended at lower interest rate spreads—as well as a growth-led approach to recovery instead of reliance upon austerity measures.[16] As economic recovery progressed in the west, the demands of the debtor governments to share in the growth seemed workable.

[15] Edward Schumacher, "4 Latin Chiefs Join in Debt Warning: Latins Ask Easing on Debts," *New York Times*, May 21, 1984.
[16] Benjamin Cohen, *In Whose Interest?*, 221-222.

While the Cartagena Group meeting failed to lead to any kind of radical collective action among debtors, an entirely different vision of how debtors and creditors should relate emerged from the proceedings. [17] Intra-debtor tension limited some of the more confrontational visions. The most radical voice in the meeting came from the Argentinian delegation, who had been the most confrontational with the creditor banks and the least dogmatic about adhering to IMF conditionality. Argentina proposals, included attempting to divide-and-conquer the banks to break the unity of creditor pressure as well as dragging out and delaying IMF negotiations, did not find much purchase with many of the rest of the attendees, lead in their opposition by the Mexican delegation.[18] In response to these more aggressive proposals, Mexico and others were quick to stress "they were not setting up a cartel to withhold payments."[19]

They created an agreement, which they called the "Consensus of Cartagena," with seventeen proposals for changes in the debt strategy. First and foremost were the interest rates: the Cartagena group called for banks to base interest charges on new money to the "true cost raising funds" as opposed to "administered rates" like the Fed's federal funds rate, to grant longer repayment terms and charge lower loan fees. In the meantime, the proposal called on the IMF and debtor government to provide concessional loans to cover temporary increases in interest rates. Other proposals called for: limited debt payments to a "reasonable" percentage of export earnings, relaxing IMF austerity programs in the interest of prioritizing growth, and increasing funding for the IMF, World Bank, and Inter-American Development

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[17] Roger Lowenstein and S. Karene Witcher, "After Cartagena: Latin Debtors Hope for New Remedies," *The Wall Street Journal*, June 25th, 1984.
[18] Penelope Hartland-Thunberg & Charles K. Ebinger, "Mexico's Economic Anguish" in *Banks, Petrodollars, and Sovereign Debtors: Blood from a Stone?* Eds. Hartland-Thunberg, Penelope et. al. (Washington DC: Lexington Books, 1986,) 89.
[19] Edward Schumacher, "11 Latin Nations Plan to Consult Regularly on Region's Debt Crisis," *New York Times*, June 23, 1984, 1.

Bank.[20] In response to news of the meeting, worried bankers looked for ways to seize assets held by the debtor countries in attendance, while the threat of collective action sent "shares of money center banks plunging."[21]

While the original Cartagena Consensus was moderate in its demands—notably avoiding any call for debt reduction, focusing instead on relief in the form of eased repayment terms—the panic of commercial bankers and by their banks' shareholders is indicative of the threat that debtor cooperation posed. From the beginning of the crisis, banks, the US government, and the IMF alike had stressed the importance of handling the crisis on a case-by-case basis. While bankers treated the importance of the case-by-case approach as self-evident, the unspoken advantage it gave to creditors was cementing unequal power relations as individual debtors were left to negotiate with what Jerome Roos has described as the "creditors' cartel," made up of the banks, the IMF, and western governments.[22] In the eyes of creditors, the mere specter of debtor cooperation, no matter how moderate, opened the door to the possibility of an eventual threat of collective default. Through their collective proposal, the members of the Cartagena Consensus were implicitly recognizing their shared interests in the debt crisis as a class. In response, the Creditor's Cartel would co-opt some of the relief envisioned by the Cartagena Consensus in such a way to maintain the divide-and-conquer imperative. In terms of building the Washington Consensus, thwarting the alternative Cartagena Consensus helped ensure that the economic

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[20] Lowenstein et al., "After Cartagena," 31.
[21] Phillip L. Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown Publishers, 1995,) 820.
[22] Jerome Roos, *Why Not Default? The Political Economy of Sovereign Debt* (Princeton: Princeton University Press, 2019,) 127, 135.

health of Latin America countries was tied to their economic relationship with the imperial core, as opposed to political economic relationships with one another.

Building the "Second Phase:"

While the Cartagena Group deliberated their vision for a new road in the debt crisis, officials from banks and western governments were already putting together an alternative plan. On June 6th, 1984, heads from the world's largest commercial banks, along with Fed Chair Paul Volcker and IMF director Jacques de Larosière, gathered at the Union League Club in Philadelphia to chart out the next phase of response to the debt crisis. Specifically, with the immediate threats of financial collapse of 1982-83 worked out, bank and regulatory officials began to look for longer term solutions to the debt burden.[23] Both Wriston and Rhodes attended to represent Citibank and the restructuring committees, respectively. The conference was particularly urgent for Citi and other US commercial banks, as confidence in the American banking community had been shaken quite severely by the run on the Continental Illinois National Bank and Trust which had occurred just a month earlier.[24] Like many of the major commercial banks, Continental Illinois had gotten deep into energy loans over the 1970s and had "non-performing loans" on its books equal to $500 million more than the banks total capital. The FDIC, the Federal Reserve Bank of Chicago, and other major banks all loaned billions of dollars in a rescue operation.[25]

On the agenda for the meeting were options for the possibility of providing outright debt relief to Latin American debtors. Volcker and the Federal Reserve had proposed

[23] Krugman et. al., "LDC Debt Policy," 727.
[24] Robert A. Bennett, "Banks Plan Concession to Mexico: Brazilian Talks Also Expected," *New York Times*, June 6, 1984, D1.
[25] Benjamin Klebaner, *American Commercial Banking: A History* (Boston: Twayne Publishers, 1990,) 232.

possible caps on interest rates for new loans to debtor countries, despite resistance form US banks. Representatives from German banks, who were less exposed to Latin American debt than their American counterparts, also advocated for interest rate relief by suggesting that interest on loans be capitalized and converted into principal. Wriston, keeping up his characteristic resistance to any kind of debt concessions, insisted that interest rates should be based on the "economic performance" of debtors alone. As described by his biographer, Wriston "shed no tears for Continental, nor was he about to cry for Argentina, Brazil, or Mexico. He recognized the need to buy time, but he was not about to give away the store."[26]

For his part, Wriston gave a speech to the conference attendees giving a post-mortem assessment of what went wrong with the crisis and what shape recovery should take. In Wriston's assessment the "technical lending problem" behind the crisis in LDCs was a "lack of equity." That is, out of some misguided nationalist sentiment, developing countries chose to finance projects entirely through borrowing instead of foreign investment. "We bankers, along with many others," Wriston explained, "made a mistake in not recognizing this structural deficit." The solution then, was more structural adjustment to be made in developing countries to make foreign capital more welcome. Wriston was sure to suggest that this adjustment was not to be put on the shoulders of the banks, but on the borrowers:

> The simple fact is that while lenders can reschedule or stretch out maturities, only the borrower can take the actions necessary to repay debt…As lenders, we can supply time for an adjustment process to work—and they do—but we cannot put that process in place. That can only be done by the country itself…We know what measures must be taken to right an economy over time, we know that the IMF has overseen dozens of successful programs…based on the fact that no one can do for a borrower the things it must do for itself.[27]

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[26] Zweig, *Wriston*, 819.
[27] Walter Wriston, "Global Recovery and World Debt," June 4, 1984, MS134.001.005.00021, Walter B. Wriston Papers, Tufts Digital Library, http://hdl.handle.net/10427/36093.

Wriston's rhetoric here is revealing of the contradictions around economic sovereignty inherent in the coming Washington consensus. Wriston's insistence on the responsibility of borrower governments to make their countries attractive for capital obscured the power of capital to dictate what those economic policy changes should be. If banks dictating to borrower countries policy conditions for new credit agreements were unseemly, like in the Peruvian situation of the 1970s,[28] the IMF offered a way to sanitize those same directives. For Wriston, following IMF conditionality packages meant a country was making changes "for itself."

William Rhodes, Citibank's top executive for Latin America and representative on the bank restructuring committees, explained this rationale in much more direct way when asked by the *Washington Post* why banks want borrowers to reach agreements with the IMF before extending new money. According to Rhodes, while banks wanted to be assured that borrowers would pursue adjustment programs, they found that monitoring position to be "a very difficult role to play as a group" and that a "multinational agency like the International Monetary Fund is better equipped to do so."[29] The IMF allowed banks to outsource the role of policy intervention to an agency with more political legitimacy—at least in the eyes of their home governments and shareholders. The IMF also enabled commercial banks to shift more of the costs of their own over-lending to taxpayers. Using funds from member quotas provided by the US and other Western governments, the IMF could provide the money to debtor countries that would ultimately come back to the banks in the form of interest payments. The IMF was therefore both the banks' enforcer and their insurance policy.

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[28] In 1977 Citibank and other large US commercial banks drew criticisms of overreach with harsh conditions attached to a private loan package, which the government of Peru ignored. See Chapter 3.
[29] "Q&A: William H. Rhodes on the Debt Crisis," *The Washington Post*, August 19, 1984, 156.

While interest rate caps or capitalization were unpalatable, bankers like Wriston eventually made peace with a proposal made by De Larosière, with Volcker's backing, to begin a longer-term approach in upcoming negotiations with Mexico via a Multiyear Rescheduling Agreement (MYRA). The idea behind the MYRA was to avoid the need for the kind of emergency financial fire-fighting that large debt payments coming due all at once, like in 1982-1983, could produce. De Larosière explained to the gathered bank representatives that given the "heavy amortization payments of the public sector due to the banks over the period through 1990," it would be "unrealistic to expect that [the payments] could be covered by syndications or other voluntary credits year by year."[30] Instead of needing to rely on fresh loans to help pay off burdensome future payments coming due, debtor countries could instead negotiate with the IMF and commercial banks a longer term schedule for payments. Wriston found this strategy more palatable than the concessions suggested by the German delegation because it avoided direct write downs of the debt, thereby preserving the health of Citi's balance sheet. Whereas the Germans preferred interest rate concessions instead of extending any new money to debtors, the MYRA approach that won out involved ongoing commitments from both the IMF and commercial banks to debtor countries. By the end of the meeting, most of the banking delegates gave their support to the proposal, confirming the new strategy. The next day, William Rhodes issued a press release confirming that banks had endorsed the MYRA strategy for upcoming negotiations with Mexico, which was reported on enthusiastically in both the American and Mexican press.[31]

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[30] Boughton, *Silent Revolution,* 366.
[31] Ibid.

Somewhat ironically, the multiyear approach had been pushed for by Mexican economic officials since 1983.[32] While the multiyear approach was not exactly debt-relief, it still represented an easing of repayment terms. The extension of a multiyear program to Mexico served as a hopeful model for other debtor countries. "We're doing this on the basis of Mexico's performing exceedingly well," Rhodes explained to the press, "under their [economic adjustment] program." [33] The restructuring goals that bankers wanted reward Mexico for meeting payment schedules included a dramatic drop in the government budget deficit and a transition from a $5.2 billion current account deficit in 1982 to a $5.5 billion surplus in 1983.[34] Within one year, Mexico had become a net exporter of capital, at the cost of its own domestic economic growth. Thanks to austerity and recurrent devaluations of the peso, by the end of 1983 imports and real wages had fallen by two-thirds.[35] With the Mexico package, bankers like Rhodes were hoping to "send a signal to other debtors that a positive economic performance will be rewarded with more favorable terms on debt."[36] Strategically, the offer to Mexico helped to reinforce the larger case-by-case approach of the larger debt strategy. By appearing to make some level of concession, bankers and the IMF hoped to continue to dissuade any kind of collective action taken by debtor countries.

The crux of the MYRA approach that most contributed to the developing Washington Consensus paradigm was the "enhanced surveillance" powers it granted to the IMF. As opposed to earlier standby or extended fund arrangements, under a MYRA the IMF would closely "monitor" a country's economic performance and make this information "available to

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[32] Zweig, *Wriston*, 820.
[33] Michael R. Seiset and Frazier, Steve, "Mexico, Foreign banks Agree to Work Out Plan to Reschedule Several Years of Debt," *Wall Street Journal*, 37.
[34] Memo, Christopher Hicks, "Mexico-Background for Inter-Agency Group," September 4, 1984, Folder "IG-IEP on International Debt: 09/06/1984," Box OA10699, Poole, William: Files, Ronald Reagan Library.
[35] Roos, *Why Not Default?*, 151.
[36] Seiset and Frazier, "Mexico," 37.

the commercial banks."[37] The actual MYRA agreement with Mexico, which was not finalized until September, provided that Mexican authorities would "make available at the beginning of each year their annual operative financial program" and that the Fund would "conduct mid-year reviews of the performance of the Mexican economy."[38] This arrangement was more acceptable to the Mexican officials than the bankers' committee first suggestion that Mexico "obtain a series of one-year IMF stand-by arrangements" for each year of the rescheduling.[39] The mid-year reviews were an innovation on the Fund's part, as it would give banks the opportunity to monitor how well debtors were moving towards their annual economic targets. This monitoring would occur over the duration of the agreement, which represented the most significant rescheduling of debt so far in the ongoing crisis.

Inside the Reagan White House, the Interdepartmental Group on International Economic Policy (IG-IEP) was monitoring the Mexican negotiations. In August, the IG-IEP met twice to discuss updates on talks between the banks and Mexico, Argentina, and Venezuela. As laid out in internal memos, the administration had a five point strategy in positioning towards LDC debtors: (1) insist that debtors adopt "comprehensive, credible and effective programs" for righting balance-of-payments deficits, (2) insist that the US and developed countries pursue policies of "non-inflationary economic growth" so as to provide a market for LDC exports, (3) to continue to strengthen the IMF, (4) encourage continued commercial bank lending to countries going through adjustment, and (5) to provide "bridge financing" for debtors needing assistance before IMF and bank funds were available. The same memo discussed alternative approaches including transferring bank debt to the creditor

[37] Krugman et. al., "LDC Debt," 727.
[38] Boughton, *Silent Revolution*, 368
[39] Memo, Christopher Hicks, "Mexico-Background for Inter-Agency Group," September 4, 1984, Folder "IG-IEP on International Debt: 09/06/1984," Box OA10699, Poole, William: Files, Ronald Reagan Library.

nation governments (in effect nationalizing the debt), relaxing the requirements of IMF adjustment programs, and increasing official aid. For the IG-IEP, these were untenable options given the possible "public intrusion into the marketplace" and "commitment of budgetary resources that neither the Executive Branch nor the Congress believe is desirable."[40]

For the IG-IEP, Mexico represented the ideal debtor, while Argentina represented the "furthest back" on the road to adjustment. The IG-IEP was concerned by the response of the Argentinian government to the Argentine bank advisory group's rejection of an extension on a $125 million payment coming due by the end of 1984. In response the Argentina finance minister threatened to "disband the bank advisory committee, suspend talks with the IMF and consider other responses." What worried the IG-IEP so much was how a possible Argentina confrontation could be a "deleterious influence on other LDC debtors." What the administration wanted to avoid was any indication that the debt issue was a larger "north-south" issue and not a case-by-case one.[41] If some bigger agreement was not made between the Argentinian government, its creditors, and the IMF was not made by the end of year, the IG-IEP recommended the US should collaborate with other LDC debtors and creditor countries to formulate a "coordinated effort to isolate" Argentina "while avoiding direct official statements against the regime."[42] If the carrot to countries like Mexico was to be a relaxation of payment schedules and interest rates, the stick for recalcitrant debtors like Argentina would be financial and political isolation.

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[40] Ibid.
[41] Ibid.
[42] Ibid.

While the Argentina negotiations remained in a stalemate, Mexico finalized the first MYRA with the IMF and the banks on September 8th. The agreement rescheduled a total of near $50 billion in public debt consisting of what had been outstanding at the outset of the crisis in August 1982. In addition, the agreement extended a new $5 billion-dollar syndicated loan with Citi serving as the lead bank. The maturities of these debts were stretched out up to 14 years. According to the Mexican agreement with Citi, the annual and semi-annual economic reports would be made available to lenders no later than March 1st and September 1st, respectively.[43] As opposed to the 1.75 percentage point spread over borrowing costs that Mexico was currently paying banks, future interest rates spreads would be tied to a maximum of 1.5 points above the LIBOR.[44] This lessening of rates stood to save Mexico up to $350 million a year in debt payments. In the course of negotiations with the IMF and the bankers' restructuring committee, the rhetoric for stretching the maturities was described as "streamlining the profile of these maturities to levels which can realistically be refinanced through normal market transactions."[45] Again, the purpose of the MYRA approach was to allow debtors to continue both borrowing from and making payments to private commercial banks without requiring emergency intervention when big payments came due. Banks would be able to lend at their discretion, instead the forced lending which occurred early in the crisis.

Ten days after the finalizing of the Mexican MYRA, Argentinian officials yielded to pressure from the banks and came to an agreement with the IMF over conditionality

[43] Cable, Enrique Castro Tapia to Joaquin Pujol, "Re: Proposed Amendments to United Mexican States 5 Billion DLRD. Credit Agreement Dated March 3, 1983," November 29, 1984, Folder: Fund Relations with Commercial Banks Jan. 1984 – Oct. 1986, Country Files: Mexico/150.1, IMF Archives.
[44] Ibid; James L. Rowe Jr, "Loan Terms to Be Eased for Mexico," *The Washington Post,* June 6, 1984.
[45] Cable, The Ministry of Finance and Public Credit of the United Mexican States to the International Banking Community, July 20, 1984, Folder: Fund Relations with Commercial Banks Jan. 1984 – Oct. 1986, Country Files: Mexico/150.1, IMF Archives.

adjustments. In a letter of intent, the Argentinian negotiators led by finance minister Bernardo Grinspun agreed to an austerity program including a near 1000 percent target for reduction in inflation (which stood at about 600 percent in 1984), elimination of price controls, dramatic cuts in the budget targeting the fiscal deficit, and the standard currency depreciation stipulations. In exchange, the Argentinian government was allowed to maintain modest wage-indexing for government employees.[46] While the scheduled increases in wages were enough for the Argentinian government to save face with workers, with inflation they represented a far smaller raise in real terms than the six percent offered on paper. Wages had been an especially difficult topic of negotiations with the IMF, given active opposition from Argentinian trade unions. Just two weeks prior to the agreement, Peronist unions had held a 24-hour general strike.[47] Despite this active resistance at home, the Argentinian agreement represented another blow to more confrontational debtor approaches.

The Argentinian agreement came just in time for US banks. If the stalemate had continued into October, the Intra-agency Country Exposure Review Committee (ICERC)—a federal supervisory body—would have possibly moved to classify Argentina as "Value Impaired." If this happened, policy stipulated that banks would have to take a ten percent write-off in the value of the Argentine loans on their books. For a bank like Citi, this would have meant a $121 million hit, representing seven percent of their yearly earnings. For Bank of America and Chase, the situation was even worse, with twelve and fourteen percent of yearly earnings on the line, respectively. As of June 30, lack of payments on Argentinian loans had already resulted in $11 million income reduction for Citi, $5 million for Bank of

[46] Agreement details drawn from: Boughton, *Silent Revolution*, 393; Kedar, *The International Monetary Fund,* 160.
[47] Lynda Schuster, "Argentina Moves Toward the Accord with the IMF," *Wall Street Journal,* September 17, 1984, 33.

America, and $13 million for Chase.[48] While it may have not come up in the negotiations between bank restructuring committees, the IMF, and debtor countries, the urgency in getting countries like Argentina into new agreements had just as much to do with the precarity of the banks' position than debtors' needs for new financing.

Weeks after the Mexican and Argentinian agreements were finalized, the annual joint meeting of the World Bank and International Monetary Fund was held in Washington. The Reagan administration took the opportunity to applaud the Mexican MYRA, and thereby continue to support the banks' divide-and-conquer debt strategy. An internal memo from Treasury Secretary Reagan and Secretary of State Shultz urging Reagan to give speech to the meeting cast the moment as an opportunity to display a certain sense of sympathy to struggling debtor nations. "Your appearance would also demonstrate the sensitivity of the U.S. and other industrialized nations," the memo explained, "to the wrenching economic adjustment measures adopted by many developing countries, particularly in our Hemisphere, in managing their debt burdens."[49] In his actual speech before the meeting, Reagan pointed to the strong recovery of the US economy as "helping lead the world from recession toward a new period of lasting economic expansion," as a way to assuage debtor governments by indicating that the growth would soon be shared. Reagan directly addressed the concerns of debtor nations over the US interest rates and the cost they imposed for loan payments but countered by pointing to the "far greater benefits these countries receive" from growth in the industrialized world. The $12 billion dollar increase in US imports from indebted LDCs over

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[48] Memo, Bob Bench to Todd Conover and Joe Selby, "Argentine Debt," September 5, 1984, Folder 7, Box 102, Donald T. Regan Papers, Manuscript Division, Library of Congress.

[49] Memo, Donald T. Regan and George P. Shultz to Ronald Reagan, "Welcoming Address to the International Monetary Fund/World Bank Joint Annual Meetings," August 17, 1984, Folder "09/25/1984 IMF/World Bank, Sheraton Hotel," Box OA16001, Series II: Events, Advance Office of Presidential: Records, Ronald Reagan Library.

the year, Reagan cited as an example, was more than enough to cover a one percent increase in interest rates. The idea was essentially recovery in the US economy meant more US dollars spent on imports from debtor countries which would then provide the income for those debtor countries to send right back to the US as interest payments. As expected, Reagan named the Mexican agreement as an example of "what can be done through the pursuit of responsible policies."[50]

By the end of 1984, in addition to Mexico, MYRAs were in place for Ecuador and Venezuela. The Ecuadorian agreement, like the Mexican one, contained clauses intended to continue IMF monitoring even if Ecuador stopped drawing on IMF funds after a year-long standby agreement. This clause, also like the Mexican one, would not need to be activated as Ecuador continued to draw from IMF facilities up through the 1990s. The Venezuelan agreement, however, was different. As an OPEC member, Venezuela had not needed to draw upon fund resources and was by 1984 still in a "substantial creditor position in the Fund." Still, with the decline in oil prices, Venezuela needed to reschedule its private bank loan payments. The banks only agreed on the condition that Venezuela be subject to the IMF's new enhanced surveillance protocols.[51] Despite their differences, the Venezuelan, Mexican, and Ecuadorian agreements all served to tie access to international capital markets to surveillance by the IMF, and therefore to austerity and market reforms.

In the history of the larger debt crisis, 1984 represents a watershed year where banks, regulators, and the IMF could transition away from a firefighting, emergency approach, to a more long-term vision. In the words of one contemporary observer:

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[50] Ibid.
[51] Boughton, *Silent Revolution*, 412.

> The sun broke through the storm clouds in 1984 to induce a sense of euphoria: the crisis was downgraded to the status of 'problem,' which was quite manageable without significant far-reaching changes inn policies or institutional arrangements.[52]

The first wave of debtor adjustment had worked so well that governments like that of Mexico experienced a quick swing in the trade balance, and a momentary influx of liquidity.[53]So while 1984 was a sort of economic anomaly, a small period of growth in a larger period of decline, it was nonetheless critically important for shaping what came after and the shape of the Washington Consensus to come. Perhaps most importantly, a kind of synergy emerged between creditor banks and the IMF. As evident in the MYRAs, the IMF wasn't just bailing out the banks anymore, but instead serving as a kind of co-signer for the debtors. New money from the banks and easing of repayment terms would only come through agreeing to be subjected to a level of political scrutiny from the IMF and following the rules of structural adjustment. As the Citi banker William Rhodes recalled, 1984 marked "the beginning of the concept of debt reduction."[54] This "reduction" which was, in actuality, just more renegotiation, restructuring and rescheduling extant debt was nonetheless built upon this deeper tie between the IMF and debtor governments. Debtors found their access to new capital mediated through the IMF, as opposed to their own policy priorities.

Castro's Challenge

Marking the 32nd anniversary of the Cuban revolution, on July 26th, 1985, Fidel Castro gave a speech in a small farming village "in the shadow of Guantanamo Naval Base." Of main concern for Castro was the Latin American debt crisis, or as he called it, "a battle for

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[52] Morris Miller, *Coping is Not Enough! The International Debt Crisis and the roles of the World Bank and International Monetary Fund* (Homewood, Il: Dow Jones-Irwin, 1986,) 10.
[53] Krugman et. al., "LDC Debt Policy," 696-697.
[54] Krugman et. al., "LDC Debt Policy," 727.

the new economic order in Latin America, a battle for the economic integration of Latin America." For the first time since the onset of the crisis, Castro suggested that Latin American debtor countries simply refuse to pay the $360 billion of debt still outstanding. In connecting the ongoing debt crisis to the Cuban revolution, Castro cast a shadow of radicalism over the future of the crisis. By only referring to the US indirectly, "using the term 'imperialists,'" Castro made explicit the undercurrents of US exploitation that Western press coverage had intentionally avoided. It is therefore telling that the *New York Times* coverage of the speech did not report any of the specific charges of imperialism Castro made in the speech.[55]

Castro's speech reflected his newfound focus on the debt issue, which he had been taking up since the beginning of the year. While Castro was careful to craft his appeals to not be too threateningly revolutionary to scare off western lenders, of which Cuba was also a client, Castro's calls for Latin American cooperation flew directly in the face of Washington's preferred case-by-case basis. Just weeks before the speech at Guantanamo, Castro told a meeting of trade unionists that the debt problem was a "struggle for our independence." Castro most stinging comments compared the debt situation to a kind of slavery and again made central the question of imperialism:

> I am not proposing revolution right now… [the debt problem] is a struggle for our independence, because that independence does not exist right now. With the foreign debt around our neck, our independence is a joke…At least with slaves, the owners worried that they would not die on them. But who worries about an unemployed laborer dying? They are so unconcerned with our dying that they spend millions on sterilization programs to make sure we are not even born.[56]

[55] Joseph B. Treaster, "Castro, Marking Revolution, Talks of Debts," *New York Times*, July 28, 1985, A13.
[56] Gordon Matthews and Forde, John P. "As Latin Debt Crisis Lingers, Castro Calls Havana Parley," *American Banker*, July 22, 1985.

The *American Banker* worried that Castro's provocation came at a time when big debtors were "newly being made aware of how long and difficult their economic adjustment is going to be." Depressed oil prices were worsening the position of the "model" debtor, Mexico, and "resistance to austerity" continued apace in Argentina, the most uncooperative debtor. Over the course of 1984, despite the new agreements, new bank lending had dropped precipitously across Latin America. One banker quoted in the *American Banker* reflected that the situation was looking untenable as the region would require "steady net infusions of foreign capital to supplement domestic saving for investment."[57] So as the economic situation worsened, Castro turned attention towards the shared nature of debtors' struggles. An alternative to the divide-and-conquer strategy was in the air.

Castro's debt crusade culminated in a week-long Havana conference at the end of July attended by 1,200 representatives from nearly all the Latin American nations. The attendees included "academics, labor leaders, members of the clergy, former chiefs of state and few representatives of governments." Only Nicaragua, Bolivia, Ecuador, and Brazil sent official government representatives. While most speakers were in support of Castro's call for a unliteral debt renunciation, others pointed to the need to maintain working relations with creditors for purpose of development and instead called for eased repayment terms. Notably, the detractors included Mexico—the model debtor—and Brazil, the other top overall borrower next to Mexico. While these bigger borrowers, with much more to lose in compromised relations with western creditors, were publicly apprehensive about Castro, the *New York Times* reported that according to Latin American diplomats, leaders of these countries were "privately delighted by the Castro Campaign."[58]

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[57] Ibid.
[58] Joseph B. Treaster, "Cuban Meeting Stokes Emotions on Latin Debt," *New York Times,* August 1, 1985, D1.

Western diplomats speculated that Castro's posturing was a bid to "end his long isolation in Latin America and to project himself as a regional leader" and worried that he was indeed "having some success." Western observers comforted themselves, however, with the knowledge that Cuba itself had recently refinanced $3.5 billion in debt to private lenders—a number which would have been much higher had it not been for official aid coming from the USSR. So, while the revolutionary rhetoric behind Castro's campaign may have not had solid material ground, it was still effective in changing shifting the atmosphere of bargaining. One conference attendee summarized the situation astutely:

> [Castro] is improving our bargaining situation with the banks…He is pushing them to the wall with the idea that we won't pay. We will pay, we have to pay. But we can only pay if the rules of the game are changed. We have to push for better terms. Castro is pushing for all of us. He is saying things we don't dare say. He may help us find some middle ground, and we appreciate this.[59]

As this anonymous diplomat's sentiments would indicate, debtors saw total refusal of repayment as untenable alternative. But the mere specter of debtor collaboration was enough to move the conversation, and possibly shift the balance of power.

Castro's calls for a debt revolt may have represented a road not taken, a foreclosed alternative, but nonetheless were still significant. Like the Cartagena Consensus before it, the threat of debtor solidarity could not have gone unnoticed by lenders and Washington officials. As opposed to Cartagena, Castro was not just calling for collaboration, but for collective resistance. Castro's invocation of the imperial dynamics that suffused the debt crisis centered on just the kind of blatant exploitation and gun boat diplomacy that the banks were hoping to sanitize themselves from under the cover of the IMF. Framing the crisis as a matter of imperialism, moreover, threatened the case-by-case strategy which would become a

[59] Ibid.

central piece of the Washington Consensus. Debtors were not just united by a shared economic burden, but in a larger struggle over sovereignty and political autonomy.

Just months after Castro's provocation, on September 19th, 1985, Mexico City was struck by "the worst earthquake in the history of the country."[60] While the exact death toll remains unknown, some non-governmental sources estimate more than 40,000. Whatever the true number was, the body count was high enough for the Mexican Social Security Service's baseball field to serve as a makeshift morgue.[61] The economic shock was staggering—the cost of the damage, as estimated by the IMF, was approximately 3½ percent of annual GDP.[62] Amid their grappling with the debt crisis, the De La Madrid administration was not prepared to commit to any kind of significant economic response to the disaster. "The government, stunned, unprepared," as described by historian Enrique Krauze, "reacted slowly and clumsily." The Ministry of Foreign Affairs went as far as to declare that "'under absolutely no conditions' would they request aid, least of all from the United States." Given the lack of an effective governmental response, it was civilian volunteers who ended up undertaking most of the rescue work. As described by Krauze, for the government it was a missed opportunity to restructure the allocation of economic resources away from the capital, given that the "national debt was in large part of the debt of the capital. Food, housing, transportation, services—all of them were subsidized in the capital."[63] The Mexican government's lack of organized response was emblematic of the new governance paradigm of Mexico and, to a lesser extent, debtor countries in general. The PRI was now led by an

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[60] Enrique Krauze, *Mexico: Biography of Power* (New York: HarperCollins, 1997,) 765.
[61] "¿Mas de 40 mil Muertos en el sismo de 1985,?" *DiarioCrítico*, September 19, 2008, https://www.diariocritico.com/noticia/99041/noticias/mas-de-40-mil-muertos-en-el-sismo-de-1985.html.
[62] Boughton, *Invisible Revolution*, 371.
[63] Krauze, *Mexico*, 766-767.

administration that was willing to privilege creditor interests over the dire relief needs of its disaster-stricken populace.[64]

The earthquake came at a time of turbulence in Mexico's relationship with the IMF, which drove the lack of a substantive response by the De la Madrid administration, if only with the rhetorical cover it provided Mexican officials. Weeks earlier, the IMF had decided Mexico's economic performance was behind the adjustment targets laid out in the 1984 rescheduling agreement and "cutoff" Mexico's access to the remaining $900 million drawings scheduled through August.[65] Specifically, Mexico's fiscal deficit was too high, budget reserves were too low, and "domestic credit growth was above target."[66] To restore Mexico's status as the model debtor, representatives of the Mexican finance ministry, led by Jesus Herzog's second-in-command Angel Gurría, met with the bank advisory group in early December to reaffirm Mexico's commitment to economic adjustment. In the meeting, Gurría presented bankers highlights of Mexico's 1986 budget which projected GDP growth of "-1 percent to 1 percent, as compared to 3.9 percent in 1985," "a dramatic decrease in the overall public sector deficit," and a higher current account surplus.[67] On the basis of this renewed commitment to austerity, Mexican authorities formally requested emergency relief funding on December 11th, nearly three months after the earthquake. The IMF executive board approved the request in early January and released $320 million to the Mexican account.[68]

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[64] On the technocratic transformation of PRI leadership see: Miguel Ángel Centeno, *Democracy Within Reason: Technocratic Revolution in Mexico* (University Park: Penn State Press, 1994).
[65] James L. Rowe Jr., "IMF Cuts Off Lending to Mexico," *Washington Post,* September 20, 1985.
[66] Boughton, *Invisible Revolution*, 371.
[67] Cable, The Ministry of Finance and Public Credit of the United Mexican States to the International Banking Community, "Re: Mexico," December 3, 1985, Folder: Fund Relations with Commercial Banks Jan. 1984 – Oct. 1986, Country Files: Mexico/150.1, IMF Archives.
[68] Boughton, *Invisible Revolution,* 372.

The gap between the attitudes of Latin American elites like Castro and Gurría reveals yet another crossroads in the unfolding debt crisis. Compared to the relative progress made in 1984, 1985 revealed the continuing fragility and uncertainty of the debt situation. Castro was raising the specter of debtor collective action while Mexico, the "once and future epitome of the case-by-case adjustment strategy," was wavering in its progress. If anything, the exogenous shock of the 1985 earthquake happening at a time when Mexico had already been cut off from IMF funding highlighted the exact kind of dependence on western creditors that Castro was protesting. Paradoxically, for Mexico to access new funding to rebuild after the earthquake's destruction the Mexican government had to first affirm its commitment to austerity. As scholars of neoliberalism have shown, policymakers have often utilized moments of crisis to "roll out" neoliberal policy.[69] Following this pattern, the IMF and commercial banks were able to capitalize on the earthquake to ensure Mexico remained committed to the adjustment program. Still, the cracks in the case-by-case approach that appeared mid-decade were enough to encourage policymakers to announce an overhaul of the debt strategy through the Baker Plan.

The Baker Plan

On October 8th, 1985, Treasury of the Secretary James A. Baker III, proposed before the annual IMF-World Bank meeting in Seoul, South Korea a new approach for handling LDC debt. The "Baker Plan," officially called "a Program for Sustained Growth," prioritized economic growth in the debtor countries with the hope that they would be able to "'grow' out

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[69] See: Jamie Peck, *Constructions of Neoliberal Reason* (Oxford: Oxford University Press, 2010;) Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (New York: Picador, 2007).

of their debts."[70] By placing emphasis on debtor growth, the plan was an attempt to combat a sense of "battle fatigue" that had come to surround debt negotiations. The challenge was getting banks to stay committed to the long term while also managing the extant debts on their books.[71] The plan was designed, in the words of a Congressional Research Service report, "in part to counteract declining commercial bank willingness" to commit new loans to "troubled third world debtors." While old loans and IMF-imposed adjustment programs had kept debtor countries out of default since 1982, they were not successful in allowing debtor countries to share in the economic recovery that was continuing apace in the economies of creditor countries. As growth slowed in the industrial countries mid-decade, major debtors were experiencing "adjustment fatigue." With prospects for recovery stymied, government officials in debtor countries could no longer politically justify the continued exportation of capital out of the home countries.[72]

The Baker Plan's solution was three-fold. First, Baker called on debtor countries to continue liberalization and marketization schemes to empower the private sector and create "more flexible and productive economies."[73] Second, Baker aimed to bring the World Bank and "regional development banks" further into the recovery plan by imploring them to lend an "additional $9 billion over 3 years to participating countries." Like the IMF funds, World Bank loans would be subject to "structural adjustment conditionality." Third, on top of official funding, Baker called for $20 billion in "new money" to come from the commercial banks-- $7 billion of which was to come from US banks specifically.[74] The inclusion of the

[70] U.S. Library of Congress, Congressional Research Service, *The Baker Plan*, IB86106; (1987), 2.
[71] Zweig, *Wriston*, 848.
[72] Boughton, "Silent Revolution," 418.
[73] Nancy A. Aliquo, "Treasury Secretary James Baker's 'Program for Sustained Growth' for the International Debt Crisis: Three Steps Toward Global Financial Security," *Dickinson Journal of International Law* 4, no. 2 (1986): 276.
[74] Congressional Research Service, *The Baker Plan*, 2-3.

World Bank in the Baker plan was novel, as the organization had been largely sidelined in the international debt issue since the beginning of the balance-of-payments issues in the 1970s.

There was no immediate action taken towards implementing the plan at the meeting, and Baker's initiative was met with skepticism from economic and state officials. For one, Baker's plan called for an increase in World Bank lending to troubled debtors but without a corresponding increase in the bank's capital stock. Observers were also skeptical that weary commercial banks would make good on the $20 billion ($7 billion from US banks and the rest from foreign banks) in fresh money that Baker called on them to lend.[75] While the chairman of Manufacturers Hanover noted that the plan was the first so far that was "prospective" instead of "reactive," the prospective future bank lending was a big ask of "already overcommitted to the Third World." The vice president of investment bank Goldman Sachs told the *Washington Post* that the Baker Plan represented a "reasonable first step" had it been taken prior to the buildup of inflated commercial bank loan portfolios. The new lending that Baker asked banks for threatened to cut into revenues from banks' earlier loans to debtor countries.[76] Wriston, for his part, came out in support of the plan weeks after the IMF/World Bank meeting, calling it a "superb objective."[77]

Reactions to the introduction of the Baker Plan, reactions were mixed. Weeks after Secretary Baker introduced his plan, the economist Jeffrey Sachs took to the pages of *The New Republic* to offer his insights into "how to save the third world." Sachs opened with the observation that "nobody is happy with the IMF these days:"

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[75] Ibid, 3-4.
[76] Hobart Rowen, "Reaction Mixed to Debt Plan," *Washington Post*, October 9, 1985.
[77] Zweig, *Wriston*, 848.

> Most Latin American governments see the IMF as an agent of American commercial banks. Supply-siders in the Reagan administration and in Congress complain that the IMF's heavy emphasis on austerity in the debtor countries is an obstacle to world growth. In recent weeks, administration officials have stated their intention of enlarging the World Bank's role, in the belief that the bank will be more growth-oriented than the Fund.[78]

Sachs was echoing a common sentiment that relying primarily on austerity as the main adjustment tool for debtor countries was in contradiction with policy goals like economic growth and geopolitical security. Sachs summed up that the Reagan administration had believed in the immediate wake of the crisis that "financial retrenchment under IMF supervision" along with a solidified global recovery would be enough to keep the crisis under wraps. Sachs continued to explore why following IMF adjustment policies had not spawned economic growth in the debtor countries. Adjustment policies such as monetary devaluation, while politically distasteful, was "essential to spur exports." Debtor countries ignoring such mandates were not allowing "IMF programs" to "do well for the poor, in restoring sound economic management." Such action would be more useful than "anything that the debtor countries would do themselves."[79]

Sachs did not disagree with Secretary Baker that spurring economic growth in the debt-burdened countries was a paramount concern. In Sachs' view, however, there were "two obstacles" to a "textbook adjustment" in which indebted countries "would shift production towards labor-intensive exports to the U.S. and Europe" and "net export earnings" would be used "both to make debt service payments and to pay for the increased imports needed for faster growth." Those obstacles were the "political power of currently favored industries within the debtor countries" and "the rise of protectionism in the developed world, which

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[78] Jeffrey Sachs, "How to Save the Third World: Forgive Some Debt, Forget Protectionism, and Trust the IMF," *The New Republic*, October 28th, 1985, 20.
[79] Ibid, 21.

makes a strategy of export led growth foolhardy to debtor nations."[80] To help overcome these problems and kickstart growth, Sachs advocated for cancelling at least some of the outstanding debt. Sachs was worried that under the conditions suggested by the Baker Plan "debtor governments" might find "the political and economic costs of default no longer outweigh the burdens of austerity." Sachs still favored the IMF conditionality attached to aid, qualifying that "debt relief must be a spur to beneficial reform, rather than a substitute for reform."[81]

Latin American debtors, for the most part, welcomed the Baker plan as at least a step in the right direction. For Argentina, the plan represented a recognition on behalf of the US government that the Latin American debt problem was long term and would require ongoing attention. Argentinian economic officials, however, still believed that what was ultimately needed was "fundamental" changes in US economic policy towards the issue. Like the MYRE's from the year prior, the Baker plan still included no relief in terms of the cost of the debt. The Argentinians hoped for some kind of interest rate cap or other regulatory intervention to limit the cost of new debt. Elaborating on the Argentinian position, a staff memo from within the Reagan administration noted that without some kind of relief in the debt burden—anything from higher prices for debtor exports or any kind of new funding from whatever source—the problem would lead to "further reduction in consumption to meet the debt service" and therefore "an indeterminant increase in political instability is

[80] Ibid, 22
[81] Ibid, 23

inevitable."[82] Like Sachs, Argentinian and US officials agreed that without some kind of more official relief, the Baker plan was not fully tenable.

Another issue with the Baker plan was that, at the time of its rollout, the plan was not officially a multilateral initiative. That is, neither the World Bank nor IMF had been formally consulted about or had given approval of the Baker Plan before Secretary Baker's rollout. Still, meeting on November 13, 1985, the IMF executive board gave enthusiastic support to the plan. In their official response to the Baker Plan, the executive board confirmed the IMF's commitment to a wider scope of structural adjustment measures and called for the fund to work closely with the World Bank to develop confidence-promoting debt strategies. In a growing distaste with commercial banks reluctance to lend new money to debtors, the statement also called for a "strengthening" of their role in "encouraging" banks to provide new lending. As noted by the IMF historian James Boughton, more direct measures like forcing banks to lend or providing incentives through "government guarantees" were seen as an "inappropriate" disturbance of the "market-oriented nature" of bank lending. More bank involvement was crucial, as the executive board understood the $20 billion in new lending Baker called for as a bare minimum.[83] The simultaneous desire for more bank involvement and hesitancy to institute policies that would create that new lending revealed a growing contradiction in the Washington Consensus strategy: a large motivation for conditionality and adjustment stipulations was to make debtor countries attractive for private investment. But as the behavior of the banks seemed to indicate, their level of lending was determined by

[82] Memo, David G. Wigg, "Latin American Economic Conditions and Reactions to Baker Proposals," November 5, 1985, Folder "(C) Debt – New Ideas – Baker Plan (2)," Box 6, Danzansky, Stephen: Files, Ronald Reagan Library.
[83] Boughton, *Silent Revolution*, 422.

their own exposure concerns and fear of getting more deeply embroiled in the problem they had created.

The World Bank's position on the Baker Plan was more complicated than the IMF's. In early 1986, speaking before the Council on Foreign Relations, World Bank Vice President Eugene H. Rotberg was ambivalent about the feasibility of the measures proposed by Secretary Baker. "It is not at all clear--even whether the suggested $20 billion increased lending by banks to LDCs, over three years, was intended as a maximum or minimum," Rotberg said. In Rotberg's view the $20 billion could have been a maximum amount possible given the overexposure of banks in their extant loans, an "indispensable" minimum needed for stability, or simply "all the banks could be 'asked' for with a straight face." The $2 billion that Baker asked for, when spread across the three years according to the plan, represented only a 2.4 percent annual increase of debt exposure for banks. In the context of the 1980s, Rotberg felt that the requested increase was "but a fraction" of increased lending and "unwisely" gave banks a "sense of leverage." Without the Baker plan, banks would have had to expect to lend far more "in their own self-interest"—that is to ensure continued payment of interest on older loans. The ultimate signal, in Rotberg's formulation, was that the US government's primary concern among the issues presented by the debt problem was the exposure of the banking sector. Banks were therefore inclined to bide their time and wait and see "what might be guaranteed to them by way of protection."[84]

As Rotberg saw it, the World Bank was now being called into the debt crisis as an additional party that could hopefully offer banks the kind of protection policymakers sought but was difficult to provide through legislation. The World Bank, Rotberg said, was being

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[84] Eugene H. Rotberg, "An Outline of Remarks: 'Financing Development: The Real World,'" February 4, 1986, Folder 9, Box I99, Robert S. McNamara Papers, Manuscript Division, Library of Congress.

“looked to as the only game in town.”[85] What banks wanted was the for the World Bank to guarantee any new loans, so banks could put less capital at risk. Any guarantees given would be selective and limited—not enough to backstop the entirety of new debt. “We are not like the IMF. We don’t make BOP loans. We are not likely, consciously, to jeopardize our preferred creditor status,” Rotberg explained. The World Bank’s role would be to “mostly give good economic development advice” while also monitoring economic performance. In practice, this would mean that any LDC coming to the World Bank for new loans would have to meet the Bank’s economic criteria, including “market-based economies, an absence of subsidies, or a plan which can support savings, investment, export and growth.”[86] With World Bank’s substantial entry into the debt crisis in the wake of the Baker Plan, the dictates of the coming Washington Consensus were continuing to materialize, and again at behest of the commercial banks. As Rotberg noted, the World Bank was brought in because policymakers needed an additional institutional body that could provide protection to commercial banks and the stability of the financial sector. Like the IMF, World Bank loans to troubled LDCs would now come with conditionality stipulations, in the form of “economic development advice,” and monitoring of economic performance.

The Baker Plan, then, marked a fundamental shift in the purpose and scope of World Bank lending. In their original post-war conceptions, the IMF’s intended purpose was to provide short term-financing for Bretton Woods member states facing balance-of-payments issues while the World Bank (along with the Marshall Plan) was meant to finance the reconstruction of war-torn Europe. From 1968 to 1980, under President Robert S. McNamara, the World Bank began to focus more on long-term financing of development

[85] Ibid.
[86] Ibid.

projects in the Global South. McNamara was adamant about centering the issue of poverty alleviation in his vision of the World Bank's larger purpose. For McNamara, in his rhetoric at least, poverty was not just a "symptom of underdevelopment," but rather was a "condition that must be attacked" via World Bank lending programs.[87] By the time of the Baker Plan, the World Bank was already drifting away from McNamara's vision. His successor, former Bank of America executive A.W. Clausen, fired many of the economists McNamara had brought on staff and replaced them with a more market-oriented staff. Now, under the Baker Plan, the World Bank would come to resemble the IMF by providing loans to finance the restructuring of debtor country's economies in the name of efficiency.[88] This transformation at the World Bank, then, was critical in shaping the coming Washington Consensus as the primary purpose of both the World Bank and the IMF in the Global South moved closer to becoming structural adjustment.

Even with so much of the surveillance and monitoring responsibility passed onto the IMF and World Bank, observers at the time still worried that the Baker Plan brought the US government uncomfortably close to dictating the internal economic policies of debtor countries. While the Treasury was not actually putting up any money under the Baker Plan, there was still an implicit guarantee that the US government was guaranteeing continued bank support of debtor economic growth through the next three years. This served as the carrot behind the plan, while IMF conditionality and World Bank monitoring served as the stick. The *New York Times* observed that until the Baker plan "industrialized countries had quietly orchestrated debt policy," but Baker's initiative now represented a shift whereby

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[87] John L. Maddux, *The Development Philosophy of Robert S. McNamara* (Washington D.C.: World Bank, 1981,) 15.
[88] Joseph Stiglitz, *Globalization and its Discontents* (New York: W.W. Norton, 2003,) 13-14.

governments were "directly and overtly involved in pushing banks" to continue lending. Again, the language of bailouts appeared: "By intervening between commercial banks and their borrowers, the U.S. has opened itself up to demands for a bailout of the American banking system…the government would find such demands hard to deny once it has prodded the banks to make the loans."[89] The *Times* piece described the entry of the World Bank, responding to US interests, into the debt issue as pushing "Reagonomics" and unpopular policies in debtor countries. With the World Bank and US pushing privatization, "low return" development and infrastructure projects could fall wayside to higher return, short-run projects that would be more attractive to private companies.

Troubled Progress

Just months after the roll out of the Baker Plan, the eleven countries of the Cartagena Consensus met again in Montevideo, Uruguay. While Latin American debtors initially welcomed the Baker Plan as a positive first step, the plan's inadequacies were enough to encourage the Cartagena members to release a collective platform for further debt negotiations. In a document entitled "Declaration of Montevideo: Emergency Proposals for Negotiations on Debt and Growth," the collected finance ministers laid out a kind of addendum to the Baker Plan. In their view, the Baker Plan failed both to recognize that growth in debtor countries would require more than only "new cash flows" and severely under-estimated the amount of fresh liquidity that would be needed. As a reparative measure, they offered nine proposals which notably included imposing regulations targeting financial profits. The first proposal, for example, was for joint action by creditors to return interest

[89] S. Karene Witcher, "Risky Medicine: Baker's Plan to Relieve Debt Crisis May Spur Future Ills, Critics Say," *Wall Street Journal*, November 19, 1985, 26.

rates to “historic levels” and consequently “narrow bank spreads.” Other proposals targeting the banks included: a separation of new cash flows from existing debt to allow debtors to finance internal development projects in addition to just “balance of payments disequilibria,” commercial banks committing to at least increasing new lending enough to keep up with “international inflation,” and imposing “ceilings” on net resource transfers from debtor countries to limit capital flight—which they noted capital markets often encouraged.[90]

While the earlier Cartagena statement included targeting interest rate spreads, this time they went much further in targeting bank profiteering. Not only were they asking the banks make less money on new loans, but the Cartagena participants were also asking for increased bank commitment in terms of new money. Importantly, this would mean exactly what banks were trying to avoid—keeping Latin American debt on their balance sheets. In the words of the World Bank Vice President speaking on the Baker Plan, the main thing the banks wanted was “out.” Also unlike the groups’ 1984 statement, moreover, this time they went as far as to raise the specter of non-payment on loans: “If this proposed series of measures is not adopted, the region will face an extremely dangerous situation that will of necessity oblige it to limit its net transfers of resources in order to head off greater social and political instability that could reverse the process of democratic consolidation.”[91]

But it was not just the banks the new Cartagena proposals went after, they also questioned the legitimacy of the IMF and World Bank conditionality stipulations which were central for Baker and the larger debt strategy as it had been developing since 1982. “Steps should be taken,” they said, “to avoid conditionality requirements that in practice seriously

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[90] Consensus of Cartagena: Meeting of Ministers, “Declaration of Montevideo: ‘Emergency Proposals for Negotiations on Debt and Growth,’” December 16-17, 1985, Folder “Debt Initiative: The Baker Plan,” OMD Subject Files, Jacques De Larosière Papers, IMF Archives.
[91] Ibid.

restrict use of the resources of the various lending institutions." What they were saying, essentially, was that the austerity requirements imposed by the IMF and World Bank were keeping them from spending the money they were getting from those same institutions. They creditor-centered strategy ensured that all new money would just flow back to the creditors in the form of payments extant debt, which contradicted Baker's apparent insistence that debtors be encouraged to "outgrow" their debts. The proposal elaborated: "IMF conditionality must take account of the need for growth in production and employment and respect each country's own ability to formulate and execute its adjustment plans."[92]

These proposals rightfully pointed out the contradictions inherent in the debt strategy as it existed, and by extension, the coming Washington Consensus. That is, for all the talk of the importance of growth and development, conditionality requirements prevented debtors from taking the necessary policy steps that would yield those results. As the statement noted in its opening, "living standards in Latin America" had since the onset of the crisis "slipped back a decade."[93] Mass unemployment could not be fixed through austerity, but rather through the exact kind of government investment that the Washington Consensus institutions were set on preventing.

Despite its more radical suggestions, the Cartagena group's December statement did not generate much of a response from bankers or Western governments. As described by the *Wall Street Journal*, had the statement come in 1983 "even a hint that debtors might be forming a common front to halt payments would have caused panic in the international financial system." But given how the debt crisis had evolved since then "shell-shocked bankers take such developments in stride." An economist from Bankers Trust remarked the

[92] Ibid.
[93] Ibid.

proposals did not “sound all that inflammatory.”[94] The relative lack of reaction may have been because of the Baker Plan’s insinuation that more money would be coming from official lenders instead of the banks.[95] Still, the Montevideo statement represented a stark alternative from the precepts of the coming Washington Consensus. The Cartagena group offered a vision whereby the burden of adjustment would be shared between debtors and lenders—debtors would invest in growth-oriented policies, and banks would accept lower returns to help debtors get out from the hole that the banks built for them. “Structural Adjustment” would not just be for debtors, but for creditors and their home governments as well. Like the first Cartagena statement, moreover, the Montevideo statement represented debtors’ yet again finding a sense of solidarity in their shared struggle. As opposed to the atomized nature of individual IMF and World Bank loans and conditionality programs, for a moment debtors highlighted the possibility for collective action.

Less than a year after the Baker Plan’s emergence, in a hearing before the Senate Committee on Foreign Relations, policy makers confronted a pressing example of the political and economic costs of austerity that Sachs had gestured to in his *New Republic* piece: Mexico. The hearing was held to have Secretary Baker communicate the Reagan Administration’s approach to developments in global economic relations. In his opening statement Committee Chair and Indiana Republican Richard Lugar stated that the committee was not only interested in economics but also “the political well-being of nations around the globe.” Lugar was concerned that “our exports are adversely affected by Mexican economic problems and our difficulties with illegal immigration are made worse by unemployed

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[94] S. Karene Witcher, “Latin American Debtors Display an Unusual Degree of Agreement,” *Wall Street Journal,* December 23, 1985.
[95] Boughton, *Silent Revolution*, 425.

Mexicans seeking jobs in this country." In his own testimony, Secretary Baker did not directly address the humanitarian dimensions of the Mexican economic challenge. Baker did mention, however, that Mexico had yet to see meaningful "export-led growth" because political reforms had not gone far enough in order to attract new capital flows and stem capital flight from the country.[96] The impression given of the exchange in the hearing was that the Reagan administration was not concerned with the social cost of austerity and or even with the connection between Mexico's debt burden and the country's lack of growth, but rather on its inability to make political conditions palatable for capital.

Throughout 1986, economic conditions were indeed getting bad enough in Mexico and other Latin American debtor countries for them to begin even more leverage in debt negotiations. At the time of the congressional hearing, Mexico was still reeling from the twin economic shocks of the earthquake and the international collapse in the price of oil. At the market's peak, oil sales made up 70 percent of Mexico's foreign export earnings.[97] By the end of 1986, the price of oil collapsed from $27 a barrel at the start of the year to a low point of less than $10 per barrel.[98] In the face of the evaporation of this source of revenue, Mexico had "woken up to the realities of modern international trade."[99] For Mexico, this meant an end to the long-standing protectionism which helped fuel its import substitution industrialization program of the previous decades. In the immediate postwar years, the US had made relative peace with Mexico's protectionism by restricting certain Mexican exports

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[96] United States. Congress. Senate. Committee on Foreign Relations. *Hearings before the Committee on Foreign Relations on Economic Summit, Latin Debt and the Baker Plan,* 99th Cong., 2nd sess., May 20, 1986, 1, 3-7.
[97] "Mexico's Capital Idea," *Euromoney*, September 1986, 164.
[98] Robert D. Hershey Jr., "Worrying Anew over Oil Imports," *New York Times,* December 30, 1989, 33.
[99] "Mexico's Capital Idea," 164.

and moving production facilities into Mexico itself for serving the Mexican market.[100] By the time of the debt crisis, this attitude was long gone, and in July 1986 Mexico joined the General Agreement on Tariffs and Trade (GATT). Responding in approval, the United States government lifted an embargo on Mexican tuna while large corporations like Ford and Unilever ramped up direct investment. With foreign corporations expanding operations in Mexico, the De La Madrid administration looked the other way as Mexican regulations were flaunted. Unilever, for example, violated a Mexican law passed in 1973 which capped foreign control of any domestic company at 49 percent when the company purchased a 61 percent stake of the Mexican subsidiary of US food company Anderson Clayton. The Mexican subsidiary of IBM was 100 percent foreign owned. Mexican companies were goaded into these deals by the carrot of debt reduction via debt-equity swaps. Foreign corporations would buy out Mexican companies' debt in exchange for a proportional share of stock.[101]

Also in 1986, worsening economic conditions in Argentina pushed the government into closer cooperation with the IMF. In June 1985, Argentina introduced a new currency—the austral—as part of a larger "Austral Plan." The plan was designed to halt inflationary pressure by freezing prices and public wages, limit deficit growth through "revenue increasing measures," and stabilize the currency by pegging the austral to the dollar. While initially the plan did succeed in dropping inflation in 1985, by the end of the year the real exchange rate was again overvalued.[102] Argentinian officials negotiated with the IMF for the

[100] Hector Aguilar Camín and Lorenzo Myer, *In the Shadow of the Mexican Revolution: Contemporary Mexican History 1910-198,* trans. Luis Alberto Fierro (Austin: University of Texas Press, 1993,) 194-195.
[101] "Mexico's Capital Idea," 165.
[102] Sebastian Edwards, *Crisis and Reform in Latin America: From Despair to Hope* (Oxford: Oxford University Press, 1995,) 34-35.

first half of 1986 to be able to draw more money from the existing stand-by arrangement with the fund.[103] By promising the fund that the "government would keep domestic lending under control and restrict the growth in the money supply to 3% of GNP," Argentinean Minister of Economy Juan Vital Sourrouille secured the increased funding, bringing Argentina's total commitment to the IMF to $2.9 billion—over 200 percent more than their IMF quota.[104] These promises proved untrue, and by the end of the year inflation was still rising and the deficit had increased to 7.2 percent of GDP.[105] Argentina ended 1986 in new negotiations with the IMF over a new stand-by agreement, with adjustment in macro-economic policy again at the center of the discussion.[106]

For both the model debtor country, Mexico, and creditors' biggest headache, Argentina, the advances made in 1984 failed to illuminate any light at the end of the tunnel in 1986. Instead of prosperity and recovery, earlier policy commitments and concessions made to creditors and the IMF had led both countries to only more commitments and more concessions. The openness to foreign investment which would be codified in the Washington Consensus was being driven into fruition by foreign corporations buying up Mexican subsidiaries despite regulatory prohibitions. The failure of the Austral plan in Argentina forced the country to accept more rigid austerity policies and commit to more widely sweeping conditionality policies. In both cases, economic policy change was gradually becoming more drastic. In a more dire economic climate, moreover, the members of the Cartagena Consensus were unable to exert the kind of pressure they could in 1984.

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[103] Boughton, *Invisible Revolution,* 463-465.
[104] Ibid, & "Alarms and Excursions in Argentina," *Euromoney*, September 1986, 163.
[105] Edwards, *Crisis and Reform*, 36.
[106] Boughton, *Invisible Revolution,* 466.

Conclusion

For all its shortcomings and detractors, the Baker Plan was still a significant enough shift in the international approach to the debt crisis for the financial trade publication *Euromoney* to name Baker as their 1986 "finance minister of the year." In its reasoning, the coverage from *Euromoney*, lauded the Baker Plan as an assumption of economic leadership on the part of the US on par with the Marshall Plan. While it perhaps goes without saying that the treatment of Latin American debtors was in no way commensurate with the grants and direct aid afforded war-torn European countries, what the writers at *Euromoney* saw was a similar effort to completely reorganize the world financial system.[107] On this charge, they were correct—the international economic order the Baker Plan began to usher in was a major turning point, and eventually would congeal into the Washington Consensus. "Before [Baker's] appointment," *Euromoney* explained, "it would have been unthinkable to suggest that the international debt crisis could be solved by further large-scale lending to the debtor countries." What made this palatable for the financial community was that the Baker Plan codified into economic policy that new loans would be granted in connection with "a country's willingness to pursue growth-oriented policies." Commercial bankers, who had been "worn down by endless rounds of futile negotiations," were given lifted spirits and "new resolve to tackle the long-term structural problems of the debtor countries rather than just worrying about interest payments."[108]

In terms of building the Washington Consensus, Baker helped seal, at least on its face, a unified front between commercial banks, western governments, the IMF, and the World Bank. While the multi-year rescheduling agreements set the stage for longer-term

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[107] Richard Evans, "Finance Minister of the Year: Baker," *Euromoney,* September 1986, 93.
[108] Ibid, 94.

dependent relationships between debtors, the IMF, and the banks, the Baker Plan officially put the US government behind structural adjustment. In a certain sense, by bringing the US state behind a new conditionality-based debt paradigm, Baker put the "Washington" in Washington Consensus. And with the US at the head, other creditor countries fell in line. By August 1986, *Euromoney* reported, "Japan and a number of other countries" were in talks with the World Bank "on specific ways to establish a new financial system to help channel funds to the Third World."[109] The US and other creditor countries were confirming their financial commitment to the Global South, but with (very big) strings attached. While the Baker plan did not do much to alleviate the debt crisis, or address debtor's concerns, it did establish new rules of the game.

Perhaps more importantly, the Baker plan, along with the MYRA, were able to head off the threat of debtor solidarity and resistance in the middle years of the Latin American debt crisis. Through offering limited relief through payment rescheduling, the MYRA was able to skirt the call for more robust debt relief as called for the Cartagena Consensus. By shifting the focus of the debt strategy onto "economic growth," the Baker plan was able to renew commitments from commercial banks, the IMF, and the World Bank to keep channeling enough loan money to debtor countries to enable them to keeping making interest payments. Thanks to exogenous shocks like the Mexico City earthquake and the collapse of the international oil market, creditors enjoyed a greater sense of leverage along with an enhanced ability to extract commitments to more structural reform. Creditors' preferred divide-and-conquer approach was maintained and strengthened through the recruitment of the World Bank into structural adjustment lending. For purposes of building the coming

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[109] Ibid.

Washington Consensus, by the end of 1986 it was established that the relationship between developing countries in economic crisis and international financial institutions would be long-term and individual.

CHAPTER V

THE BANKERS' D-DAY: LOSS RESERVES, THE BRADY PLAN, AND DEBT REDUCTION

It was lunchtime on May 19, 1987, and the new chief executive of Citibank, John Reed, was out on a "solitary stroll through midtown Manhattan." Leaving the Citi building on Park Avenue during the day was a rarity for Reed, but today was different. Reed took the opportunity to decompress—on top of getting himself a sandwich he also "browsed in bookstores" and "bought a pair of shoes." Shortly before his lunch break walk, Reed had briefed Citi leadership on what he was going to announce to the press shortly after the closing bell at the New York Stock Exchange that afternoon: that Citi was going to allocate $3 billion in loss reserves against its Latin American loans. This was a watershed moment in the history of the debt crisis, what one writer called "the banking equivalent of the D-day invasion." [1]

Since 1982 the stance of the US commercial banking sector towards debt negotiations was that no debt reductions would be granted, and that debtors would be encouraged instead to pay off extant loans through economic growth and, in some cases, eased repayment terms. In 1985, then-Treasury Secretary James Baker continued this strategy, known as the Baker Plan, but placed a larger emphasis on economic growth as a way for debtor countries to outgrow their debt burdens. Now, after years of adjustment in debtor countries, Citi was signaling its desire to get out from under their Latin American loans entirely. Just as Citi had led the rest of the banks into Latin American lending, it was now leading them out. In the words of Norman Bailey, a former National Security Council expert on the debt situation,

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[1] Phillip Zweig, *Wriston: Walter Wriston, Citibank, and the Rise and Fall of American Financial Supremacy* (New York: Crown Publishers, 1995,) 851-854.

Citi's announcement was the "*coup de grâce*" for the Baker plan and the larger debt strategy up until that point. "We're in a totally new phase," Bailey observed, "where everybody is going to cut his own deal."[2]

Nearly five years after the onset of the Latin American debt crisis, Citi's 1987 move toward debt relief marked the beginning of a larger shift in the debt strategy. By the end of the year, Mexico had reached a deal with Morgan Guaranty to offer to exchange $20 billion of outstanding loans for negotiable bonds. Three years later, this securities-based approach to resolving the debt crisis would be formalized with government backing in the US Treasury's "Brady Plan" and issuance of "Brady Bonds," both named for Jim Baker's successor, Nicholas Brady. The reliance of the Mexico-Morgan deal and Brady plan on converting loans to bonds places these debt reduction strategies squarely in a larger process of "financialization" of the US economy identified in a wealth of previous scholarship on the rise of finance. The works of Gerald Davis and Greta Krippner, specifically, have demonstrated how the securitization of loans like home mortgages and forms of consumer credit enabled the expansion of the financial sector.[3] The centrality of securitization in the larger strategy of final stage of the debt crisis is an important addition to this body of scholarship. Exit bonds for Latin American debt did more than just facilitate financial expansion, they enabled commercial banks to offload the risk of their questionable Latin American loan portfolios onto secondary markets.

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[2] Lenny Glynn, "Taking the Hit on LDC Debt," *Institutional Investor*, July 1987, 173.
[3] See: Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge: Harvard University Press, 2011,); Gerald F. Davis, *Managed by the Markets: How Finance Re-Shaped America* (Oxford: Oxford University Press, 2009); Gerald A. Epstein, *Financialization and the World Economy* (Chelentham, UK: Edward Elgar Publishing, 2005), Youn Ki, "Large Industrial Firms and the Rise of Finance in Late Twentieth Century America," *Enterprise & Society* 19 No. 4 (December 2018: 903-945).

To be able to offload this risk, the Citi loss-reserve build up and Mexico-Morgan deal came only after five years of conditionality agreements and structural adjustment in Latin American debtor countries. Until this final phase of the debt crisis, the IMF, commercial banks, and US Treasury had worked in concert to keep loan payments on the original debt flowing. To this end, the banks and IMF had first extended loans of new money to pay interest on old debts in an initial financial firefighting phase of the crisis up through 1983, granted on the basis of severe austerity commitments from debtor countries. These rescue packages, combined with lax enforcement of capital reserve standards stateside, ensured that the banks that were greatly over-exposed to potential bad loans were saved potential insolvency.

Then, in a second phase of strategy throughout the middle years of the decade, the creditor institutions began to offer limited relief through new multi-year restructuring agreements which offered eased repayment schedules and longer maturities.[4] In addition to fiscal austerity, conditionality stipulations evolved to include wider, more structural, and market-friendly reforms designed to attract private capital back into debtor countries and encourage continued primary exports flowing to creditor countries. To enforce compliance with these requirements, IMF surveillance of debtor countries economic policy became more frequent, more invasive, and longer-term. These limited relief policies were partially motivated by a desire to head off alternative plans put forward by Latin American political elites which sparked fears in the creditor institutions of a looming "debtors' cartel" which

[4] On the evolution of phases in the debt strategy see: Paul Krugman, Thomas O. Enders, & William R. Rhodes, "LDC Debt Policy" in *American Economic Policy in the 1980s* ed. Martin Feldstein (Chicago: University of Chicago Press, 1994,) 691-739.

could have threatened the dominant case-by-case approach which better served creditor interests.

Similarly, the move towards substantial debt reduction in the third phase of the debt crisis came only after the economic strain on debtor countries had worsened enough to motivate louder calls for debt forgiveness in the US and a greater threat of complete moratoriums on debt payments emanating from Latin American debtor countries. In this context, Citi and other money-center banks' buildup of large loss reserves was an effort to preserve leverage over debtor countries while also upholding the case-by-case negotiation approach. The ability of banks to commit significant funds to loss reserves was itself guaranteed by the previous years of continued loan payments from debtor countries. The reforms undertaken in debtor countries to guarantee these payments were substantial enough for US security officials to join in the calls for debt reduction. By the late 1980s, the ruling administrations in debtor countries were satisfactorily responsive to creditor economic interests to make the risk of austerity-generated unrest deposing those capital-friendly governments and thereby compromising US foreign policy goals too much to bear. The 1989 codification of debt reduction in the Brady plan, therefore, was only possible after the health of the US banking system had been assured and a near-decade of adjustment policy had molded debtor country governments into the kind that the US foreign policy establishment wanted to preserve.

As a testament to this paradigm shift in debtor country governance, 1989 was also the year when the development economist John Williamson coined the term "Washington Consensus" to describe the market-friendly economic policy rubric becoming widely adopted in Latin America. The "Washington" in "Washington Consensus," for Williamson, referred

to the unified front between the IMF, World Bank, and US Treasury—all headquartered in Washington, D.C.—in backing the slate of policy reforms undertaken by debtor governments. What Williamson's phrasing obscures, however, is the critical role of Wall Street banks whose balance sheets were served by these policy changes. The Washington Consensus was not solely a product of an agreed-upon intellectual program for sustained economic development, but rather was constructed in a piece-meal fashion based on the changing material needs of creditor banks throughout the debt crisis.

The Citi Loss Reserves

In the opening months of 1987 John Reed was having a hard time getting along with Treasury Secretary James Baker and Federal Reserve Chair Paul Volcker. Secretary Baker, according to the *Wall Street Journal*, called Reed "several times to complain about the bank's tactics in negotiations with specific debtor countries."[5] What worried Baker and Volcker alike was the "rigid stance" that Reed had developed towards recent negotiations with debtor countries trying to secure lower interest rates on extant loans. Reed felt bullied by the Fed and Reagan Administration in agreeing to reduce rates on $8.6 billion of loans to Mexico in 1986 and was determined to "wrest control of the debt problem away from Volcker, the IMF, and the Latins."[6] In the Mexican case, Reed was nearly successful in derailing the negotiations completely, and fought with Volcker "over an eighth of a percentage point" on interest rates. "Rates had never been sliced thinner than one eighth," one history of Citibank described, "so for the first time the salami was cut into sixteenths." Consequently, the $6 billion of new money loans Mexico ended up with were priced at

[5] Art Pine, "U.S. Policy Makers Fear Citicorp Stance on Debtor Nations Imperils Global Plan," *Wall Street Journal*, February 13, 1987, 1.
[6] Zweig, *Wriston*, 850

“13/16 of a percentage point” over LIBOR. In Reed’s view, such minute struggles over details were worth hashing out given his belief that “the banks” had become “pawns of Mr. Volcker and the IMF.”[7] In negotiations with other countries, Citi under Reed was being equally difficult: in October 1986 Citi blocked a resolution by Chile’s advisory committee to consolidate the countries loan payments into a single payment instead of biannual ones, months later Citi refused to consider a request from the Philippines for a quarter-percentage point reduction in rates.[8]

The adversarial and hardline attitude Reed brought to the debt negotiations may have had to do with the fact that prior to assuming the chief executive position at Citi, he had never “been a banker and never made a loan.”[9] With a Sloan School MBA, Reed’s background was in management, not finance. When was hired at Citi in the 1960s, Reed skipped out on the regular credit training Citi required for new hires. Reed first made his name at Citi working on information systems in the international division, before climbing the ranks to head Citi’s consumer division. Focused more on marketing than traditional financial concerns, Reed was largely responsible for Citi’s success in making ATM’s “consumer friendly and ubiquitous.” Reed was hand-picked by Walter Wriston as his successor upon Wriston’s retirement in 1984, seen as the “most entrepreneurial of possible candidates.”[10] Reed’s managerial focus on efficiency and sense for the importance of the Citi brand, perhaps influenced his desire to get out from under the LDC loans which were a drag on the balance sheet and a public relations challenge. Reed was also notably overconfident in

[7] Ibid.
[8] Pine, “U.S. Policy Makers Fear Citicorp,” 1.
[9] Zweig, *Wriston*, 729.
[10] James Freeman and Vern McKinley, *Borrowed Time: Two Centuries of Boom and Bust at Citi* (New York: Harper Business, 2018,) 226-230.

his knowledge of Latin American clients, given his having grown up in Brazil and Argentina, due to his father's position at Armour and Company, the international meat packer.[11] Reed was alleged to have made arrogant quips in negotiations like "don't tell me about Brazil, I lived there."[12]

Reed's decision to greatly expand the Citi loan loss reserves, then, was primarily a power play. In the view of the Congressional Research Service, Citi "was seeking to reassert control over its Third World loans and, as much as possible, insulate its lending decisions from political pressure." After continually feeling pressured in loan negotiations, Reed's move served to increase the bargaining power and leverage of creditors. The $3 billion increase to reserves meant a second quarter loss for Citi of $2.6 billion—"the largest quarterly loss in the history of U.S. banking"—and an "annual loss of $1 billion" which represented Citi's "first annual loss since the Depression."[13] As noted by one historian of Citibank, however, "no real money was really lost by Citibank" as the balance sheet reworking was "just an accounting maneuver."[14] The significance for the balance-of-power in debt negotiations was the Citi was demonstrating its ability to take a loss on its position, effectively rendering any threat of non-payment from debtors as toothless. The shift in leverage was demonstrated perhaps most dramatically in the secondary market for LDC debt. Before the Citi decision, LDC debt was selling for between 75 to 85 cents on the dollar. By mid-1987, that number had dropped to 40 and below.[15] Simultaneously, Citibank stock "surged."[16]

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[11] Ibid, 226.
[12] Quoted in: Zweig, *Wriston*, 850.
[13] U.S. Library of Congress, Congressional Research Service, *The Citicorp Initiative: A Brave New World for the Third World Debt Problem* by Patricia A. Wertman, "
[14] Zweig, *Wriston,* 855.
[15] Krugman et. al., "LDC Debt Policy," 699.
[16] Zweig, *Wriston*, 855.

In addition to taking power away from political opponents like Volcker and debtor countries, Citi's move also brought immense competitive pressure to the commercial banking industry. The size of Citi's total reserves accounted for 25 percent of LDC loans and 100 percent "against all other nonperforming loans." This ratio of reserves quickly became the "Citibank standard" which other major banks fell I line with. In effect, this meant that only banks that were capitalized strongly enough could keep up. Powerful banks like Citi were free to be more hardline with debtors while banks with more fragile positions had to remain "more accommodative."[17] As such, the move did not make Reed and Citibank any new friends among commercial bankers—the quarterly loss for the entire banking industry amounted to $10 billion, which made 1987 the worst year in banking history up to that point. Citi's move had "promoted discord," among all the banks that were in on LDC debt. One rival chief executive, Lewis Preston of Morgan Guaranty, was "furious that Reed had acted unilaterally and forced the hand of its competitors."[18] This would set Morgan on a path for revenge which would yield equally consequential results by the end of the year.

Outside of Reed's background and disposition towards the issue, one of the key motivating factors in Citi's loss reserve was Brazilian president Jose Sarney's declaration of an open-ended moratorium on all interest payments on Brazil's $65 billion extant debt with foreign commercial banks. President Sarney's announcement, made on February 20, 1987, was made in response to the failure of Brazil's "Cruzado Plan"—an effort to tame domestic inflation with the introduction of a new currency, which had backfired given to capital flight and a depletion of Brazil's foreign reserves.[19] Sarney's move was not meant as a complete

[17] Wertman, "The Citicorp Initiative," 3, 8.
[18] Zweig, *Wriston,* 856.
[19] See: Werner Baer, *The Brazilian Economy: Growth & Development* (Bolder Colorado: Lynne Rienner, 2014,) 106-113.

repudiation of Brazil's debts, but was an attempt to gain leverage in negotiations with creditor banks for more favorable terms. In announcing the moratorium, Sarney went as far as to explain that Brazil was not adopting "an attitude of confrontation" and promised that domestic austerity measures would be taken in the meantime.[20] Still, the action was disconcerting to bankers and western security officials alike given its political implications. The CIA report on the moratorium expressed a concern that Sarney was "unable or unwilling to fend off intense political pressure from several groups with Brazil—including the left, labor, and some influential members of the ruling coalition—to suspend payments." The CIA did not see cause for immediate concern that the Brazilian move might encourage other debtors to do the same but noted that suspensions by "other key Third World debtors" might occur "if debt rescheduling and new money negotiations break down.[21] Like the Cartagena Consensus and Castro's calls for repudiation which came before it, the mere possibility of more debtor autonomy which Brazil's moratorium posed was enough to engender a change in course on the creditor side of the equation.

In addition to Brazil, Reed and Citibank were also using the reserve build-up to move against calls for debt forgiveness originating stateside. Two of the most prominent voices for forgiveness were Democrat New Jersey Senator Bill Bradley and the liberal economist Jeffrey Sachs. In the summer of 1986, Bradley, in response to the shortcomings of the Baker plan, put forth his own "Bradley Plan" which, in addition for calling for more debtor autonomy, proposed a "three percent write-down and forgiveness on principal on all

[20] Alan Riding, "Brazil to Suspend Interest Payment to Foreign Banks," *New York Times*, February 21. 1987.
[21] Directorate of Intelligence - Central Intelligence Agency, *Brazilian Debt Moratorium: Potential International Financial Repercussions*, February 26, 1987, CIA Freedom of Information Act Electronic Reading Room, accessed February 15, 2024, https://www.cia.gov/readingroom/docs/CIA-RDP90T00114R000100080001-9.pdf

outstanding commercial…and structural adjustment loans for eligible countries."[22] Bradley's stated motivation, in a departure from all previous debt plans, was fighting poverty—not just in debtor countries, but domestically.

In a quintessential Keynesian view of the debt crisis, Bradley stressed how the diversion of capital in Latin America towards debt repayment left debtor countries with less ability to spend on US imports. Less money spent on US imports, as Bradley observed, meant less American jobs: "In fact 400,000 Americans have lost their jobs because the Latin American export market dried up and another 400,000 Americans didn't get jobs because Latin American economies stopped growing." For debtors, Bradley correctly observed, debt payments meant "siphoning off funds that they need to improve their own living standards."[23] While Bradley's understanding of the issue did not take account of the fact that a fair amount of the debt that Latin American countries took on was to continue domestic development precisely to *avoid* relying on US imports, his proposal was radical, and threatening, in that it acknowledged that some of the debt would never be repaid. Speaking on behalf of the banks, Assistant Treasury Secretary David C. Mulford rejected Bradley's proposal precisely because of the loss banks would have to absorb: "Such proposals, by forcing losses on private lenders, would reduce access to private markets [for debtors], including trade finance, for a very long time to come…the very time when…finance will be required to sustain the growth recovery we all desire."[24] While both Bradley and Mulford

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[22] Bill Bradley, "A Plan to Alleviate the Debt Crisis and Save American Jobs," *American Banker*, July 26, 1986, 4.
[23] Ibid.
[24] Mark Sullivan, "Treasury's David Mulford Blasts Bradley Third World Debt Plan," *American Banker*, July 31, 1986, 2.

were paying lip service to the need for growth in debtor countries, Mulford rejected the idea that said growth could be had at the expense of bank earnings.

While the treasury and bank executives lined up in opposition to Bradley's proposal, Jeffrey Sachs was openly supportive, describing the Bradley Plan as "breaking new ground" for offering a program based on "debt forgiveness by the commercial banks rather than debt rescheduling and full interest servicing." Sachs, in a paper published by the Brookings Institution, proposed six additional principles on top of Bradley proposals. The first was centering debt relief in a "new comprehensive strategy of debt management," but the other five were about moderating how and when relief should be offered. In Sachs vision, debt relief would be offered "selectively" keeping with the case-by-case standard the IMF, the Treasury, and the banks had been following, and should be "applied selectively, limiting relief to the country's most in need."[25] Coincidentally, John Williamson, the economist who would later go on to coin the "Washington Consensus," offered commentary on Sachs' proposals in the same paper. Williamson believed that "Sachs is right to argue in favor of selective rather than general debt relief," but that relief should be offered on a selective enough basis to prevent "opening the floodgates so that Brazil and Mexico also qualified."[26]

Even though the Citibank reserve buildup created losses in the banking industry, it was preferable for commercial bankers over the relief options advanced by Bradley and Sachs precisely because it denied debtors outright forgiveness. Even though the increased loss reserves would permit banks to make write-downs on extant debt, that was the last of bankers' motivations. Write offs, moreover, were not the same as forgiveness. As explained

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[25] Jeffrey Sachs and John Williamson, "Managing the LDC Debt Crisis," *Brookings Papers on Economic Activity,* Vol. 1986 no. 2 (1986): 404.
[26] Ibid, 436.

by one Citibanker: “Anytime you start writing off correctly, you immediately begin collecting real (sic) hard. Writing down would never involve forgiveness.”[27] In addition to the benefit of greater leverage in debt negotiations, Citi’s move promised another benefit: a lower tax bill. Because loan losses show up as an expense on a on a profit-and-loss statement, it lowers a banks taxable capital base. From an accounting perspective, the losses Citi accrued in making the loss provisions would be offset by savings through tax-deductions.[28] Setting reserves against Latin American loans, then, was effectively a way to shift some of the burden of the debt crisis onto the government and taxpaying public via the loss in total tax revenue.

Citibank’s potential tax benefit also improved its competitive position over other banks. As acknowledged by the *Wall Street Journal*, this move was “laden with irony” given that, under Walter Wriston, Citi had led other banks into the LDC loan market. Wriston’s notorious quip about countries not going bankrupt, helped to persuade smaller banks to get into the “foreign-lending game.” “Now, after taking over from Mr. Wriston in fall of 1985,” the *Wall Street Journal* observed, “Mr. Reed is leading the way in acknowledging that loans to foreign countries can go very sour indeed.”[29] The smaller, regional banks with less of a capital base simply could not afford to set aside big reserves on LDC loans. The less well-capitalized large banks were hit as well. Bank of America, which had the lowest amount of equity capital out of the 25 largest banks, had to sell off large subsidiaries including notable discount brokerage Charles Schwab.[30]

[27] Lenny Glynn, “Taking the Hit on LDC Debt,” *Institutional Investor*, July 1987, 170.
[28] Julio Escolano, “Tax Treatment of Loan Losses of Banks” in *Systemic Bank Restructuring and Macroeconomic Policy* eds. William E. Alexander et. al. (Washington: International Monetary Fund, 1997,) 146.
[29] “Citicorp Sharply Lifts Loss Reserves, Putting its Rivals on the Spot,” *Wall Street Journal*, May 20, 1987, 23.
[30] See: Gary Hector, *Breaking the Bank: The Decline of Bankamerica* (New York: Little Brown & Co, 1988.)

National Security and The Mexico-Morgan Deal

In the newest phase of the debt crisis, the national security dimension of the problem continued to evolve as well. The case of Mexico in 1987 is especially demonstrative of the intersection between banks' new approach to the debt and the federal government's security priorities. On January 22, 1987, the White House issued National Security Study Directive Number 5-87 (NSSD 5-87), which called for an "interagency review of the situation in Mexico." Like in the early years of the debt crisis, the impetus of the directive was alarm over stability in debtor states. For Mexico in particular, the cause for concern was the approaching end of President Miguel De La Madrid's *sexenio* (the popular term used to refer to the six-year terms of Mexican presidents), which was "rapidly turning" attention towards the question of his successor to take office in September 1988.[31] Whereas the PRI had dominated Mexican politics since the 1920s in a "perfect dictatorship," security officials in the Reagan administration were anxious about the ability of the PRI to handle the discontent that structural adjustment had engendered throughout the Mexican populace.[32]

The Reagan administration felt that "certain practices and policies of the Mexican system impede economic recovery and hazard foreign support." In addition to Mexican ambivalence towards the conflicts in Central America that the US was heavily invested in, the White House saw border issues like "drugs and immigration" as potential "irritant[s]" in the US-Mexico relationship.[33] Ironically, the increases in drug trafficking and undocumented

[31] "National Security Study Directive Number 5-87 (Mexico)," January 22, 1987, *NSSDs Digitized Reference Copies,* Ronald Reagan Presidential Library, accessed January 5, 2024, https://www.reaganlibrary.gov/public/archives/reference/scanned-nssds/nssd5-87.pdf.
[32] On the origins of the term "Perfect Dictatorship" see: Enrique Krauze, "La Dictadura Perfecta," *Letras Libres*, November 12, 2012, https://letraslibres.com/revista-espana/la-dictadura-perfecta/.
[33] "National Security Study Directive Number 5-87."

migration were direct results of the economic deprivation that debt crisis was perpetuating. In response to these issues the directive called for a comprehensive study that would offer policy recommendations on issues like getting the Mexican government to continue cooperating on "economic reform," continuing to "muster support" for Mexico among US banks and the "international financial community," and what to do in case the domination of the PRI seemed "headed towards demise or fundamental change."[34]

Also in early 1987, Norman A. Bailey—a former investment banker and member of the National Security Council in the early years of the debt crisis—proposed measures to address the kinds of concerns laid out in NSDD 5-87. In booklet fittingly titled *The Mexican Time Bomb*, Bailey and his co-author, Richard Cohen, advanced the "Bailey-Cohen Thesis." For Bailey and Cohen, the policies implemented in Mexico were exemplary of a general "misdiagnosis" of the debt problem, on behalf of the Baker plan and the IMF, as "no more than a temporary liquidity shortage." The problem with that approach was that it was centered around extending new loans to maintain payments on existing debt, which amounted to something resembling a Ponzi scheme. What was needed in Bailey and Cohen's view was not just relief in renegotiated terms of existing loans, but also a "reduction in the absolute volume of debt." Mexico, the once "model debtor" that had helped establish the dominance of the case-by-case IMF conditionality based-approach, had begun rejecting the consensus it helped establish.[35]

The same 1986 deal between Mexico, the banks, and the IMF that pushed John Reed to launch the loan-loss reserve buildup, worried Bailey for a similar reason. Whereas Reed was frustrated with how much money in new loans the banks had been pressured to put up,

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[34] Ibid.
[35] Norman A. Bailey and Richard Cohen, *The Mexican Time Bomb* (New York: Priority Press, 1987,) 2-5.

Bailey's concern was the $12 billion price tag of the total aid package that would add to the already overwhelming weight of Mexico's debt burden.[36] The negotiations themselves had been adversarial enough for President De La Madrid to threaten "an indefinite suspension of all debt service payments to commercial banks."[37] A secret visit from Paul Volcker in Mexico City had been enough to back De la Marid off from the default threat, but a rift had emerged within members of his cabinet that led to the ousting of Jesus Silva Herzog. Herzog was seen as too close with foreign creditors by Secretary of Budget and Planning Carlos Salinas (who would go on to the presidency in 1988) and other officials who favored more confrontation with creditors. As representative of the increasing threat of default, the departure of Herzog had a "profound psychological impact on Washington and Wall Street.[38] This growing political turmoil in Mexico scared Bailey and the Reagan Administration alike, as a threat from the model debtor could derail the entire debt strategy.

To head off the growing threat, Bailey and Cohens' remedy to the Mexican situation both endorsed the Bradley Plan's proposal for debt write downs while also proposing market reforms that were very much in line with the coming Washington Consensus. The first two of Bailey and Cohen's six recommended steps were "liberalization and rationalization of the Mexican economy" and "increased development funding to aid the liberalization of the Mexican economy. The liberalization the proposed consisted of liberalizing trade practices, encouraging foreign investment, and cutting back on "overregulation." Bailey and Cohen recognized that "in the absence of other features," these market reforms would be "unacceptable to the Mexican government." To ease the transition, Bailey and Cohen

[36] Ibid, 4.
[37] Jerome Roos, *Why Not Default? The Political Economy of Sovereign Debt* (Princeton: Princeton University Press, 2019,) 159.
[38] Bailey and Cohen, *The Mexican Time Bomb,* 42-43.

recommended increased development funding from the IMF and World Bank (instead of from commercial banks) and export guarantees from the US. On the trade front, perhaps foreshadowing NAFTA, they called for "a halt to any further protectionist measures on the part of the creditors director against the goods of Mexico." In terms of concessions to debtors, Bailey and Cohen offered limiting debt service to a percentage of GDP or GNP or foreign exchange earnings. As to be expected, Cohen and Bailey also recommended regulatory "flexibility" on banks that would allow them to give reductions on interest or principle without having to record any losses. Lastly, in another instance of foreshadowing, this time prefiguring the Brady Plan, Bailey and Cohen recommended the eventual securitization of Mexico's private debts. Securitization would offer banks a way to either limit "profit and asset losses," or access to additional liquidity when needed.[39]

Bailey and Cohens' proposed program is notable for several reasons. First, despite paying lip service to the need for direct debt reductions, the write-downs their plan would enable would be marginal at best. Second, the tempering factor in their actual reduction offer was the needs of commercial banks. In their formulation, regulatory flexibility would have to be granted to ensure that banks could offer some form of write down without taking any actual hits to their earnings. The third, and perhaps most significant reason, is that in their opposition to the austerity imposed on debtors, they recommended the exact other kind of market-based reforms aside from just fiscal restraint and deficit reduction that Williamson would eventually describe as part of the Washington Consensus. Bailey and Cohen's plan reveals how in these later years of the debt crisis, the overall strategy begin to shift away from being based solely on the IMF and banks' insisting on fiscal discipline and larger, more

[39] Ibid, 49-50.

structural reforms came into the picture. Mirroring the irony of Citibank leading commercial banks out of LDC lending, Bailey and Cohen were pushing structural reforms like free trade and deregulation under the guise of offering debtors a path towards debt reduction. At a moment of real uncertainty, when Mexico, the model debtor was threatening potential non-payment on loans, the carrot of debt reduction appeared along with the stick of liberalizing structural reform.

Later that year, such structural reforms would come in Mexico as part of the *Pacto de Solidaridad Económica.* While "Black Monday"—the global stock market crash on October 19, 1987—was bad worldwide, it was worse in Mexico. While in industrialized, creditor countries the market tailspin lasted a few days and falls in equity prices were limited to between 11 and 22 percent, the Mexican crash lasted six weeks while stocks lost 75 percent of their value.[40] In December, in response to the economic fallout, the *Pacto* was signed by representatives from the De La Madrid administration, the largest Mexican labor union, and the Mexican private sector.[41] The agreement contained many elements that would become definitive of the Washington Consensus in coming years. For purposes of trade liberalization, the plan massively devalued the peso by 18 percent, reduced tariffs, and eliminated all "nontariff trade barriers." Through austerity measures including budget cuts and higher prices for government services like utilities, the agreement signaled to creditors a renewed commitment to fiscal discipline. Lastly, to bring inflation under control, wages would be established through periodic negotiations between labor, business, and the government "on the basis of projected inflation." Importantly, this meant wages would be adjusted not on past

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[40] James M. Boughton, *Silent Revolution: The International Monetary Fund, 1979-1989* (Washington D.C.: International Monetary Fund, 2001,) 451.
[41] Sebastian Edwards, *Crisis and Reform in Latin America: From Despair to Hope* (Oxford: Oxford University Press, 1995,) 39.

inflation data, but on future expectations of inflation—which the IMF approved of as a more aggressive anti-inflationary measure.[42] By garnering IMF support through the *Pacto*, Mexico was once again acting as a "model debtor." Compared to similar inflation-fighting measures like the Austral plan in Argentina or the Cruzado plan in Brazil, the Mexican *Pacto* was further reaching in restricting the economy.

At the same time the *Pacto* was being deliberated, in December 1987, J.P. Morgan reached a deal with Mexican officials to exchange $400 million of the bank's loans to the country for $263 million of bonds.[43] The $137 million that Morgan would have to charge against its own loan loss reserves represented the first time one of the large US commercial banks was extending some form of debt forgiveness. In the words of one historian, this Mexico-Morgan deal was a "watershed for the debt strategy." As part of the deal, negotiated with the help of the US Treasury, Mexico offered $20 billion of outstanding loans to more than 500 banks in exchange for discounted bonds. Only 100 banks took Mexico up on the offer and in total $3.67 billion in loans were swapped for $2.56 billion in bonds. The Treasury supported the deal by guaranteeing the principle of the bonds. The reason that the deal was not even larger was due to resistance from other big banks, led by Citibank, that the deal had been negotiated outside of the restructuring committee. Bankers were also concerned that only the principle of the debt was guaranteed by the treasury, while interest payments were not. [44] Given that the deal resulted in a much less of an exchange of loans for bonds than its authors hoped, some bankers lost faith that the debt crisis could be improved through more complicated financing scheme. Still, Mexico was $1.1 billion less in debt, and

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[42] Boughton, *Silent Revolution*, 451.
[43] Peter Truell, "Morgan Swaps Loans for Bonds in Mexico Deal," *New York Times*, March 7th, 1988, 1.
[44] Boughton, *Silent Revolution,* 491.

by moving the market on LDC debt, Lewis Preston at Morgan got his revenge on Reed for the Citi loss reserves.

The limited debt reduction it offered, however, was not the most important feature of the Mexico-Morgan deal. The most significant piece of the deal for shaping the debt strategy to come was the involvement of the Treasury as a guarantor of some of the bonds' value. When Gustavo Petricioli, Silva Herzog's successor as the Mexican finance minister, sent a cable to Mexico's private creditors offering them the new bonds in exchange for the Mexican loans the creditors held, he made sure to stress the US Treasury's guarantee right in the second paragraph. The new bonds as Petricioli described, were "fully secured as to repayment of principal at a stated maturity by a pledge of U.S. Treasury zero-coupon securities" and "meant to be traded in the capital markets."[45] By agreeing to backstop bonds on behalf of the Mexican government—the price of which would be determined by market pressures—the US Treasury was effectively pushing the Mexican state to adjusting governance based on market signals instead of domestic priorities.

Outside of ensuring financial stability, the more direct involvement of the Treasury also served US security interests. Also in December of 1987, the Reagan administration issued a response to the national security study directive on policy towards Mexico. National Security Decision Directive Number 291 (NSDD-291) on US policy towards Mexico assigned different agencies to monitor and prepare reports on each of the areas of concern laid out in the original study directive. In the language of NSDD-291, Mexico's economic health was part of a larger set of concerns over foreign policy goals including political unrest

[45] Cable, Gustavo Petricioli to the Banks Party to Mexico's Public Sector Restructure and New Restructure Agreements and 1983 and 1984 New Money Agreements, "Re: Invitation to Exchange Existing Indebtedness for United Mexican States Collateralized Floating Rate Bonds Due 2008," January 18, 1988, Folder: Fund Relations with Commercial Banks Nov. 1986-1989, Country Files: Mexico/150.1, IMF Archives.

in Central America and the transshipment of narcotics across the southern border. Reagan assigned the Secretary of the Treasury to "devise a long-term strategy for helping Mexico overcome its external debt problems," but clarified that it "should be understood that Mexican efforts to frustrate U.S. policy in Central America" would "affect the U.S. attitude toward such assistance."[46] Greater involvement of the Treasury in the Mexican debt strategy, then, would mean more leverage for the US in getting Mexico to cooperate with American foreign policy interests.

The bigger financial role cut out for the US Treasury in the Mexico-Morgan deal was an important step in solidifying the Washington Consensus. By guaranteeing Mexico's only option for actual debt reduction through bond sales, the Treasury helped ensure Mexico would stay disciplined in pursuing market-friendly policies while also making the Mexican government beholden to upholding US security interests through the threat of ending such financial assistance should the Mexican government waver. This thematic governance by markets, enforced by US security policy, is central to the Washington Consensus and neoliberal politics in general. As Nelson Lichtenstein has shown, in the early 1990s the Clinton administration moved rightward in part because of pressures from the bond market.[47] The Mexico-Morgan deal was therefore part of a greater sea-change in political economy, where governments had to backstop international capital markets and conduct policy at the behest of financial interests. More specifically, the Mexico-Morgan deal provided a model

[46] "National Security Decision Directive Number 291 (U.S. Policy Towards Mexico)," December 16, 1987, *NSDDs Digitized Reference Copies*, Ronald Reagan Presidential Library, accessed January 5, 2024, https://www.reaganlibrary.gov/public/archives/reference/scanned-nsdds/nsdd291.pdf.
[47] See: Nelson Lichtenstein and Judith Stein, *A Fabulous Failure: The Clinton Presidency and the Transformation of American Capitalism* (Princeton: Princeton University Press, 2023.)

for the coming Brady Plan which would pave the way to the exit from the debt crisis for commercial banks.

The Baker Plan Runs Out of Steam

By the time of the 1988 presidential election, it was clear to government officials and bankers alike that the Baker plan had failed to bring any kind of real resolution to the debt crisis into view, and a new approach would be needed. Jim Baker left the treasury in August 1988 to run George Bush Sr.'s campaign. Baker's handpicked successor, Nicholas Brady, ultimately won the appointment despite an internal power struggle between Baker and Secretary of State George Shultz over whose choice would take the post. Baker preferred Brady because he was well-known on Wall Street, having served as the co-president of the investment bank Dillon, Read & Company. In the wake of the 1987 market crash, it seemed especially important that Baker's successor carried no risk of introducing volatility into already fragile financial markets.[48] In the wake of Baker's departure, an opinion piece in the *Washington Post* stressed the need for a replacement to the Baker Plan—especially important given the potential of the debt crisis to become a campaign issue in the upcoming election. The *Post* noted that the only real growth the Baker plan kicked off was "in the size of [debtor] countries' debts." Michael Dukakis, Bush's democratic opponent in the presidential race, had publicly given his support to the Bradley plan and direct forms of debt reduction.[49] If the Republicans were to remain competitive on economic issues, they would have to accept the emerging consensus around debt reduction. But, equally important, it would not be

[48] Julie Johnson, "Baker Resigns to Work for Bush; Brady is Named for Treasury Job," *New York Times,* August 6, 1988, 1, 8.
[49] Hobart Rowen, "Beyond the Baker Plan," *The Washington Post*, September 1, 1988, A23.

safe for the incumbent Republican administration to publicly retreat from one of its key policies in an election year.[50]

One of Brady's first appearances as the new Secretary of the Treasury was at the Annual IMF-World Bank meetings in Berlin held in late September. Perhaps symbolic of the failure of the Baker plan and larger debt approach by that point, between 40,000 and 80,000 people took to the streets in protest of the meetings, with the debt crisis and exploitation of developing countries at the center of their concerns.[51] Michel Camdessus, who had replaced Jacques de Larosière as the head of the IMF in 1987, discussed the need for new forms of debt relief in his opening remarks to the meeting. New "techniques" needed to be found, in Camdessus's words, "not just to provide additional finance, but also to lighten, in a mutually agreeable, market-based way, the relative burden of existing indebtedness."[52] Camdessus and others referenced the Mexico-Morgan deal as a possible model, but did not immediately know how to transform that framework into a larger one that could offer sizable debt reduction without "transferring risk from private lenders to official creditors."[53] Ironically, in the Treasury's underwriting of the Mexico-Morgan bonds, that risk transfer was already taking place. In addition to this government backing, reduction was slowly becoming acceptable to banks because their own levels of risk had been reduced via the large reserves on loan losses, which they were given ample time to set aside thanks to regulatory forbearance.

For his part, Jeffrey Sachs joined in the chorus of critiques of the Baker plan and went one step further to question the efficacy of IMF conditionality strings attached to loans.

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[50] Krugman et. al., "LDC Debt Policy," 700.
[51] "Big Protest at IMF Site," *New York Times*, September 26, 1988, D3.
[52] Quoted in: Boughton, *Silent Revolution,* 492.
[53] Ibid.

Sachs pointed to a significant structural disincentive for developing countries to comply with conditionality stipulations: if successful adoption of reforms just meant transferring more capital back to their lenders, conditionality represented a "high marginal tax on successful adjustment." At this point Sachs was still completely behind the kinds of liberalizing reforms that such loan stipulations would mandate, pointing out that countries "in crisis are often in poor economic shape in large part because of bad policy choices in the past."[54] The problem with conditionality was just one of proper material incentives. To Sachs, focusing on the carrot of debt reduction, instead of the stick of conditionality and surveillance, would give debtor countries a real incentive to reform. By the closing of 1988, then, a general paradigm shift had happened regarding debt reduction. The banks had prepared their balance sheets for it, and economists and politicians could see that non-reduction-based options had been exhausted.

The Baker plan had also exhausted itself in the eyes of security officials. A CIA intelligence assessment, dated December 1988, predicted a series of coming challenges that the international financial community would have to face in the coming year. The crux of the problem, according to the report, was that since 1982 banks had greatly reduced their risk exposure in the debt situation, but that the same improvement had not been extended to debtor countries. While creditors had become "insulated" to major disruptions, debtors continued to "suffer from low economic growth and net outflows of needed capital." The security concern was the same as it had been since the beginning of the crisis—that the economic punishment inflicted on the populations of debtor countries could bring leaders

[54] Jeffrey D. Sachs, "Conditionality, Debt Relief, and the Developing Country Debt Crisis," in *Developing Country Debt and the World Economy*, ed. Jeffrey D. Sachs (Chicago: University Chicago Press, 1989,) 276-277.

into power willing to take a more "hardline" approach to the banks.[55] Carlos Salinas de Gortari had just been elected in Mexico, and was known to security officials to have belonged to the faction of the De La Madrid administration that pushed for more confrontation with the banks.[56] The CIA report concluded, consequently, that debt relief—"in the form of new financing at concessional rates or outright debt reduction"—was the most important concern going forward.[57]

In early 1989, the very instability that officials feared appeared on the streets of Caracas, Venezuela. On February 27, six days of protests and riots began which would ultimately leave more the 3,000 Venezuelans dead in a infamous episode now known as the *Caracazo*.[58] The day the protests erupted almost directly following a government announcement increase in the price of "gas, public transportation and other consumer items."[59] The price raise was part of a larger package which the Venezuelan government had agreed to in order to qualify for a $460 million infusion of new money from the IMF. While the immediate impetus for the protests was this latest round of austerity, Venezuela had long been suffering economically since before the debt crisis. "Since 1980," according to a *Chicago Tribune* reportage piece, "the average person's income had fallen 20 percent."[60] The situation in Venezuela was additionally aggravated by the fact that much of the debt the country had accumulated had financed capital flight instead of productive investment.[61] The

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[55] Directorate of Intelligence-Central Intelligence Agency, *LDC Debt: Current and Emerging Issues*, December 1988, CIA Freedom of Information Act Electronic Reading Room, accessed February 15, 2024, https://www.cia.gov/readingroom/docs/CIA-RDP90T00114R000100080001-9.pdf
[56] Bailey and Cohen, *The Mexican Time Bomb,* 42.
[57] CIA, *LDC Debt*.
[58] Roos, *Why Not Default?*, 163.
[59] Jorge G. Castaneda, "Debt Fever Erupts: Democratic Latin America Can't Sustain Lenders' Terms," *Los Angeles Times*, March 8, 1989.
[60] Stephen Chapman, "Venezuela's Riots: A Grim Omen for Latin America," *Chicago Tribune*, March 5, 1989, 3.
[61] Krugman et. al., "LDC Debt," 701.

Tribune was just one of many press outlets to lay blame for the violence on the IMF. This consternation with the IMF was great enough to provoke public denials from the fund. The IMF, director Camdessus stated, could "never dictate…measures to a sovereign country."[62] In response, in an open letter to Camdessus from Venezuelan president Carlos Andres Perez compared IMF conditionality to giving "medicine to a patient without taking into account his organic conditions."[63]

The Venezuelan case was especially worrying to outside observers, given the country's status as an oil exporter and one of the most affluent Latin American countries. Previous instances of unrest in smaller countries may have been tolerable for security officials, but violence in Venezuela threatened to spill over into states with much larger debt burdens like Brazil and Argentina. The *Tribune*'s coverage of the riots concluded by confirming some of the US foreign policy establishments worst anxieties about the debt problem:

> If our goal is to push democratic countries toward Marxism or military rule, we've hit the perfect formula. If we'd rather foster political and economic progress, we're doing something wrong. Ordinary Latin Americans have endured more than a fair allotment of pain. It's time American bankers had their turn.[64]

The dynamic identified by the *Tribune* and the anxieties of the CIA were one in the same. After nearly six and half years of crisis the banks had been insulated from any impactful economic consequences, and even continued to grow in profitability. Meanwhile, the growth promised to Latin American debtors through the Baker plan had yet to materialize. Something had to give. In a news conference following the riots, President Perez presented

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[62] Quoted in: Boughton, *Silent Revolution*, 517.
[63] George de Lama, "Venezuelan Riots Worry Neighbors: Latin Debt Crisis Gains New Urgency," *Chicago Tribune*, March 5, 1989, 3.
[64] Chapman, "A Grim Omen," 3.

the current situation as a choice between a "new treatment on the foreign debt" or "the destruction of the region's democracies."[65]

By March 1989, with George H.W. Bush's defeat of Michael Dukakis in the 1988 US presidential election behind them, the new administration was ready to head the ample warnings from Latin America and devise an alternative to the Baker plan. While the concern for political stability in debtor countries was a real motivating factor, it was not a new one—the National Security Council and CIA had been cautioning about the risk of pushing too much austerity in Latin America from the very outset of the crisis. The critical difference between 1983 and 1989, was that the commercial banks were no longer on the verge of insolvency. With the benefit of regulatory forbearance, the banks had been afforded plenty of time to build up their balance sheets to be able to withstand some form of write downs to their bad loans. Instead of getting the banks to commit more new money to debtor countries as advertised, the Baker plan had merely financed banks lowering their own exposure.[66] Aside from the diminished risk for global financial collapse, a change in the debt strategy was becoming palatable because structural reforms in debtor countries were also already well underway. State assets had been sold off, trade had been liberalized, and currencies had been devalued. It was not coincidental that it was not until so many years into the crisis that policy makers finally began to come around to debt reduction as a legitimate strategy. Even the debt reduction the Bush administration would soon offer would still be built around the interests of bank balance sheets.

The Brady Plan

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[65] De Lama, "Venezuelan Riots," 3.
[66] Krugman et. al., "LDC Debt," 700.

On March 10, 1989, Treasury secretary Brady rolled out his new debt plan in a speech before a symposium on the debt issue sponsored by Bretton Woods Committee and the Brookings Institution. There were two main points to Brady's plan. First, Brady moved the official preferred policy of the US government to debt reduction instead of economic growth as the Baker plan had stressed. Second, these reduction measures were to be "voluntary" and "market based." As Paul Krugman has noted, these two goals were in contradiction. Bankers could not be expected to join in any "large-scale debt reduction" voluntarily.[67] And the bankers did indeed resist. Of offense to William Rhodes of Citibank, was the fact that Brady's speech made no mention of debt reduction "by governments or the international financial institutions," and instead focused on the banks. Lead by Citibank, consequently, the banks lobbied successfully to ensure that Brady's proposal only called for a twenty percent reduction in debtor countries' outstanding debts to commercial banks.[68]

As for the role of the international financial institutions, Brady called on the IMF and World Bank to allocate a certain portion of their loans to debtor countries towards financing new debt reduction plans. To support the IMF in this goal, Brady indicated the new administration's favorable attitude towards future increases in member countries' fund quotas. In somewhat of a surprise, Brady also called on the IMF to relax its need for strict conditionality before granting new financing to debtor countries. While the banks and debtor states negotiated their new debt reduction packages, Brady did not want the IMF to interfere by cutting off funds before arrangements could be made.[69] This facet of the plan was an important part of the "carrot" offered by the new Brady plan. Whereas the IMF used to

[67] Ibid, 701.
[68] Zweig, *Wriston*, 860.
[69] Boughton, *Invisible Revolution,* 493.

strictly require agreements to be in place with major bank creditors before a country could receive stabilization funding now that requirement was relaxed.[70]

While Brady may have called on the IMF to be less strict in its conditionality enforcement, the Brady plan was by no means a retreat from structural adjustment. In his speech announcing the new plan, Brady emphasized that "there is no substitute for sound policies." One of his main motivations with the new plan was to reverse the trend of capital flight from debtor nations. While debt reduction was one tool to attract capital back to debtor countries, the countries would have to maintain the kind of market-friendly policies that holders of capital preferred. Importantly, the Brady plan also upheld the case-by-case approach. Each debtor country would have to make its own case for reduction and negotiate its own deals with the banks and international financial institutions.[71]

Despite these significant carryovers from early iterations of the debt strategy, the Brady plan drew criticism from observers in the US. Despite their successful lobbying which ensured a milder plan, executives at Citibank were still wary of the Brady plan as a slippery slope towards debt forgiveness. "Debt forgiveness is a word you'll never hear," Citi chairman John Reed declared to a meeting with shareholders in wake of the plan's rollout.[72] While the former Fed chair Paul Volcker acknowledged that debt reduction was "indeed a recognition of reality" by 1989, he still worried that "countries that still had adequate means to pay" might demand more debt reduction that they deserved.[73] Martin Feldstein, the former deficit hawk chair of Reagan's Council of Economic Advisors who left in 1984, given his

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[70] William Cline, *International Debt Reexamined* (Washington DC: Institute for International Economics, 1995,) 219.
[71] U.S. Library of Congress, Congressional Research Service, *The "Brady" Plan and the Third World Debt Problem* by Patricia A. Wertman, 89-425 E, 1989, 3-4.
[72] Zweig, *Wriston*, 861.
[73] Paul Volcker & Toyoo Gyohten, *Changing Fortunes: The World's Money and the Threat to American Leadership* (New York: Times Books, 1992,) 217.

disappointment with the administrations spending habits, took issue with the potential cost that Brady's plan would impose on American tax payers. Feldstein worried that Treasury-backed reduction schemes would only further incentivize banks to discontinue all lending to debtor countries, thereby prohibiting the kind of economic growth needed in debtor states to fully work off the debt.[74]

Jeffrey Sachs, on the other hand, welcomed the Brady plan as "a welcome shift." Sachs was concerned, however, over the voluntary nature of the Brady plan. While the plan offered private holders of LDC debt multiple avenues through which to reduce debt obligations, Sachs noted that banks could still "decide to hold on to the existing debt…in the belief that they will be repaid eventually." While banks had already in essence forgave some debt through write-offs and loss reserves, the still considerable claims they held against indebted countries could prove problematic. As Sachs summarized the lingering problem was encapsulated in the "continuing debate over who will determine the allocation of burdens among the banks, the debtors, the international institutions and national governments."[75]

While Sachs and the other critics of the Brady plan had completely different reasons for their concerns, it is notable that they all shared some degree of concern over the behavior of the banks. Volcker was worried that the Brady plan might incentivize countries to skip out on their obligations to commercial banks, and Feldstein was worried that this dynamic would discourage banks from continued lending all together. For Sachs the problem was a lack of anyway to guarantee banks' meaningful participation in the kinds of debt reduction that the plan offered. For each of the plan's critics, problems seemed to stem from the voluntary and market-based nature of the plan that Brady stressed. How the banks chose to respond to the

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[74] Martin Feldstein, "A Wrong Turn in LDC Debt Management," *Wall Street Journal*, March 15, 1989.
[75] Jeffrey Sachs, "Making the Brady Plan Work," 88.

plan was completely up to the banks, and therefore there was no way to ensure who the outcome would be favorable for.

In their judgment of the situation, the CIA emphasized the problematic variable of banks' willingness to participate in debt reduction. In a report of "key judgments" from the director of the CIA on the debt situation circulated throughout Bush cabinet members, the CIA forecasted "difficult negotiations" to follow from the announcement of the Brady plan. "We are concerned by the wide gap," the report said, "between the expectations of Latin countries for debt reduction and new money and the willingness of commercial banks to provide them." This gap was especially concerning given the lack of "political stability" in debtor countries like Argentina and Brazil which would hinder their ability to undertake the necessary reforms to be eligible for debt reduction under the Brady plan. While countries like Mexico could be expected to continue the path of economic restructuring, the CIA worried that model debtors like Mexico receiving debt reduction packages not made available to other debtors could incentivize "coordinated" suspension of payments among other debtors.[76] The CIA's concerns over possible retaliation from debtors to uneven debt concessions reveals that even at the final stage of the debt crisis, the specter of debtor cooperation was still present enough to constitute a security threat to US interests. Importantly, it was the potential behavior of the banks, and not just debtor governments, that was cause for concern for the CIA.

In keeping with the "model debtor" trend, Mexico and its bank advisory committee came to the first post-Brady debt agreement in July 1989. The deal came only after four

[76] Director of Central Intelligence-Central Intelligence Agency, *Latin America's Prospects for Managing its International Debt: National Intelligence Estimate, Key Judgments*, CIA Freedom of Information Act Electronic Reading Room, accessed February 15, 2024, https://www.cia.gov/readingroom/docs/CIA-RDP90T00114R000100080001-9.pdf

months of "acrimonious negotiations" over how much the debt would ultimately be reduced. Initially the Mexican delegation wanted a 55 percent decrease of extant debt, while the banks only offered 15. Initially, the IMF was sympathetic to the Mexican position and went so far as to "scold the banks for offering less," according to the economist William Cline. The basis of the Mexican and IMF point of view was that 55 percent was equal roughly to the discount that Mexican debt was trading on in secondary markets. In keeping with market logic, the IMF saw the Mexican position as justified.[77] The compromise reached in the final deal offered Mexico a 35 percent reduction on the $48.5 billion of eligible long-term bank debt. The deal reached reflected the "menu of options" approach that had been developing throughout the latter half of the debt crisis, whereby Mexico was given several financing options in either reducing or paying off their debt. The options included exchanging existing loans with bonds worth the 35 percent reduction on their principal debt but carrying "market-related" interest rates, or bonds that maintained 100 percent of the principle with a significantly reduced interest rate. If neither of those conversion schemes worked, a third option provided for 15-year loans of new money equal to 25 percent of the $48.5 billion which would maintain the full value of the debt but in effect provide Mexico with discounted new money to pay off the old debts.[78]

Just like the Mexico-Morgan deal, a significant piece of the first Brady plan agreement was the backstopping of the new bonds by the US Treasury. These new debt instruments were coined "Brady Bonds" by the press and served as an attractive investment for, in the words of the *Washington Post,* "risk-takers." While the bonds themselves received a "double-B" rating from the US credit rating agencies, they were collateralized by "double

[77] Cline, *International Debt,* 220-221.
[78] Zweig, *Wriston*, 861.

A- or better rated securities." Mexico had earned the relatively good credit rating given its decade of diligent adherence to its previous financial agreements, the continued economic reform program under President Salinas, and anticipation of a coming free-trade agreement with the United States. As of the *Washington Post* article in December 1990, the $1,000 bonds were trading at $430, meaning an ultimate yield-to-maturity of 14.86 percent—a healthy return for investors. "As a sovereign country, Mexico has unique policy resources" the *Post* elaborated, "to offset financial shocks that corporations do not have."[79]

The *Post*'s advertising of Brady Bonds as carrying little downside risk because of sovereign countries ability to guarantee payment sounded suspiciously close to Walter Wriston's infamous 1982 quip that there was little reason to worry about bank over-lending to developing countries because "countries don't go bankrupt."[80] After a near decade of crisis, precipitated precisely because of just how close countries in Latin America did indeed come to going bankrupt, the selling pitch for Latin American debt had not changed. What had changed, and changed dramatically, was the political-economic landscape in the debtor countries. By the time of the Brady plan, as observed by Miguel Angel Centeno, Mexico had since 1982 been sending approximately $10 billion to creditor banks while also "receiving practically no new investment capital" and "simultaneously increasing its external debt by close to 50 percent."[81] The cost of the favorable credit rating on the Brady Bonds, and the modest debt reduction Mexico received, were these years of extracting capital from the country to send to the global north.

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[79] James E. Lebherz, "For Risk-Takers, Mexican 'Brady Bonds,'" *The Washington Post*, December 9, 1990, H11.
[80] Walter B. Wriston, "Banking Against Disaster," *New York Times,* September 14, 1982.
[81] Miguel Ángel Centeno, *Democracy Within Reason: Technocratic Revolution in Mexico* (University Park: Pennsylvania State University Press, 1994,) 198.

On February 4, 1990, Mexico's fortified commitment to its creditors and Brady Bond investors was symbolized by the bankers singing the accord that had been negotiated the year prior. In an "elaborate ceremony" held in Mexico City, as recounted by Philip Zweig, President Salinas "promised to 'double' Mexico's fiscal discipline." In his speech, Secretary Brady declared Mexico to be "a beacon of hope for other debtor nations."[82] In the next few years, Mexico would indeed reap some benefits of its enhanced credit rating—inflation fell, the public sector stopped running deficits, and external debt fell dramatically in relation to GDP.[83] In the same period, similar debt reduction agreements would be reached in Venezuela, Brazil, and Argentina with each country receiving equally modest debt reductions to the Mexican agreement at about 35 percent.[84]

In Argentina's case, getting to the eventual reduction agreement was an arduous process. In 1989, Carlos Menem replaced Raul Alfonsín as the Argentinian president and almost immediately embarked on a rigorous privatization program. Under Menem, the Argentine legislature quickly passed a series of laws to facilitate a radical restructuring of the state and Argentinian economy. As described by Claudia Kedar, the new policies not only "paved the way for approximately 350 decrees related to privatization, deregulation, appointment of judges, and the right to strike," but also "led to an unprecedented concentration of power in the executive."[85] Despite protests from workers, Menem's privatization and deregulation campaign went far enough for foreign investors to "overlook official corruption" and buy up liquidated public companies. Even the Buenos Aires Zoo was

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[82] Zweig, *Wriston*, 862.
[83] Boughton, *Silent Revolution*, 515.
[84] Cline, *International Debt*, 234-235.
[85] Claudia Kedar, *The International Monetary Fund and Latin America: The Argentine Puzzle in Context* (Philadelphia: Temple University Press, 2013,) 166-168.

sold off. Similarly, Brazil only reached their own debt reduction agreement after a "draconian" anti-inflation and austerity campaign run by a new presidential administration also mired in accusations of corruption. [86] Just months after completing reduction negotiations with the banks, Brazilian president Fernando Collor de Mello was forced into resignation by an impeachment effort—only after blocking the entire budgets of the Ministries of Education, Health, Labor, and Social Development.[87]

Both the concentration of presidential power in Argentina and political corruption in Brazil continued a larger theme: across Latin American debtor countries, governments were being restructured so as to be more responsive to the interests of foreign creditors than the dictates of the electorates in their home countries. Despite assurances from the bankers and creditor country officials on the compatibility of free markets and democracy, the cost of free market reforms repeatedly came to be the thwarting of democratic pressure. Getting both Argentina and Brazil into Brady plan debt reductions through market liberalization policies required de-liberalizing the political sphere. The kinds of reforms needed to satisfy creditors enough to finally grant meaningful debt reduction could not have been done with democratic consent. In Argentina, this problem was dealt with by concentrating more power in the executive branch to pass sweeping privatization and deregulation policies. In Brazil the adjustment policies were instituted through corruption and enough malfeasance to warrant impeachment.

By the time Bill Clinton replaced George H.W. Bush as US president in early 1993, with debt reduction agreements in place for the largest Latin American debtors, the Latin American debt crisis—at least from the perspective of the banks—was over. In August 1992,

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[86] Zweig, *Wriston*, 863.
[87] Baer, *The Brazilian Economy*, 118-119.

when the Argentinean debt reduction agreement was signed, Citibanker William Rhodes said that "with this agreement, we are looking at the end of the debt crisis."[88] Nearly a year earlier, *Forbes* magazine declared the end of the debt crisis, going so far as absolve Walter Wriston for his role in instigating the crisis. "Walter Wriston wasn't so dumb," *Forbes* said, "to suggest that sovereign nations don't go bankrupt." Years of painful adjustment and political unrest in debtor countries was summarized in the article as "years of nasty surprises" from "insolvent debtor governments" that had finally given way to "sounder policies."[89]

Conclusion

It was in November 1989, eight months after the initial presentation of the Brady plan, that John Williamson first gave his paper coining the term "Washington Consensus" at a conference held by the liberal, pro-free trade Washington D.C, think tank the Institute for International Economics. [90] Born in England during the Great Depression, Williamson first studied economics under Lionel Robinson at the London School of Economics before moving on to Princeton for graduate study, earning his PhD in 1963.[91] Before joining the Institute for International Economics in 1981, Williamson had worked as a staff economist for the IMF since 1968. Prior to achieving notoriety for the Washington Consensus, Williamson was known for his specialization on exchange rates and advocacy for a middle ground between the fixed rates which were predominant in the Bretton Woods era, and the

[88] Zweig, *Wriston*, 863.
[89] Laura Jereski, "Good News at Last," *Forbes*, October 28, 1991.
[90] The Institute for International Economics now operates as the Peterson Institute for International Economics. On the Peterson Institute and globalization see: Steve Rattner, "What's our Duty to the People Globalization Leaves Behind?" *New York Times*, January 26th, 2016.
[91] Kurt Schuler et. al., "The Washington Consensus in History: An Interview with John Williamson," *Center for Financial Stability Papers in Financial History*, January 30, 2020, 3-7.

floating rates which had been the cause of so much economic pain for debtors throughout the 1980s crisis.[92]

The conference, entitled “Latin American Adjustment: How Much Has Happened?”, was attended by a healthy mix of Western and Latin American economists, bankers, government officials, and journalists. Many in attendance, such as former Reagan security advisor Norman A. Bailey and economist William R. Cline, had been regularly commenting on the crisis throughout the 1980s. In his paper “What Washington Means by Policy Reform,” Williamson laid out ten economic policy targets which he thought could be used as a rubric to measure “the extent to which various countries have implemented the reforms being urged on them.” The “Washington” in “Washington Consensus” for Williamson included not just the various governmental and official agencies headquartered in D.C. that negotiated directly with debtor countries, but also the network of think tanks from whose research those agencies drew. In the paper, Williamson stressed that the tenets of the Washington Consensus were “policy instruments” and not “objectives or outcomes” in their own right. Rather, Williamson thought that such instruments were determined by a shared goal of “growth, low inflation, a viable balance of payments, and an equitable distribution of income.” Adding to this, Williamson saw his ten points as reflecting a broader consensus in Washington around political goals in Latin America including “the promotion of democracy and human rights, suppression of the drug trade, preservation of the environment, and control of population growth.[93]

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[92] Clay Risen, “John Williamson, 83, Dies; Economist Defined the ‘Washington Consensus,’” *The New York Times,* April 15, 2021, https://www.nytimes.com/2021/04/15/business/economy/john-williamson-dead.html.
[93] John Williamson, ed., *Latin American Adjustment: How Much Has Happened?* (Washington D.C.: Institute for International Economics, 1990,) 7-8.

Tellingly, the first two of the ten points as presented by Williamson were "fiscal discipline" and "public expenditure priorities."[94] Intentional or not, leading with fiscal discipline reflected the fact that imposing austerity measures was the immediate response of the Washington Consensus institutions when the crisis first emerged in 1982. Before any of the other policy instruments like privatization or tax reform worked their way into conditionality agreements, the IMF and the banks wanted strict deficit reduction targets. The immediate effect of these stipulations was cuts to public spending measures like industrial development and social welfare programs. In other words, all the other Washington Consensus policy targets were downstream from austerity. In his concluding remarks Williamson seemed to attest to this crude material basis behind the consensus policies by reflecting that instead of growing out from the cutting edge of development economics, the Washington Consensus measures all seemed to stem from "classical economic theory, at least if one is allowed to count Keynes as a classic by now." "This raises the question," Williamson continued, "as to whether Washington is correct in its implicit dismissal of the development literature as a diversion from the harsh realities of the dismal science?"[95]

While in his later years Williamson labored to dissociate his definition of the Washington Consensus from those "harsh realities," his original presentation of the Washington Consensus in 1989 reveals an at least implicit knowledge of the social unrest, widening inequality, and economic turbulence that the consensus policy agenda has wrought.[96] Even in his critique of the later ideas about the consensus, Williamson conceded

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[94] Ibid, 8, 10.
[95] Ibid, 19-20.
[96] On Williamson's disavowal of later use of the term "Washington Consensus," see: John Williamson, "The Strange History of the Washington Consensus," *Journal of Post Keynesian Economics* 27, no. 2 (2004): 195-206.

that the original list “emphasized that policy was changing away from what had long been regarded as orthodox in developing countries—inflation tolerance, import substituting industrialization, and leading role for the state—toward what had long been orthodox in OECD countries—macroeconomic discipline, outward orientation, and the market economy.” By 1989 many, many Latin American nations were, in Williamson’s view, still plagued by “inefficient” state-owned enterprises and “repressive state regulation of private businesses.”[97] As the history of the Latin American debt crisis demonstrates, however, the dismantling of “repressive” restriction on the private sector has yet to produce the kind of growth and prosperity delivered by the earlier political economic model.

What is conspicuously absent from Williamson’s original paper, moreover, is the role of Western commercial banks in encouraging the older state-led model in Latin America throughout the 1960s and 1970s by the generous funding offered by aggressively marketed loans. While Williamson’s description of the Washington Consensus, both in 1989 and later, was couched in a sort of market naturalism, the “inefficiency” which consensus policies sought to displace was itself, in part, a product of the vagaries of Western financial markets. When those markets soured, and debt payments finally became too much, debtor governments were coerced into structural adjustment to become compatible with neoliberal political economy. The timing of Williamson’s proclamation of a consensus in the wake of the transition towards debt reduction was not merely coincidental. Rather, the purpose of the Brady Plan, intentional or not, was to preserve neoliberalized Latin American political regimes by finally offering debt relief to governments that fully conformed with the dictates of the Washington Consensus.

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[97] Ibid, 197.

CONCLUSION

FROM CONSENSUS TO CRISIS

Nearly five years after the end of the debt crisis, the IMF Secretary's department published a twenty-three-page long defense of the Fund's role in Latin America throughout the 1980s. Authored by the IMF's in-house historian, James Boughton, the paper argued against the errant "conventional wisdom" that the IMF "tended to act on behalf of creditors and industrial countries more than those of indebted developing countries." Boughton identified seven different areas of criticism which he felt were overblown or not based in the actual data from the crisis. Among these criticisms, Boughton included two that stand out among the rest: One, that the IMF acted throughout the crisis as the "handmaiden of the commercial banks," and two, that the IMF "imposed inappropriate 'Washington consensus' conditions." In response to the critique of the Fund's relationship with commercial banks, Boughton did not bother to deny that the "Fund helped the banks." Without continual infusions of new money from the IMF and commercial banks throughout the crisis, debtor countries would have "little choice but to default" which may have left debtors better off in the long run than continuing loan payments. But, as Boughton responded, this would have dropped the value of overexposed banks' assets to the point of precipitating a possible "collapse of the international banking system."[1] Boughton was not alone in this rationale, the chair of the FDIC gave the same explanation for going easy on the banks in the early debt crisis.[2]

[1] James Boughton, "The IMF and the Latin American Debt Crisis: Seven Common Criticisms," *IMF Policy Discussion Papers* 23 (October 1994:) 1-26, 6.
[2] L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993,) 127.

Conceding the IMF acted on behalf of the banks, Boughton's rebuttal was that helping the banks equated to helping the debtors, given what he saw as their "mutuality of interests." By ensuring that debtor countries did not go into default, the IMF guaranteed those countries' continued access to international capital markets. The value of maintaining that access, Boughton argued, was greater than the "real economic and political cost of adjustment" that loan stipulations mandated.[3] As the history of the debt crisis reveals, however, access to private capital markets was less of a benefit creditor authorities bestowed upon debtors than a threat wielded to ensure cooperation. As security officials readily admitted throughout the crisis, financial isolation was the planned response to debtor resistance or any actions that would threaten the case-by-case basis that the IMF, banks, and US government preferred to conduct debt negotiations. In the 1980s, moreover, the primary reason that debtors required access to private credit markets was for access to financing used to make payments on older debts contracted throughout the 1970s and 1960s. As this dissertation has shown, threats of financial isolation could only carry weight because of this dependence on bank loans which emerged out of the vacuum left by dwindling official government-to-government aid programs in the 1960s.

On the charge of inappropriate imposition of Washington Consensus conditions, Boughton again does not bother to refute that the IMF's conditionality programs were built upon an insistence on "market-oriented policies, low fiscal deficits, and limits on the growth of domestic credit financed by the monetary authorities." Instead, the question for Boughton is whether the IMF imposed such conditions too "rigidly" and "in cases where they are not strictly appropriate." In response Boughton contends that "the IMF showed a degree of

[3] Boughton, "Seven Common Criticisms," 6.

flexibility throughout the decade," citing the contingency clauses inserted into the Mexican agreement of 1986 and the Fund's endorsement of Argentina's heterodox Austral program in 1985 as examples. Boughton also explains that Latin American leadership were on board with Washington Consensus market reforms as a "silent revolution" over the course of the decade decreased "the belief in state-dominated economic development and in the need for capital controls."[4] The revolution in Latin American governance, however, was anything but silent. Whether through popular protest on the streets of Caracas and Santo Domingo, or in the vision for a more shared burden of adjustment put forth by the authors of the Cartagena Consensus, the Washington Consensus was regularly contested throughout its formative years. Despite this regular contestation, the structural dependence on foreign capital was strong enough to give creditors the leverage they needed to maintain the case-by-case approach while a new generation of political leadership in major debtor states, more amenable to Washington Consensus policy mandates, came into power.

As evidence that problems with debt crisis policy reforms may have had more to do with debtor country politics than problem inherent to the policy reforms themselves, Boughton cites Mexico as one debtor country which had "laid the basis for more balanced growth over the longer run"—continuing the "model debtor" rhetoric so common throughout the crisis years.[5] Even in the model debtor country, the social costs of adjustment had been enormous: Over the course of the decade approximately 400,000 Mexican jobs disappeared while the labor force grew by 8 million.[6] After 1982, the Mexican economy experienced six consecutive years of zero growth, which had decreased social stratification in Mexico only so

[4] Ibid, 16-18.
[5] Ibid, 7.
[6] Miguel Ángel Centeno, *Democracy Within Reason: Technocratic Revolution in Mexico* (University Park, Pennsylvania: Penn State Press, 1994,) 202.

far as Mexicans became "more equal in their poverty."[7] In the same time period, the number of families with an income less than two minimum wages increased from 40 to 60 percent, while the minimum wage itself for more than 40 percent in real terms. When President Carlos Salinas de Gortari took office in 1988, the real minimum wage would have had to double by the end of his administration in 1994 just to catch up to 1982 levels.[8]

While moderate economic growth did return under Salinas's administration, shortly after his leaving office and just two months after the IMF published its defense of Latin American debt policy, financial crisis returned to Mexico. On December 20, 1994, Mexican authorities devalued the peso and promptly lost $5 billion in foreign reserves. In the ensuing panic Mexican officials let the peso exchange rate freely float, and with the value of the peso in a freefall, international financiers were once again worried about the threat of a Mexican default. Just ten days early, US president Bill Clinton had singled out Mexico as a model of economic progress and political reform in Latin America at a conference in Miami.[9] In a combined $50 billion bailout from the US Treasury, IMF, and Bank for International Settlements, Mexico and world financial markets were pulled from the edge of an "economic apocalypse"—as then-Treasury official Larry Summers called it. Still, the peso crisis triggered a deep recession in which unemployment doubled.[10]

Mexico's 1994 crisis was only the first of several financial panics that the IMF would intervene in throughout the rest of the 1990s. In 1997, countries across Southeast and East Asia, faced similar rapid devaluations and deteriorations of foreign exchange which

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[7] Quoted in: Hector Aguilar Camín, *In the Shadow of the Mexican Revolution: Contemporary Mexican History, 1910-1989* (Austin: University of Texas Press, 1993,) 228.
[8] Ibid, 228-229, 244.
[9] Sebastian Edwards, *Crisis and Reform: From Despair to Hope* (Oxford: Oxford University Press, 1995,) 296-297.
[10] Nelson Lichtenstein and Judith Stein, *A Fabulous Failure: The Clinton Presidency and the Transformation of American Capitalism* (Princeton: Princeton University Press, 2023,) 368, 373, 375.

compromised their abilities to meet debt obligations. Again, like 1982, the crisis was preceded by a buildup of debt across the region fueled by "euphoric lenders in developed countries keen on diversifying their portfolios."[11] After a period of rapid growth in the early 1990s described by the World Bank as the "East Asian Miracle," countries like Thailand, Indonesia, and South Korea became dependent on the inflow of foreign capital, which made them vulnerable to any shock that might drive down their respective currencies. When such a shock came, each country went to the IMF for rescue loans and faced typical Washington Consensus conditionality stipulations. Just a year later, in 1998, the Russian ruble collapsed. Infamously, a large portion of rescue money from the Washington Consensus institutions was stolen by oligarchs taking advantage of the post-cold war chaos of the Russian economy. This time, however, US finance did not escape entirely unscathed, with the collapse of the US hedge fund Long-Term Capital Management (LTCM) being tied to fluctuation in world interest rates ignited by the Russian financial crisis. To keep the chaos from engulfing the US banking system, US financial giants like Chase Manhattan and Goldman Sachs came together with a $3.65 billion deal to take over LTCM.[12]

Perhaps the most infamous, post-Washington Consensus financial crisis was the one that roiled Argentina throughout a period of economic depression lasting from 1998 to 2002, largely blamed on the failure of Washington Consensus policies.[13] When the Argentinian peso collapsed in 2001, despite multiple IMF standby agreements preceding it, an effort by the government to head off a country-wide bank run by closing the banks and limiting

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[11] Robert Z. Aliber and Charles P. Kindleberger, *Manias, Panics, and Crashes: A History of Finanical Crises,* 7th ed. (New York: Palgrave McMillan, 2015,) 307.
[12] See: Ibid, 12, 307-308; Lichtenstein and Stein, *Fabulous Failure*, 383, 390-397.
[13] See Michael Mussa, *Argentina and the Fund: From Triumph to Tragedy* (Washington D.C.: Institute for International Economics, 2002.)

withdrawals backfired by pushing a populace already economically exhausted by years of recession and high unemployment beyond their breaking point. Through December 2001, in an event known as the *Argentinazo*, protest and riots in the streets of Buenos Aires left twenty-five people dead, hundreds wounded, and pushed the Argentine president into resignation. In acts of resistance, unemployed workers occupied factories and created experiments in non-hierarchal economic democracy in a movement known as *Horizontalidad,* or horizontalism.[14] At the political level, President Néstor Kirchner, after taking office in 2003 pursued an agenda of detachment from the IMF, relying on a domestic policy program attacking unemployment and poverty. Given the Kirchner's success and support from a broad anti-IMF coalition, in September 2003 the IMF broke with precedent and made a $12.5 billion emergency loan with no conditionality stipulations and without first consulting with commercial banks.[15]

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The point in summarizing these numerous post-Washington Consensus crises is to illustrate how what happened in Latin America over the 1980s and the decades prior sent ripples across the world. If the purpose of the Washington Consensus was to rehabilitate developing economies to make them compatible with a globalized marketplace, to prevent future crises, it's not so clear that that goal was accomplished. Even in the supposed success stories from the 1980s crisis like Mexico, financial crisis remained endemic and a return to

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[14] See: Maria Sitrin, *Everyday Revolution: Horizontalism and Autonomy in Argentina* (London: Zed Books, 2012.)
[15] Claudia Kedar, *The International Monetary Fund and Latin America* (Philadelphia: Temple University Press, 2013,) 174-181.

the kind of robust economic development which characterized the immediate postwar decades never materialized. In 2009 at G20 summit held in London, then-British Prime Minister Gordon Brown declared that the Washington Consensus was "dead." Shortly after, in an interview with John Williamson the *Washington Post* asked if Brown was right. In response, Williamson emphasized the point that he has continually tried to make that what people call the Washington Consensus is not what Williamson meant by the term: "It depends on what one means by the Washington Consensus. "If one means the ten points that I tried to outline, then clearly, it's not right. If one uses the interpretation…that it is a neoliberal tract, then I think it is right." Outside of his original ten policy points, Williamson went on to summarize his idea of the consensus as a program to enable countries to "absorb" themselves "into the global economy," and reject the notion that the Washington Consensus could be responsible for the 2007-2008 global financial crisis.[16]

The history of US banks during the Latin American debt crisis, however, suggests that 2008 could not have played out as it did without the precedents set during the formative years of the Washington Consensus. While Williamson is correct in pointing out how malleable and ambiguous the term "Washington Consensus" can be, the common denominator across the various definitions is that creditor interests are privileged over that of debtors. Each of the major points in Williamson's policy description emerged as conditions debtor states had to undertake either to be permitted access to new credits or to be able to payments on old ones. As the experiences of the recurrent crises in Mexico and Argentina in the 1990s and early 2000s attest, Washington Consensus policies failed to create sustainable, stable economic development in debtor countries. What Washington Consensus policies did

[16] "Outspoken: A Conversation with John Williamson, Economist," *The Washington Post*, April 12, 2009, B2.

succeed in, however, was preventing a collapse in the international banking system and thereby protecting creditor countries from the kind of economic chaos that would ensue should the large money-center banks at the heart of the US economy become insolvent. If the Washington Consensus is, or was, anything, it is the playbook adopted by policymakers in 1982—the stakes were too high to not go easy on the banks.

But what history has shown is that the idea that banks and creditors could be meaningfully isolated from the consequences of over-lending, from building up debt exposures exceeding their total capital, is a fantasy. It is a fantasy because the house of cards that bank balance sheets became leading up to the 1982 crisis only grew more precarious in the crisis' aftermath. With the conclusion of the Latin American debt crisis arriving through securitizing the remaining problem debts on commercial banks books' into "Brady bonds," banks learned that non-performing risky loans could be sold off in new debt instruments and therefore not compromise bank earnings. And so, banks continued to make risky loans—in Asia and Russia in the 1990s and then eventually at home in the US, through mortgages that were then securitized into Collateralized Debt Obligations (CDOs). Just like the 1970s, in the years leading up to 2008, the buildup of debt across the economy was big business for commercial banks. The business of debt was so much wider reaching then that the US financial sector could not be spared from the consequences. The main concern of policymakers responding to the 1982 crisis was the possibility for the debt crisis to spiral into an economic disaster on the scale of the Great Depression. While such a disaster was postponed for nearly two decades, eventually the chickens came home to roost. Like in 1982, policymakers acted quickly to protect the banks, but in 2008 it was the populations of the US

and other creditor countries that had to experience the kind unemployment and desperation that Latin Americans lived with the during their lost decade.

If anything is to be learned from the history of the Washington Consensus, it is that the economic burden generated by the fragility of our financialized world economy cannot be pushed on debtors' shoulder continuously and without consequences for creditors. In the 1930s decades of speculation and over-lending brought upon the US and world a wave of bank failures and economic devastation, and in the 2008 it happened again. In the 1930s, however, policymakers responded by tightly regulating the banking sector to limit the amount of risk that could be spread throughout the wider economy. Consequently, the immediate postwar decades saw growth and shrinking inequality in the US and other industrialized countries, and economic "miracles" of rapid growth in places like Mexico and the developing world. Then, in the 1960s, commercial banks found a way to evade regulatory restrictions through vehicles like the Eurodollar market. In the 1970s, in a world beset by oil shocks and economic stagnation, banks seized the opportunity to patch over the global maldistribution of wealth through expansive lending. Contemporary observers saw that the buildup of debt was becoming untenable, but ultimately failed to take meaningful action to create a regulatory framework to moderate the levels of risk developing in the financial sector. The subsequent financial crises were not inevitable, but rather were facilitated through a series of conscious policy choices.

It is important to note that the choices made leading up to and during the debt crisis were regularly contested. The policies that pushed the burden of adjustment onto debtor countries in the 1980s were not the work of some shadowy cabal of elites conspiring to extract as much money out of debtor countries as possible. In popular discourse, the phrase

“international bankers” often conjures up problematic conspiratorial ideas about financial elites pulling the strings of the world economy. The history of commercial banks and the Washington Consensus proves that the reality is much more mundane. Commercial bank executives, central bankers, IMF officials, and members of US Senate Banking Committee were not a unified bloc that imposed a lost decade on Latin America by design. Rather, they were separate parties themselves divided on how to pursue their respective interests. Faced with a global economic catastrophe, they chose the easiest path of going easy on the banks for the sake of keeping the debt crisis and social unrest from spilling beyond the borders of debtor countries. What the history reveals is that the unique challenges posed by the financialized economy cannot be solved easily. The burden of adjustment is a global problem, and therefore that burden must between shared creditors and debtors, between the Global North and Global South, and between the haves and have-nots. In 2023 global debt reached a record high of $313 trillion.[17] Time will tell if world political leaders will heed the lessons of the Washington Consensus era should this current debt spawn a new crisis.

[17] Jorgelina Do Rosario, “Global Debt Hits New Record High: $313 Trillion,” *Reuters*, February 21, 2024, https://www.reuters.com/business/global-debt-hits-new-record-high-313-trillion-iif-2024-02-21/.

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