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Containing the Crisis, 1983–85

When the debt crisis hit in 1982, the IMF worked alongside the authorities of major creditor and debtor countries, together with the leading commercial banks, to avert a possibly epic financial catastrophe. As recounted in the preceding chapters, the initial containment of the crisis was achieved through a combination of actions designed to prevent a collapse of the international banking system, assist countries in correcting macroeconomic policies to restore financial and economic viability, and thereby lay the foundation for sustainable economic growth and a restoration of normal financial relationships.

In a few cases, notably Chile, the crisis was thus largely passed. In others, however, the imbalances were so severe that several more years would be required to correct them. These cases included the three largest countries in Latin America: Mexico, Brazil, and Argentina. Until those three economies could recover, the debt crisis would continue to pose a systemic threat. This chapter details the struggles undertaken to keep that threat at bay during the first three years.

Mexico

Without doubt, Mexico was an early success case. By March 1983, the EFF-supported adjustment program was on track, the balance of payments was strengthening, and bank financing had been regularized through the signing of a concerted-lending agreement with over 500 banks (see Chapter 7). Barring further disasters, Finance Minister Jesus Silva Herzog and his team had bought enough time and had obtained enough outside support to bring the economy back from the brink. Also without doubt, however, this success was as fragile as glass. Ever more arduous negotiations would have to be completed before victory could be declared for the EFF arrangement and the Mexican economic recovery.

Rescheduling Official Credits

Once the bank package had been completed in March 1983, the next step was to secure similar financial relief from official creditors. Mexico did not want to formally request a rescheduling of official credits from the Paris Club, an avenue that heretofore had been crossed mainly by low-income countries that lacked access to

commercial credits.[1] Having little alternative, however, the government requested that its official creditors consider a rescheduling confidentially, outside the formal auspices of the Paris Club, but otherwise in the usual manner. Accordingly, the creditor group met during June 20–23, 1983, at the OECD headquarters in Paris, under the chairmanship of Michel Camdessus (who also chaired the Paris Club). Mexico's chief debt negotiator, Angel Gurria, headed the official delegation, and several IMF staff—including Claudio Loser (Chief of the Stand-by Operations Division, Exchange and Trade Relations Department) and Joaquín Pujol (Chief of the Mexico/Latin Caribbean Division, Western Hemisphere Department)—participated in the meeting. The staff gave detailed explanations of the progress being made under the EFF arrangement, and the discussions covered a range of complex issues such as the treatment of officially guaranteed debts of the private sector. In the end, the 15 creditor countries agreed to reschedule approximately $1.2 billion in officially guaranteed private sector debts over a six-year period.[2] The main effect of this non–Paris Club deal, however, was not so much to strengthen Mexico's reserves as to lengthen the maturity of official credits, since it largely enabled Mexico to repay its bridge loan from the BIS (see Chapter 7) on time in August 1983.

Rescheduling Debts of the Private Sector

A simmering concern among Mexico's commercial bank creditors was the handling of private sector debts, a substantial portion of which was in arrears. Throughout the months of negotiations over the initial bank package, the banks and some official agencies had pressured the Mexican government to assume these debts. Supported by the Fund, Mexico had refused,[3] but it had compromised by introducing a program to cover private firms' foreign exchange losses. Known as the FICORCA scheme,[4] this program provided for firms to pay dollar-denominated commercial debts in pesos to the central bank. The creditor was required to reschedule the debts over several years, and the central bank would then guarantee to pay the creditor in dollars. Between March and November 1983, close to $12 billion in private sector debts were rescheduled under this program. The Fund staff initially were skeptical as to whether FICORCA was affordable without undermining the adjustment program,[5] but they eventually accepted it as a positive

[1]At the time, the only Latin American countries that had rescheduled debts through the Paris Club had been Chile in 1975, Peru in 1978, and Costa Rica in January 1983. For details, see Dillon and others (1985), Table 4. For background on the Paris Club and its relationship with the Fund, see Chapter 20.

[2]For further information, see Dillon and others (1985) and Kuhn and Guzman (1990).

[3]The assumption of private sector debts by the government would have counted toward the ceiling on official external debt under the EFF arrangement. Any large-scale assumption would have made it impossible to meet the program criterion.

[4]FICORCA is the acronym in Spanish for the "foreign exchange risk coverage trust fund."

[5]"Briefing for Mission to Mexico" (March 2, 1983), p. 6; in IMF/CF (C/Mexico/810 "Mission—Pujol and Staff, March 1983").

approach. FICORCA then became the prototype for similar schemes elsewhere, including in the aftermath to the Asian crisis of 1997–98.

Promoting Trade Liberalization

With the various financial arrangements in place, the Managing Director (Jacques de Larosière) turned his attention in mid-1983 to the longer-run issue of strengthening Mexico's international trade. The initial policy corrections had strengthened the trade balance by nearly $18 billion, but primarily through import compression. Exports (measured in dollars) had risen by 11 percent ($2 billion) from 1981 to 1983, while imports had fallen by two-thirds ($16 billion). To achieve better balance and longer-lasting relief, in August 1983 de Larosière proposed talks aimed at increasing Mexico's access to industrial country markets in exchange for trade liberalization by Mexico. Specifically, over lunch with Silva Herzog on August 29, he suggested that meetings be set up with officials from the major industrial countries during or shortly after the forthcoming Fund-Bank Annual Meetings, to discuss market access and the reduction of trade barriers. Silva Herzog quickly obtained the support of President de la Madrid for at least a general shift toward trade liberalization, and a Fund staff team visited Mexico City in September to press the initiative with trade officials. For the moment, those officials preferred to proceed deliberately, and primarily through quiet bilateral contacts. Nonetheless, de Larosière and Silva Herzog, with support from the World Bank, continued to make the case, and in 1986 Mexico acceded to membership in the GATT.[6]

1984 Adjustment Program

The second year of Mexico's adjustment program was negotiated in the course of two missions in the fall of 1983, headed by Pujol. Overall, the negotiations progressed smoothly. Differences in view regarding the fiscal stance and interest rate policy were largely technical and easily resolved. The Mexican authorities were confident that the requisite additional external financing could be obtained through a new rescheduling agreement with commercial bank creditors without the Fund having to impose concerted lending as a precondition for approval of the arrangement; they were, however, prepared to consent to such a precondition if the Managing Director deemed it necessary.[7] The bone of contention was wage

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[6]On de Larosière's lunch meeting with Silva Herzog, see memorandum from C. David Finch (Director of the Exchange and Trade Relations Department) to the Managing Director (August 26, 1983), in IMF/RD Deputy Managing Director file "Mexico 1983 (2)—May–December" (Accession 85/99, Box 4, Section 229). On de la Madrid's initial support and on the September mission, see memorandum from Shailendra J. Anjaria (Chief of the Trade and Payments Division, Exchange and Trade Relations Department) to Finch (September 15, 1983), in IMF/CF (C/Mexico/810). On the World Bank's involvement, starting in 1984, see Urzúa (1997), pp. 79–81.

[7]Memorandum to management from Loser and Pujol (December 11, 1983), p. 2; in IMF/RD Deputy Managing Director file "Mexico 1983 (2)—May–December" (Accession 85/99, Box 4, Section 229).

policy. The authorities planned to raise the minimum wage by 30 percent around the beginning of 1983 and by another 10 percent in mid-1984. The staff concluded that the initial increase would be excessive and would risk fueling expectations of continuing inflation. That view was also conveyed to Silva Herzog and his team by the Managing Director, at a lunch that he hosted at the Fund in early December, while the staff mission was conducting technical negotiations in Mexico City. These warnings were in vain, however, as the authorities went ahead with the planned raise at the end of the year.

Notwithstanding the differences over wage policy, the Letter of Intent specifying the policy program for 1984 was agreed upon at the conclusion of the second staff mission on December 9, 1983. The staff report gave Mexico high marks, both for performance under the first year of the program and for the strength of the 1984 program. It expressed caution regarding the recent wage adjustment, which was viewed as leaving little margin for further increases; and about contingency funds in the budget, which, if mobilized, could destabilize fiscal policy. It also noted that Mexico should introduce additional measures to reduce trade and payments restrictions, and that the authorities would need the "continued cooperation of the international financial community" to be able to service its external debts.[8] These admonitions, however, did not detract from the Fund's strong support for Mexico's adjustment effort at the beginning of 1984.[9] The Executive Board met on March 2 and approved the continuation of the arrangement without difficulty.

1984 Commercial Bank Package

Financing Mexico's balance of payments deficit for 1984 required a further agreement with commercial bank creditors. Consideration of this second package began in earnest at a New York meeting of the Advisory Committee on December

[8]"Mexico—Extended Arrangement—Program for the Second Year," EBS/84/1, Sup. 1 (January 30, 1984).

[9]When the Eighth General Review of Quotas took effect at the end of November 1983, Mexico's quota rose from SDR 802.5 million to SDR 1,165.5 million. The annual access limit under the Enlarged Access Policy was reduced on January 6, 1984, from 150 percent of quota to 102 percent, with a provision that countries demonstrating both a serious balance of payments need and a strong adjustment program could be granted access up to 125 percent of quota. (For a discussion of the evolution of Fund policy on access limits, see Chapter 17.) That same day, Mexico requested that the EFF arrangement be augmented to reflect the quota increase. That is, rather than the planned four drawings totaling SDR 1.2 billion (150 percent of the old quota but just over 102 percent of the new), the authorities requested that they be allowed to draw 125 percent of the new quota (close to SDR 1.5 billion). The staff did not consider that the "need" test could be met, but they recognized that the measures to liberalize trade that the Fund was trying to persuade Mexico to implement could put pressure on reserves in the short run. After consulting with the Managing Director and informally with a number of Executive Directors, they therefore responded that if the balance of payments were to worsen, especially as a result of trade liberalization, augmentation could be considered at that time. See memorandum from Sterie T. Beza (Associate Director of the Western Hemisphere Department) to the Managing Director (January 18, 1984); in IMF/RD, Managing Director file "Mexico—January–August 1984" (Accession 85/231, Box 1, Section 177).

William R. Rhodes, Jesús Silva-Herzog, Jacques de Larosière, and José Angel Gurría on the occasion of debt restructuring agreement for Mexico, March 1985

12–13, 1983. Claudio Loser, attending the meeting for the IMF, described the proposed program and explained that the banks would have to provide additional financing of $4 billion to fund the balance of payments. That figure was met with some skepticism, because it allowed for both a substantial rise in imports and a partial restoration of foreign exchange reserves. Citibank's vice chairman, William Rhodes, asked the IMF not to make its approval of the program contingent on this level of bank financing. Doing without a bank agreement was clearly not feasible: the program had to be fully financed, imports had to rebound from the extremely depressed level of 1983, and trade could not take place without a reasonable level of working balances in foreign exchange. But when Loser reported back to de Larosière, the Managing Director agreed to be flexible regarding both the amount and the linkage to Fund approval. If the Advisory Committee would agree informally to put together a package of close to $4 billion, he would not necessarily make achievement of the "critical mass" a precondition in his presentation to the Executive Board.

On December 23, 1983, one year to the day after the Fund's approval of the initial EFF arrangement, de Larosière cabled the Advisory Committee that Mexico had met all of the performance criteria for 1983 by substantial margins, and asked for a $3.8 billion increase in bank exposure as support for the 1984 program. Within a week, the Committee had approved the request. This time around, the banks were able to coordinate the syndication effort largely on their own, and the $3.8 billion total was reached in late April with the participation of close to 500 banks.[10]

First Multiyear Rescheduling Agreement

Now that the adjustment process was under way, the Managing Director's focus could shift still more toward the long run. How could Mexico stay on course and generate sustained growth once imports had been restored to normal levels and the IMF's direct involvement through the EFF arrangement was over? At the same time, some of the key international bankers and officials of the U.S. Federal Reserve System were beginning to worry about how to move from crisis management through annual rescheduling agreements to a restoration of normal business relationships.

Around January 1984, Wilfried Guth, a member of the Governing Board of Deutsche Bank and of the Advisory Committee for Mexico, suggested to de Larosière that the time had come for a more medium-term approach to Mexico's financing needs. Large amortization "humps" would come due in 1985 and 1986, and early planning would be required if they were to be passed smoothly. Initially, the Managing Director felt that the EFF arrangement itself constituted a suffi-

[10]The number of participating banks was about 30 less than in the first package, owing mainly to mergers of U.S. banks. The $3.8 billion total was oversubscribed, and the difference was rebated pro rata.

ciently structured contribution from the Fund, especially as it was designed to allow for a resumption of imports while preserving the viability of the balance of payments. In March, Guth wrote to de Larosière with a more specific recommendation, that the banks be encouraged to arrange their financial support operations for two to three years at a time, rather than annually. Again, de Larosière was cautious in his response, feeling that the banks as a group might be reluctant to make financial commitments beyond the end of the Fund's involvement. Two weeks later, however, when Guth and Lewis Preston (Chairman of J.P. Morgan) called on the Managing Director to express exactly those concerns, de Larosière formulated the idea of devising a procedure under which the IMF would informally monitor the country's economic policies and performance in a way that could reassure creditor banks undertaking longer-term commitments. He introduced the idea in general terms at a private conference for central bankers at the Federal Reserve Bank of New York on May 7, 1984, and reported afterward that the idea seemed to be "gaining ground."[11] Meanwhile, both Paul Volcker (Chairman of the Board of Governors of the Federal Reserve System) and Edwin Truman (Director of the Federal Reserve Board's Division of International Finance) were meeting regularly with bank officials to promote the idea of medium-term commitments.

De Larosière's proposal for what would come to be known as a "multiyear rescheduling agreement" (MYRA) began to come to fruition in June 1984. Given the novelty of the idea and the controversies that were likely to arise, it would be necessary to lay the groundwork carefully. The International Monetary Conference that was sponsored annually by the American Bankers Association provided a convenient opportunity. Many of the world's leading commercial and central bankers regularly attended the event, and the Managing Director often gave a speech there; in 1984, it was to be held in Philadelphia, Pennsylvania, in early June. On May 28, after consulting with Rhodes, the Managing Director invited representatives of the Advisory Committee banks to a private late-afternoon meeting on June 4, at the ornate Union League Club in downtown Philadelphia, to discuss arrangements for Mexico.[12] The gathering was impressive: Volcker; the chairmen (or, in a few cases, their senior associates) of all 13 of the Committee banks; Fritz Leutwiler, the president of the Bank for International Settlements; and two of the IMF's top Mexican experts, Sterie T. Beza (Associate Director of the Western Hemisphere Department) and Claudio Loser. De Larosière's presentation to the group noted that in light of the "heavy amortization payments of the public sector due to banks over the period through 1990," it was "unrealistic to expect

[11]Memorandum for files by the Managing Director's office (May 1, 1984), in IMF/RD Managing Director Chronological file "January to December 1984" (Accession 88/274, Box 3, Section 269); speaking notes for the New York conference, in IMF/RD Managing Director file "New York, May 7, 1984" (Accession 85/231, Box 3, Section 177); and report to Executive Directors at EBM/84/74 (May 9, 1984), pp. 3–4. For a contemporary report on the conference, see Peter Norman and S. Karene Witcher, "Central Bankers' Meeting on World Debt Troubles European Finance Officials," *Wall Street Journal* (May 8, 1984), p. 39.

[12]Earlier in the afternoon, the Managing Director included a general proposal for multiyear agreements in his remarks to the full conference.

that they could be covered by syndications or other voluntary credits year by year." A multiyear approach would help to reduce uncertainty, provided that the country's house was in order:

> Of course, a proposal for a multiyear restructuring can be contemplated only in the case of a country that has brought adjustment to the point where there is a substantial degree of certainty about the outlook for the balance of payments in the medium term. The policies pursued by Mexico have produced such a prospect, and it is therefore in everyone's interest that Mexico's efforts be complemented by a change in its external debt profile in a way that would enhance stability.[13]

Following the Managing Director's presentation, Volcker also made a strong appeal for a MYRA for Mexico as an antidote to what he saw as a deteriorating debt strategy. Mexico's economic prospects were favorable, especially compared with the problem cases of Argentina and Brazil. Mexico was not expected to need large amounts of additional financing, but the banks' willingness to arrange a MYRA could serve as a positive example for other countries in the region that were more seriously bogged down. De Larosière then noted that the nature of the Fund's involvement after the conclusion of the current EFF was essentially to be decided by the Mexican authorities, and he suggested that the banks discuss possibilities with them. Options included a modest follow-up program, a shadow program, or some other monitoring arrangement.

The bankers present were initially divided as to whether the time was ripe for a multiyear agreement. Several of them feared that a MYRA for Mexico would encourage Argentina to ask for similar treatment, to which the Managing Director responded that it was important to be explicit that such an arrangement was a reward for good policies and performance. Walter Wriston (Chairman of Citibank), Guth, and several others supported the proposal, and the meeting in the end gave its blessing. Rhodes issued a press release the next day, indicating that the banks had agreed with the Mexican authorities to begin negotiations on a multiyear strategy for restoring normal financial relations. The MYRA approach was thus officially launched.[14]

Agreement in principle was only the first step in getting an actual rescheduling agreement in place. The next step was to determine the appropriate monitoring procedures for the Fund. That issue was taken up in a series of meetings in New York in mid-July 1984, involving principally Gurria for Mexico, Rhodes for the

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[13]Speaking note for the meeting, as delivered; attached to a file memorandum on the meeting prepared by the Managing Director's office. In IMF/RD Managing Director file "Philadelphia Meeting, 1984" (Accession 85/231, Box 3, Section 177).

[14]Rhodes's announcement was widely reported in the press as a major breakthrough and as a tribute to the progress being made in restoring the Mexican economy to health. See, for example, *Excelsior* (Mexico City), June 6, 1984, p. 1; and *New York Times*, June 6, 1984, p. D1. Five days after the meeting between the Managing Director and the banks, the communiqué of the G-7 summit in London endorsed the use of MYRAs by indicating the leaders' willingness "in cases where debtor countries are themselves making successful adjustment efforts" to encourage the use of MYRAs for commercial debts and "where appropriate to negotiate similarly in respect of debts to governments and government agencies" (Hajnal, 1989, p. 262).

banks (followed by a meeting with the full Advisory Committee), and Beza for the IMF.[15] The Mexican authorities viewed the monitoring issue as highly sensitive, as they believed that it would not be appropriate for the Fund to play a larger formal surveillance role than in other countries that had concluded a financial arrangement, even if such a role might help to secure an agreement with the banks. Gurria therefore proposed that the IMF's activities be defined within the framework of the annual Article IV consultations, supplemented by interim technical missions if necessary. The Fund missions could review Mexico's financial program, so long as the program did not have to be negotiated with the Fund. Gurria was prepared to have the Fund supply the banks with reports on these consultations, as long as the reports focused specifically on the country's creditworthiness; but he did not want to submit to a contractual obligation from the banks for additional IMF surveillance, and he did not want a shadow program to be discussed by the Executive Board.

The banks, for their part, recognized the value of having the IMF monitor the economic policies of member countries. Although the Advisory Committee had an Economic Subcommittee (comprising staff economists from each committee bank) that advised the committee on economic conditions, there were legal and competitive reasons for not asking that group to evaluate adjustment programs. The Mexican authorities could communicate the details of their annual economic program directly to the banks, but only the IMF would be well placed to review and evaluate the program. The Fund would need to find an appropriate means of conducting such a review and communicating its findings to the banks.

Following these initial discussions, the Advisory Committee cabled the noncommittee creditor banks that it was receptive to devising a multiyear strategy and intended to resume discussions in early August.[16] Meanwhile, the Managing Director and the staff began intense discussions over whether and how the Fund might support this process. The establishment of a MYRA was a matter to be decided purely between the creditor banks and the Mexican authorities, but the position of the Advisory Committee was that for an agreement to extend beyond the end of 1985 (when the EFF would expire), an IMF monitoring procedure would have to be in place. An informal commitment by the Fund to hold semiannual consultations and to allow the Mexican authorities to release the consultation staff reports to the banks would appear to satisfy both parties, but several of the Fund's senior staff members were worried that authorization to release consultation reports would set a precedent that many member countries would find troubling and that could compromise the Fund's role as a confidential advisor to governments. In any event, such authorization would require a decision by the Executive Board.

[15]Representatives of the monetary authorities of the major creditor countries, plus the World Bank and the Inter-American Development Bank, attended some of the meetings with the Advisory Committee. Memorandum for files (July 17, 1984) by Beza; in IMF/RD Managing Director file "Bank-Fund Collaboration, 1984" (Accession 85/231, Box 3, Section 177).

[16]Cable from the committee chairmen (July 20, 1984); in IMF/RD Managing Director file "Mexico, January–August 1984" (Accession 85/231, Box 1, Section 177).

Management would support a request from Mexico, but it could not be sure that the Board would go along.[17]

Fortunately, it was easy enough for all parties to postpone a final resolution of the procedural difficulties, because the EFF arrangement was on track and was scheduled to run through 1985. During the life of the program, a letter from the Managing Director to the banks certifying that Mexico continued to meet the program criteria and to remain eligible to draw on the arrangement would be all that the banks would need to activate the next tranche of the arrangement. On September 5, 1984, after consulting informally with Executive Directors, the Managing Director sent a cable to the Advisory Committee expressing his "strong support" for the proposed restructuring, which the Fund staff viewed as "appropriate for the circumstances of Mexico." Without mentioning the issues related to the release of consultation reports, the cable otherwise set forth the basic elements of what would come to be known as "enhanced surveillance":

> The Mexican authorities would make available at the beginning of each year their annual operative financial program. . . . [They] have also indicated their willingness to enhance their Article IV consultations with the International Monetary Fund. . . . In addition to the annual consultation . . . the Fund [would] conduct mid-year reviews of the performance of the Mexican economy. . . . [This proposal is] consistent with Fund policies on surveillance under Article IV and should facilitate assessment of economic performance in the period beyond the expiration of the extended arrangement at the end of 1985.[18]

That is, the IMF would not negotiate a program with the authorities, but both the staff and the Executive Board would review the program semiannually. In an as yet unspecified fashion, the conclusions of those reviews would be communicated to the creditor banks.

On September 8, 1984, after two months of negotiations during which the IMF staff had participated mainly by explaining the details of the adjustment program to the banks, the Advisory Committee and the Mexican government agreed in principle on the largest rescheduling yet: nearly $50 billion in public sector debts would be covered, comprising those that had been outstanding on August 22, 1982 and that were currently scheduled to mature from 1985 through 1990, plus the $5 billion syndicated loan of March 1983.[19] The maturity profile was both lengthened (from 8 to 14 years) and smoothed, interest rate spreads over the London interbank offered rate (LIBOR) were reduced from those of the earlier short-term packages (ranging from ⅞ to 1½ percent over LIBOR), and the whole atmosphere was much more positive.

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[17]Except for countries under enhanced surveillance, the Executive Board did not agree to the release of consultation reports until 1999.

[18]"Mexico—Restructuring of External Debt," EBS/84/194 (September 10, 1984), pp. 1 and 5. The text in this document is dated September 8, but the cable was sent on September 5. For the cable, see IMF/RD Managing Director file "Mexico (1984)" (Accession 86/34, Box 29, Section 209).

[19]See Dillon and others (1985), p. 14 and Table 17.

Approximately half of the package was to be conditional on an IMF monitoring agreement after the end of the EFF arrangement. Specifically, the rescheduling of close to $24 billion in previously rescheduled debts now maturing from 1987 through 1990 was conditional upon the achievement of economic goals to be set by Mexico and monitored by the IMF on the basis of "enhanced" Article IV consultations starting in 1986, as described in the September 5 cable from the Managing Director. Such an arrangement could be implemented without any formal change in IMF procedures as long as no legal objection was raised to the release by Mexico of consultation reports that technically were the property of the Fund. Eventually, however, the Executive Board would have to approve specific procedures for the release of consultation reports to creditors (on which, see Chapter 10).

The 1985 Program: Storms Roll In

Even as Mexico's relations with its bank creditors were being put on a more solid footing, its ability to persist with strong adjustment policies in the face of ongoing economic difficulties and political pressures was becoming increasingly doubtful. The Article IV consultation that Loser conducted in May 1984 noted the strength of the adjustment effort but cautioned on two fronts. First, most of the improvement in the balance of payments was still coming from a compression of imports rather than stimulus to exports. That relationship was inimical to growth and therefore could not last indefinitely. Second, the exchange rate was becoming seriously overvalued as a result of a combination of large wage increases and a closely controlled rate of depreciation. International competitiveness was slipping away, and that situation could not last either.

Both the staff and management took the view that Mexico could maintain the crawling-peg exchange rate policy only by getting better control over wage increases. Even as the staff mission was still in Mexico City, the Managing Director met with the Mexican president, Miguel de la Madrid, at the Vista Hotel in Washington. De Larosière advised the president that unless the midyear increase in the minimum wage could be held to less than 10 percent, inflationary pressures were likely to again reach a destabilizing level. The president indicated that he shared that concern, but an increase that small was not feasible. In the president's view, the chief problem was the threat from the rising level of world interest rates, which could hurt developing countries both by raising the cost of servicing their debts and by choking off the recovery in world trade. The Managing Director, and later the staff, would convey these various concerns to the banks in the course of the summer, but the problems did not become manifest until the fall, after the authorities and the Advisory Committee had agreed on the terms of the MYRA.

The staff (again led by Pujol) began negotiating the third year of the program at the end of October 1984, but they immediately ran into trouble. The authorities acknowledged that they were not on course to meet the performance criteria for the end of 1984, yet they were devising a program for 1985 that would aggravate the problem and widen the gaps. On December 6, the central bank accelerated the rate of depreciation under the crawling peg, but the rate remained well

below the inflation rate and the overvaluation of the exchange rate was becoming increasingly severe. Efforts to liberalize trade had bogged down, wage policy was lax, and fiscal adjustment had weakened. Two years of adjustment had left incomes depressed, the burden of servicing external debts was still harsh, elections for the House of Representatives and state governments were coming up in 1985, and fatigue was setting in. Pujol had no choice but to inform the authorities that the Fund could not accept the proposed policies as a basis for the 1985 program.[20]

In mid-December and again in mid-January, Mexican officials went to Washington to meet with officials in the Fund. Pujol then went back briefly to Mexico City in late January and again in February with a full negotiating team. At the end of that mission, in early March 1985, the pace of exchange rate depreciation was accelerated again, and the negotiations continued. After one more mission to Mexico and two more visits by officials to Washington (an extraordinary total of nine sets of meetings), a Letter of Intent was finally agreed upon in the third week of March. Within a few days, the commercial banks finally signed the MYRA that the Advisory Committee had negotiated six months earlier. For that occasion, de Larosière—who had declined many earlier invitations to attend such signing ceremonies—went to New York to be present at what was clearly a historic clearing of a hurdle on the way to resolving the Latin American debt crisis.[21]

By the time the Executive Board met on June 7, 1985, to review the program and approve the third year of drawings, the protraction of negotiations had already caused one scheduled drawing (February 1985) to be missed. If the three-year EFF arrangement was to be fully utilized, it would have to be extended through the first quarter of 1986. More seriously, Executive Directors raised numerous questions about the internal consistency of Mexico's exchange rate policy. Guillermo Ortiz (Alternate—Mexico) characterized policy as aiming to set the rate of depreciation consistently with the inflation target and not to accommodate inflation overruns; the large depreciations of 1982 had instilled heavy cost-push pressures through wage demands that had weakened competitiveness and placed further pressures on the exchange rate.[22] Other Directors noted that by raising the depreciation rate twice in the past year, the authorities had signaled a change in policy toward preserving competitiveness and that this shift may have added to the cost-push pressures. Jacques J. Polak (Netherlands) took note of the nine negotiating sessions over five months and concluded that, if the Fund were going to continue to point to Mexico as an example for other countries in the region to follow, it would have to ensure that a firmer policy stance was adopted. These and other concerns were strongly and freely expressed, but at the end of the day the continuation of the arrangement was approved.

From that point, matters deteriorated rapidly. Continuing exchange market pressures forced another devaluation of 17 percent on July 25, and on August 5 the

[20]Memorandum to management from Pujol (November 26, 1984); in IMF/RD Managing Director file "Mexico (1984)" (Accession 86/34, Box 29, Section 209).

[21]See *IMF Survey*, Vol. 14 (April 15, 1985), pp. 113ff.

[22]Minutes of EBM/85/91 (June 7, 1985), pp. 6 and 10.

"controlled" rate was placed on a managed float; by that time, the controlled rate was 22 percent below the rate in the parallel "free" market. In an effort to raise confidence, the authorities announced new spending cuts amounting to some 0.3 percent of GDP for the remainder of 1985, plus a new round of trade liberalization that would raise the portion of imports that was free of licensing requirements from 34 percent to more than 60 percent. These measures came too late, and when the world oil market began to soften markedly at the same time, they were also too little. When Pujol's team returned to Mexico City in mid-August for the next program review, they concluded that several program criteria were not being met: the fiscal deficit was too large, domestic credit growth was above target, and reserve growth was deficient. The program now had to be abandoned, and the drawing that was scheduled for the end of August was to be disallowed.

The timing could scarcely have been worse. Smack on the heels of these domestic policy slippages came a pair of the worst earthquakes in Mexican history. Measuring 8.1 on the Richter scale on September 19 and 7.5 the next day, these quakes killed thousands of people in and around Mexico City, severely damaged the area's infrastructure and economic capacity, and ultimately generated losses estimated at up to 3½ percent of annual GDP. Some $1 billion in principal was about to come due to foreign creditors, but Gurria feared that he and his colleagues in government would be lynched if they even proposed such a use of scarce resources in the midst of this calamity. He successfully negotiated a rollover of those credits, but the economic damage continued. The fear of complete collapse was palpable. When Mexico City officials announced the expropriation of damaged buildings that had to be condemned, investors accelerated the flight of capital in anticipation of widespread nationalization of property.

Press coverage following the earthquakes jumped on the IMF for cutting off funds to Mexico while the country was reeling from the earthquakes. Although those stories either ignored or played down the fact that the cutoff had preceded the earthquakes by several weeks and was not linked to them in any way, the adverse publicity complicated the task of figuring out how best to help Mexico recover.[23] Although reviving the EFF arrangement was out of the question under the circumstances, de Larosière immediately (on September 20) cabled President de la Madrid that the IMF was prepared to assess the possibility of providing emergency assistance. A week later, Silva Herzog went to the Fund to request such assistance and to convey the government's interest in working with the Fund in developing a viable program for 1986.[24] At the time, Executive Directors were getting ready to go to Korea for the Annual Meetings of the Boards of Governors and could not

[23]For example, the *Washington Post* front-page story on the earthquakes (September 20, 1985) was accompanied by a story on the cutoff of drawings (a story that in fact was then six weeks old but that had been largely ignored during August) under the headline, "IMF cuts off Mexico for failure to live up to agreements." To try to stem the adverse publicity, the IMF issued a correction in the form of a press release (PR/85/30, September 20, 1985).

[24]Speaking notes by de Larosière for an informal meeting of Executive Directors in Seoul, Korea (October 4, 1985); in IMF/RD Managing Director file "Annual Meetings, 1985—Mexico" (Accession 88/274, Box 9, Section 269).

immediately schedule a discussion on Mexico. As soon as the quorum had convened in Seoul, however, the Executive Board met in informal session and agreed to "look favorably" on a request for emergency assistance.[25] Two months later, on December 11, 1985, the authorities formally requested an emergency drawing of just over SDR 290 million, or $320 million (the equivalent of one credit tranche, the maximum normally allowed under Fund policies). On January 10, 1986, the Executive Board approved the request and made the funds immediately available.

Domestic wage pressures, election-year budget pressures, declining real incomes, falling prices for petroleum exports, earthquakes . . . the plagues came in waves in the fourth year of Mexico's debt crisis. As the first major phase of the debt strategy drew to a close, Mexico—the once and future epitome of the case-by-case adjustment strategy—was mired down with difficulties that seemed well beyond the capabilities of the IMF to resolve.

Brazil

The staff team working on Brazil had to start all over in June 1983, following the collapse of the EFF arrangement that had been approved just a few months earlier. As described in Chapter 8, there had been multiple failures by all concerned, and a promising start on adjustment had been lost. Now, a huge effort would be undertaken, and the Brazilian economy would be—for the moment—brought back under control.

Restoring the Program: 1983

Prospects were rather bleak when a review mission—headed by Eduardo Wiesner, Director of the Western Hemisphere Department—made a highly publicized visit to Brazil in June 1983 to begin renegotiating the EFF arrangement.[26] There were fiscal overruns, inflationary pressures were unabated, and external financing was limited; the trade balance was much improved, but the improvement had come largely by cutting back on imports. The biggest problem was that, whatever goodwill the government might have had to tighten its belt, it faced strong opposition in a badly divided congress. In the judgment of the Fund staff and management, the government would have to be very specific regarding policy measures to be taken as preconditions for resuming drawings under the EFF. Consequently, when Wiesner met with the top economic officials in Brasilia at the end of the

[25]See press release PR/85/32 (October 4, 1985). For a more general discussion of emergency assistance by the IMF, see Chapter 15.

[26]The public pressure on the mission was raised at the outset when Fritz Leutwiler, the president of the Bank for International Settlements, held a news conference in Basel, Switzerland, on the opening day of the mission, and signaled his confidence that the Fund would successfully negotiate a new program that would enable Brazil to repay the $400 million owed to the BIS. In Brazil, Wiesner held informal conferences with the Brazilian press as the mission progressed.

two-week mission—principally Antonio Delfim Netto, the minister of planning, and Ernane Galvêas, the minister of finance—he took the unusual step of insisting not just on a commitment to reduce inflation but on a specific commitment to change the rules governing indexation of wages. The Brazilians had misgivings about this requirement, and their long-standing and highly influential Executive Director, Alexandre Kafka, complained that this level of structural involvement in policymaking was unprecedented and inappropriate. The authorities nonetheless recognized that some such measure was needed to reduce inflation. Eventually, a compromise was struck, under which the indexation formula would not be made part of the formal conditionality on the program, but there would be an understanding that the Managing Director would not take the program to the Executive Board for approval until the indexation issue had been satisfactorily resolved.

Wiesner and the other senior officials on the team returned to Washington in late June to discuss options with management, while the technical staff remained in Brasilia (in part to avoid giving the impression to the voracious local press that negotiations might have broken down). They then returned in early July and achieved what appeared to be a breakthrough. On July 14, the government promulgated Decree 2045, limiting wage indexation to 80 percent of inflation. Congress would have 75 days to overturn the legislation, but such action was unprecedented and appeared unlikely. The Managing Director, however, had his doubts about the level of commitment; let us schedule the Board meeting, he suggested, but not until October, when the danger of a policy reversal would be greatly reduced. In the meantime, he suggested privately that the Fund station a resident representative in Brazil to monitor developments more closely. The authorities resisted that idea, fearing that it would be regarded as a sign of dependency by opposition parties, but they did agree to receive staff visits on a frequent basis to accomplish the monitoring objective.

When the staff team returned to Brazil in August 1983—led by Thomas Reichmann, Chief of the Atlantic Division in the Western Hemisphere Department—inflation was still accelerating and was carrying the fiscal deficit up with it. In the short run, this problem was essentially intractable, as it resulted from the interaction of unavoidable shocks (relative prices adjustments that were necessary for the adjustment program, plus the effect of bad weather on agricultural harvests) and a high degree of wage indexation. The staff and the authorities quickly reached agreement on a target of just over 150 percent inflation for 1983 (compared with the then prevailing rate of 160 percent) and a cut to 55 percent in 1984, but no one on either side had a great deal of confidence that either target could be reached. And if inflation remained out of control, whatever ceiling was set on government borrowing would run over as well.

In this environment, discussions began on the possibility of specifying the ceiling on the "operational" rather than the actual level of the deficit, where the operational balance was defined to exclude the effect of indexation for inflation on public sector debt service. This issue arose because most debt obligations in Brazil at that time were indexed to the rate of inflation. The overall public sector borrowing requirement (a ceiling on which would be the usual performance criterion in a

Fund-supported adjustment program) is equivalent to the total change in the stock of public sector debt outstanding. That total may be divided into two components: the change attributable to the difference between government outlays and revenues, and the change (called the "monetary correction") attributable to indexation (including the payment of interest other than the "real" component). The operational deficit is measured as the total minus this second component. Through the monetary correction, a rise in the inflation rate will generate a rise in the total fiscal deficit unless the government takes contractionary action, but it will leave the operational deficit unchanged. With rising inflation, targeting the total deficit would force the government into an offsetting fiscal contraction; targeting the operational deficit would permit a neutral fiscal policy. The latter strategy would leave inflation unchecked, but if inflation could not be controlled in any case, it at least would give the government a meaningful target that it could effectively control.

Proposals to target the operational deficit were made by several high-inflation countries in the 1980s, to which the Fund reacted skeptically. Like wage indexation, the operational deficit was seen as a way to accept and accommodate inflation, when what the country needed was greater price stability. Despite these reservations, the staff usually agreed eventually to include the operational deficit as a performance criterion, along with a more inclusive fiscal target. This acceptance was essentially a negotiating tactic, a way to get an agreement on the table. Programs ended up being overdetermined, since one fiscal instrument was aimed at multiple targets. Unless inflation subsided quickly, the total deficit was likely to be the binding constraint, and the adjusted measure would be irrelevant. In this seminal case, the matter was debated without resolution during the August mission, but the option of using the operational deficit remained open.[27]

While these negotiations were going on, the commercial bank creditors were also trying to regroup. By April 1983, the original committee had clearly failed to devise a strategy capable of securing the required degree of cooperation from the diverse and fractious hundreds of creditor banks, and the banks showed no signs of being able to coordinate a response. At that point, Gordon Richardson, governor of the Bank of England, came up with the idea of asking Bill Rhodes of Citibank to take control of the bank financing. Indeed, Rhodes would have been an obvious choice to anybody except that he was already carrying an enormous load as cochairman (effectively, chairman) of the Advisory Committees for Mexico, Argentina, and Uruguay. Richardson approached Paul Volcker with the suggestion; Volcker conveyed it to Rhodes's boss, Walter Wriston; and in early June, Wriston asked an eagerly receptive Rhodes to take up the gauntlet.

Rhodes organized a new Advisory Committee along lines similar to those that he had successfully managed in the other countries. This committee, which held

[27]In the 1983 program for Argentina, discussed in Chapter 8, the fiscal criterion was specified similarly to the operational deficit, but with the understanding that the target could be adjusted as the inflation rate changed. The Executive Board agreed in 1986 to consider the use of adjusted fiscal targets on a case-by-case basis (see Chapter 13). The 1986 and 1987 programs for Mexico, discussed in Chapter 10, contained multiple fiscal targets including the operational deficit.

its initial meeting in New York on June 15, 1983, would focus much more clearly than its predecessor on putting the total package together—on the forest, not the trees. Rhodes's principal deputy would be Guy Huntrods, an executive director of Lloyds Bank International in London and one of the most experienced and knowledgeable bankers on Brazil.[28] Realizing that the banks had to have much more thorough and more direct knowledge of economic conditions in Brazil, Rhodes appointed an economic subcommittee, chaired by Douglas Smee of the Bank of Montreal, and sent the members off to Brazil the next day to prepare a detailed report.

Rhodes also saw the importance of close cooperation with the IMF. Throughout July, it became increasingly evident that the authorities in Brazil were waiting to see if they could get a large enough extension of credit from the banks to enable them to bypass the Fund's conditionality and that Wiesner was thereby being hampered in his efforts to negotiate a resumption of the EFF arrangement. In mid-August, just as Delfim was preparing to go to Paris for a crucial meeting with the Managing Director, Rhodes and Huntrods made a hurried and secret trip to Brasilia to alert the officials that they could not go forward without first seeing agreement with the Fund. Three days later, Delfim and de Larosière reached a tentative and informal agreement on the program conditions.

Even with a strong policy adjustment in place, the financing gap for Brazil was enormous. For the 12 months that were being considered for the next year of the revived EFF, the staff team estimated $9 billion would be needed, in addition to the Fund's own resources. On August 31, de Larosière and a number of the key staff people working on Brazil went to New York to tell Rhodes and his committee colleagues that Brazil needed that amount in new money from the banks. Rhodes, however, convinced the Managing Director that the banks could not possibly get even close to that amount, and Smee sharply questioned the calculations underlying the estimated gap.[29] Undaunted, de Larosière adhered to the calculated gap but agreed to try to obtain as much as $3 billion in official financing if the banks could come up with the rest.

As the summer of 1983 drew to a close, everyone was still aiming toward winning Executive Board approval of the program in October, but neither domestic nor external support was yet in hand. On September 1, Carlos Langoni, the president of the central bank, resigned in protest over what he saw as the harshness of

[28]In 1965, Huntrods—then with the Bank of England—had helped set up the Central Bank of Brazil. Shortly thereafter, he spent two years at the IMF as the United Kingdom's Alternate Executive Director. When he moved to Lloyds in the mid-1970s, he quickly became their leading specialist on Latin American loans. When the debt crisis hit, he became actively involved in the work of the first Advisory Committee before becoming a cochairman (effectively, a deputy to Rhodes) along with Leighton Coleman of Morgan Guaranty Bank.

[29]The principal technical issue concerned the treatment of gold exports. The official Brazilian accounts treated the export of gold as a financing item regardless of whether it came from reserves or from domestic production. The IMF accepted this practice, though it inflated the financing gap. In addition, the gap had been calculated to allow for a $2 billion increase in official foreign exchange reserves. The Fund viewed that amount as a minimum rebuilding from a severely depleted level, while the banks naturally wanted a more modest adjustment.

the planned adjustment program. Huge demonstrations against the Fund were now being held in Brazil, including one in São Paulo on September 5 in which the Catholic Archbishop called on the 50,000 who were assembled before him to protest what he saw as the IMF's exploitation of Brazil. The government, however, had run out of reserves and had no choice but to adjust, with or without the assistance of the IMF. So on September 15, Delfim, Galvêas, and Langoni's successor, Affonso Pastore, agreed to a Letter of Intent setting out their policy program for the coming year.

Notwithstanding this agreement, the October approval deadline was by now too close to allow time for the financing of the $9 billion gap to be assembled. With the reluctant concurrence of the BIS, which had already been forced to roll over its $1.2 billion bridge loan to Brazil since the original due date at the end of June and which could not expect to be repaid until the EFF was reactivated,[30] the Executive Board meeting was pushed back to the second half of November. Even so, it was not at all clear whence the money would come. De Larosière hoped he could count on the banks for $6 billion, but he was making little headway in persuading official creditors to cough up the remaining $3 billion. To generate any momentum on that front, he would have to convince the banks to raise their share.

The Managing Director's opportunity to up the ante came at the Annual Meetings, since the major bank chairmen would all be coming to Washington anyway. On September 20, de Larosière sent invitations to the chairmen of all of the Committee banks to meet in the Executive Board room at the IMF on Monday, the 26th (the afternoon before the opening plenary session of the Annual Meetings). Virtually all accepted, as did Volcker, Leutwiler, and Tomomitsu Oba (vice-minister of finance in Japan). The Brazilian authorities were in town but were not invited to this meeting; nor were officials from other creditor countries, in order to keep the focus on the essential role of the banks in financing the program.

De Larosière opened the meeting with a statement indicating his endorsement of the policy measures that had already been taken and of the intentions set out in the September 15 Letter of Intent.[31] He then informed the bankers that allowing for the funds that the World Bank and the IMF could provide, there remained a fi-

[30]Brazil was the only country that failed to repay its loans from the BIS on time. In December 1982, the BIS agreed to lend Brazil $1.2 billion for three months, as a bridge to the EFF arrangement. That loan was augmented to $1.45 billion, then extended to the end of June, and subsequently extended to mid-July. From mid-July to mid-September, despite a personal intervention by the Managing Director at the July meeting of the BIS governors in Basel, there was no formal agreement to extend the due date. The BIS, however, informally agreed not to pursue the matter, pending a further progress report from the Managing Director. On September 13, the BIS agreed to extend the loan until the Fund approved the resumption of the EFF, after which the loan was repaid in full. For a summary of these developments, see the BIS Annual Reports of 1982/83, p. 165; and 1983/84, pp. 151–52.

[31]This account is based largely on interviews with participants. Attendance lists, speaking notes, and other documents are in IMF/RD Managing Director file "Brazil, September–November 1983" (Accession 86/34, Box 27, Section 209); and (Accession 85/33, Box 9, Section BD 375).

nancing gap for 1983–84 totaling $11.2 billion. The Paris Club was expected soon to grant some $2 billion in debt relief for that period, and he himself was "making every effort" to line up $2.5 billion in credits from other official sources. That left $6.7 billion that would have to come from increased exposure by commercial bank creditors. He concluded by noting that he could not ask the Executive Board to approve a program that was not adequately financed. To get a timely decision from the Board, he would need written assurances by November 14 that this amount would be forthcoming.

The Managing Director then left the room. He had earlier arranged for Walter Wriston to take over the meeting at this point, so that the bank chairmen could discuss among themselves how to respond. Initially, a number of objections were voiced, principally from those chairmen who had not been personally involved in the negotiations up to this point. Even most of those who were fully familiar with the case had come to the meeting expecting to be asked to raise their exposure only by $6 billion, not $6.7 billion. Eventually, however, the largest creditors—beginning with John F. McGillicuddy of Manufacturers Hanover Trust Company—spoke in favor of the request and turned the tide of the meeting. Eventually, they agreed to aim for $6.5 billion, a figure that would be close enough to the target but that provided no room at all for slippages. Nearly 800 other creditors would have to agree to go along before they could provide the needed assurances to the Fund, but at least they had made a start.

For the next several weeks, heroic efforts were made to put the financing package together. De Larosière formally requested the major creditor countries to make commitments for their part, and he and William B. Dale, the Deputy Managing Director, held numerous follow-up meetings. The Managing Director, Pastore, and Rhodes held a large meeting at the Fund for some 60 creditor banks on October 6, after which Pastore, Rhodes, and other key bankers flew around the world to line up support.

On October 20, 1983, just as Pastore was returning to Brazil after meeting with bank creditors in six countries in North America, Asia, the Middle East, and Europe, he learned that congress had just overturned Decree 2045, the wage bill of July 14. The linchpin of the adjustment program was gone, and the prospect of a collapse was suddenly very real. On October 26, a weaker version of indexation control (Decree 2065) was issued by the government, and Pastore went back to Washington to renegotiate the program. On November 2, he met with de Larosière, who agreed that the higher rate of wage indexation could be accepted if it was offset through tighter monetary control and additional fiscal measures. This agreement would then form the basis for a revised Letter of Intent. After congress formally approved Decree 2065 on November 9, Delfim and Pastore came one more time to Washington.

The Washington meetings focused specifically on the role of the operational fiscal deficit. As noted above, this measure of the fiscal balance had been suggested by the Brazilian authorities in August as a variable that they could control, regardless of unanticipated changes in the rate of inflation. The staff had resisted this suggestion, but they did acknowledge its usefulness for assessing the degree of fis-

cal adjustment. In the program set out in the September Letter of Intent, the performance criterion governing whether future drawings could be made was specified in the customary way, as a ceiling on the total deficit, while the operational deficit was introduced as part of the justification for waiving the overrun in the total deficit in 1983. Now it was given a new role: in addition to agreeing on a ceiling for the public sector borrowing requirement, the authorities committed themselves to taking specific measures to reach a floor on the operational surplus for 1984.[32] This revision was felicitous: it satisfied the authorities' desire to introduce the operational balance as a performance criterion while satisfying the desire of the staff and management of the Fund to introduce a realistic requirement to tighten fiscal policy. Delfim and Pastore returned to Brasilia, put the final touches on the revisions on November 14, and sent the Letter of Intent to the Managing Director.

This effort put the program back on track for the moment, but the financing was still not complete. The U.S. Treasury assured the Managing Director on November 7 that the United States would put up half of the required $2.5 billion in the form of additional credits from the Export-Import Bank, but little if any of the remainder was yet nailed down, and the banks' portion was coming together slowly. De Larosière decided to postpone the Executive Board meeting to the 22nd and to extend the banks' deadline by a week. During that week, the banks obtained commitments totaling $5.85 billion, or 90 percent of the agreed total, and the finance deputies from several G-10 countries gave vague assurances that appeared to put official financing within sight of the required total. It was a shaky foundation, but it was concrete enough that the risk from building the program on it was less than the risk—to the financial system as well as to Brazil—from a further delay.[33]

The Executive Board met in restricted session (at Kafka's request) on November 22, 1983, and approved the resumption of drawings by Brazil. A few Directors expressed concerns about the ability of the authorities to carry through on the intentions specified in the program, and even about the clarity of the information available on the current situation. As one Director put it, they "had only a kaleidoscopic impression of certain facts or policy measures subject to frequent change."[34] The shift in the staff's assessment of policies between September and

[32]The September 15 program is described in "Brazil—Staff Report for the Consultation Under Extended Arrangement, and Request for Waiver and Modification of Performance Criteria," EBS/83/227 (October 19, 1983). The November revision is in "Brazil, Supplementary Letter of Intent," EBS/83/227, Sup. 1 (November 15, 1983).

[33]In addition to the $6.5 billion loan (which, in effect, would cover a portion of the interest payments due on outstanding credits), the Advisory Committee was obtaining commitments for the other three "projects": rescheduling interest payments due in 1984, maintaining trade credit lines, and maintaining interbank lines. As of November 22, each of those projects was between 85 and 95 percent complete. See "Restricted Session—Brazil—Consultation Under Extended Arrangement—Request for Waiver and Modification of Performance Criteria; and Use of Fund Resources—Buffer Stock Financing Facility—International Sugar Agreement," EBAP/84/53 (March 20, 1984), pp. 1–2.

[34]"Restricted Session—Brazil—Consultation Under Extended Arrangement—Request for Waiver and Modification of Performance Criteria; and Use of Fund Resources—Buffer Stock Financing Facility—International Sugar Agreement," EBAP/84/53 (March 20, 1984), p. 13.

November, though necessitated by the weakening of the wage law and the subsequent offsetting tightening of fiscal policy, made the program a little hard to sell.

Notwithstanding these concerns, all Directors regarded approval of the program as vitally important for Brazil and for the Fund; the magnitude of the adjustment that the authorities were undertaking—especially by cutting government subsidies on many goods—was extraordinary and could be achieved only with the support of the Fund. Recognizing the importance of the frequent-monitoring arrangement that was being introduced for this program, Directors unanimously approved the resumption of the EFF arrangement and agreed to waive the performance criteria that had been missed earlier in the year.[35]

The next day, November 23, the Paris Club agreed to reschedule $2.7 billion of Brazilian debt obligations. The banks, however, began to lose momentum in obtaining the last $600 million of their loan syndication. Once again Delfim and Pastore, plus Huntrods and others from the bank committee, jetted around Europe and the Middle East trying to line up support, only to find that many bankers were still waiting to be sure that the official creditors put up the full value of their requirements. Not for another two months was the full $6.5 billion in hand; the bank loan was then formally signed at a dinner hosted by Delfim at the Pierre Hotel in New York.[36]

Success Slips Away: The Program in 1984

The November 1983 Letter of Intent contained several important provisions governing economic policies in 1984, with the primary intent of reducing the inflation rate. Interest rates were to be raised and other measures taken to restrict credit, so as to limit monetary growth to 50 percent for the year; several tax and spending measures were to be implemented so as to bring the government's operational budget into surplus by at least 0.3 percent of GDP; and the exchange rate against the U.S. dollar was to be depreciated by at least the rate of inflation so as to prevent any appreciation in real terms.[37] To monitor progress in meeting these goals, the IMF implemented the agreement reached in July 1983 (see above) to send a staff member to Brazil frequently (normally once each month) to collect information and hold informal discussions. Beginning in January 1984, Ana Maria Jul (Deputy Chief of the Atlantic Division) was given this assignment.

Reichmann's next review mission, which went to Brazil in the second half of February 1984, found a much-improved economy. Tax revenues were up, interest rates had been raised to more realistic levels, tighter control was being exercised

[35]At the end of November, Brazil drew SDR 1,122 million, plus SDR 64.7 million under the buffer stock facility ($1.2 billion and $68 million, respectively), raising its indebtedness to the Fund from 234 percent of quota to 353 percent. For details, see Chapter 15.

[36]Tracking the progress of the $2.5 billion in official credits is far more difficult. Through 1984, very little of that money materialized, but it is debatable as to how much of the shortfall was attributable to a shortage of supply rather than demand.

[37]"Brazil—Supplementary Letter of Intent," EBS/83/227, Sup. 1 (November 15, 1983).

over the monetary base, and the legislation of October 1983 was beginning to restrain wage demands. Both the staff and the authorities were worried, however, that strict policies would become increasingly difficult to sustain in 1984. Around the end of the year, the electoral college would elect the first civilian president in more than 20 years, and pressures on government spending would inevitably rise as the election approached. A Letter of Intent reaffirming the program, subject to modifications necessitated by the delay in obtaining commercial bank credits, was quickly negotiated and signed by Delfim, Galvêas, and Pastore at the end of February.[38]

The Executive Board approved the 1984–85 program on May 9, 1984. Brazil had been out of compliance with the program at 1983, but only because of the delay in obtaining the $6.5 billion loan agreement from commercial banks.[39] With that loan in hand, the program was on track for the first quarter of 1984, and on that basis the Board granted a waiver for the earlier period. A more serious problem was that the effort to contain inflation was still hesitant and uncertain. Directors noted that getting inflation under control was now the top priority and the "major challenge" for economic policy in Brazil, and that to do so would require both tighter monetary control and a reorientation of indexation. With no change in indexation policy, the degree of demand restraint that would be needed to control inflation would produce unacceptably high costs in lost output and employment.[40] Mario Teijeiro (Alternate Executive Director—Argentina), for example, suggested predetermining the rate of exchange rate depreciation and setting wage and public sector pricing policies in advance, "consistent with a prospective decline in inflation."[41] Directors were nonetheless encouraged by the prospects for growth and external viability and readily approved the proposed program.

Through the summer of 1984, threats to the program continued to mount. On several occasions, de Larosière conveyed his concerns about the ongoing rise in inflation to Delfim, who replied that they were making strong efforts to control the problem. At the same time, the banks were complaining to de Larosière that the $2.5 billion in vague official commitments from creditor countries was not materializing, and some of his own staff members were expressing concerns to him that a planned rise in lending by the World Bank could add to government spending.[42] Press coverage, too, was harsh, not only in Rio but even in the northern hemisphere. The *New York Times* reported on August 12 that the "IMF-prescribed austerity measures" were forcing down living standards and not producing the "prom-

[38]The Letter of Intent was circulated in "Brazil—Second Year of Extended Arrangement," EBS/84/61 (March 19, 1984). Also see memorandum from Jul to the Managing Director (February 1, 1984); in IMF/RD Managing Director file "Brazil, January–February 1984" (Accession 85/231, Box 2, Section 177).

[39]"Brazil—Staff Report for the 1984 Article IV Consultation and Review Under Extended Arrangement," EBS/84/84 (April 11, 1984).

[40]Chairman's summing up; minutes of EBM/84/75 (May 9, 1984), p. 16.

[41]Minutes of EBM/84/74 (May 9, 1984), p. 14.

[42]Memorandum from C. David Finch (Director of the Exchange and Trade Relations Department) to the Managing Director (July 24, 1984); in IMF/RD Managing Director file "Brazil—1984, March–August" (Accession 85/231, Box 2, Section 177).

ised" recovery.[43] Even so, economic growth was higher than expected, as was the improvement in the current account balance.

This combination of outcomes—high inflation, high real growth, and a strengthening external picture—confounded the analysts. If price inflation—which was in excess of 200 percent a year—was due mainly to excessive demand pressures, notably the fiscal overruns (as the Fund generally believed), then the rising trade surplus had to be attributed to structural factors, and its magnitude was difficult to explain. If inflation was due primarily to structural factors, notably the indexation process (as the authorities and most Brazilian economists maintained), then the high growth rate had to be attributed to structural factors as well, and its magnitude was difficult to explain. If the truth was somewhere in the middle, as it surely was, then it was difficult to know how much of the trade improvement or the high growth could be sustained over time. This conundrum made the Brazilian situation unique, and it led to an extraordinary degree of uncertainty in the evaluation of the success of the adjustment program.

The Executive Board met next to consider the Brazilian program on November 9, 1984, again in restricted session in an effort by Kafka to minimize the possibility of leaks that could add to the political pressures that were already intense ahead of the January presidential election. The high inflation rate required the Board to grant another waiver, which it did, after an extended discussion of the problem. Polak observed that real wages, after dropping in 1983, had not risen in 1984; since not much more than that could be expected, any reduction in inflation had to result from better monetary control.[44]

The week after the Board meeting, which enabled Brazil to draw SDR 374 million (approximately the same in dollars) that month, Reichmann returned to Brazil to negotiate the terms of the program for 1985. This was to be Delfim's last opportunity to influence policy under the regime that was soon to be elected, and he took advantage of it by drafting a program aimed at continuing the gains already achieved on the trade balance and growth while reducing the inflation rate to a targeted 120 percent for 1985.[45]

Collapse: 1985

The Managing Director faced a very difficult situation as 1984 drew to a close. The outgoing government had agreed to an economic program that he and the staff had determined to be a sound basis for continuing Fund support. Was it now reasonable to expect the program to be implemented vigorously during the transition period and under the new government? In view of the implementation diffi-

[43]The next day, *O Globo* in Rio de Janeiro reported the story from the *New York Times* (p. 16), under the headline "New York Times culpa FMI pela crise brasiliera" ("New York Times blames the IMF for the Brazilian crisis").

[44]Minutes of EBM/84/163–164 (November 9, 1984).

[45]Letter of Intent, to de Larosière from Delfim, Galvêas, and Pastore (December 20, 1984), p. 4; circulated as "Brazil—Extended Arrangement," EBS/85/11 (January 15, 1985).

culties that were already apparent, de Larosière determined that the Fund would have to take a firm stand if it was to avoid undue risk. Commercial and official creditors would be meeting early in the year to decide whether and on what terms to grant additional credits or concessions to the Brazilian government, and they would expect a favorable recommendation from the Fund before proceeding. In March, the Executive Board was tentatively scheduled to consider whether to approve the next drawing under the EFF arrangement; that meeting also depended on a favorable recommendation from the Managing Director. The problem was to determine the preconditions for making such a recommendation.

The difficulty arose because parts of the program were succeeding remarkably well, while other elements were failing badly. For 1984, Brazil was estimated to have a trade surplus of $13 billion, a balanced current account, and a $7 billion surplus in the overall balance of payments—well in excess of the program's targets. This achievement, which resulted primarily from the devaluation of February 1983 but was also aided by the continued application of trade and exchange restrictions, was accomplished while real GDP was growing at a reasonably high rate (4 percent for the year). Government borrowing, however, was stuck at a rate of more than 20 percent of GDP—well above target, and a key contributor to the very high (220 percent for the year) and still rising rate of inflation.[46] In the Fund's view, as noted earlier, the gains in the external accounts simply could not be sustained without better control of the public finances and a better measure of monetary stability.

On January 15, 1985, the electoral college elected Tancredo Neves as the president of Brazil, to take office in two months. In the interim, liaison between the old and new governments on economic matters, including the program with the Fund, would be handled by the outgoing finance minister, Ernane Galvêas, and by the designated new finance minister, Francisco Neves Dornelles (nephew of the president-elect). As far as the program was concerned, the outgoing government was responsible for meeting the monthly targets through February, while the incoming officials were asked to endorse the continuation of policies beyond that date.

Although the election took place just two months after the Executive Board approved the continuation of the EFF arrangement, the program was already off track. Notably, the money supply, growth in which was to have been limited to 60 percent for the year 1985, was already some 20 percent above the interim target in December 1984. On February 1, President-Elect Neves met with President Reagan and other senior U.S. officials in Washington and was informed that Brazil would have to face the serious concerns being raised by the Fund. Against this

[46]The operational deficit was estimated at the time to have been approximately 2 percent of GDP and to have been consistent with the performance criterion under the extended arrangement. (The comparison was complicated by a definitional change made after the approval of the 1984 program, which called for a small surplus under the original definition.) The outturn was later revised to a deficit of 2¾ percent of GDP. The program targets for 1984 are given in "Brazil—Extended Arrangement," EBS/84/204 (September 28, 1984). The initial assessment of 1984 performance is in "Brazil—Staff Report for the 1985 Article IV Consultation," EBS/85/178 (July 31, 1985). For final figures, see "Brazil—Recent Economic Developments," EBS/87/184 (August 26, 1987).

background, Neves then sent Dornelles to inform the Managing Director that his government was prepared to implement the program vigorously once it took office, and to request the Fund's support in securing financing from other creditors in the meantime. If they had to wait even a few months to reschedule either official or commercial credits, keeping their finances together would be extremely difficult.

Dornelles met de Larosière on February 9 at his hotel in Paris, where the Managing Director was on a brief speaking tour. There were two issues on the table during this tête-à-tête. First, was the Neves government committed to implementing the program? That issue was readily resolved, as Dornelles indicated his own and Neves's support and their willingness to have a personal representative of the president-elect participate in forthcoming discussions with the Fund. Second, what prior actions would have to be taken before the Managing Director could convey a sense of confidence to the Executive Board and to outside creditors? In view of the existing disarray of the program, that issue was not so easily dismissed. After a two-hour discussion, it was agreed that the crucial question was whether Brazil could meet the program targets by the end of February. De Larosière would return to Washington over the weekend, and more detailed discussions would begin immediately on Monday, with a representative of Neves's participating. To get the program back on track in just three weeks would clearly take a minor miracle, but nothing less would do. Dornelles's mission had failed, and once again negotiations between Brazil and the IMF would have to start anew.

Part of the urgency of Dornelles's effort arose from the need to rapidly reach a MYRA with commercial bank creditors. When the Managing Director met with the Brazilian transition team at the Fund on February 11–12 after returning from Paris, the banks' Advisory Committee was on the verge of completing the deal. All that was lacking was a positive signal from the Fund. On the 12th, the three cochairs (Rhodes, Huntrods, and Coleman) spent the day at their attorneys' office putting the final touches on the draft agreement. Around 10 o'clock that evening, the phone rang, and de Larosière informed them that he could not yet give them the assurances of Fund support that they needed. The bankers then had no choice but to put the papers away and shelve the MYRA for what they thought would be a short delay but would turn out to be nearly a year's wait. The Managing Director emphasized, however, that Brazil had made remarkable progress in many areas, and he successfully urged the banks to continue to roll over existing credits while negotiations proceeded.

Brazil was having no better success in negotiations with official creditors. Less than $1 billion of the anticipated $2.5 billion in bilateral official credits had been made available in 1984, and there was little prospect of getting additional credits through that source in the coming year. Creditors never had been fully committed to following up on their vague initial promises, and the subsequent policy slippages had further weakened their interest in doing so. In January 1985, Brazil stopped paying interest on bilateral debts to official creditors and requested a rescheduling agreement through the Paris Club. That strategy also failed when the Paris Club responded in February 1985 by reaffirming its usual requirement that a stand-by arrangement with the IMF was a precondition for such a deal.

By March 1985, Brazil's prospects became even more clouded when the 75-year-old president-elect fell gravely ill and underwent emergency surgery the day before his scheduled inauguration. With Neves unable to assume the powers of the presidency, the vice-president-elect, José Sarney, became acting president on March 15; on April 21, Neves died and Sarney officially assumed the presidency. For the time being, he kept Neves's economic team intact, but he lacked Neves's political support, and everyone was now operating under extreme uncertainty.

In late May, Wiesner headed a mission to Brazil to conduct the annual Article IV consultations and to try to negotiate a new program. Those negotiations broke down, principally because of disagreements over the large extent of monetary financing of fiscal deficits, which the authorities saw as necessary and the staff saw as inflationary.[47] Nonetheless, the government introduced new fiscal controls in early July, and it appeared that the impasse might be breakable. On August 19, de Larosière and Dornelles met again in Paris, and the minister conveyed his support for the July policies. The question remained, however, as to how deep President Sarney's own support went and whether Dornelles could get approval for the required policies in the face of opposition from the planning minister, Joao Sayad. At least a hint of the answer to that question came just eight days after the de Larosière–Dornelles meeting, when Sarney abruptly fired Dornelles and replaced him with a far more radical finance minister, Dilson Domingos Funaro.

Funaro initially tried to maintain the existing policy stance and continue negotiating a resumption of the EFF arrangement with the Fund. In September, several government technicians visited the Fund headquarters to resume talks on the program. Those talks were inconclusive, and Funaro soon shifted to a more radical stance.[48] As he put it to the Interim Committee at its meeting in Seoul, Korea, on October 6,

> Brazil would honor its international commitments, but the government must also fulfill its responsibilities to its people. In the present circumstances, growth was an imperative dictated by the legitimate demands of the Brazilian population. . . . Any debt restructuring exercise would have to comply with that growth requirement.[49]

Funaro also met separately with de Larosière in Seoul, but the meeting was tense, as the two men were far apart in their conceptions of what policies were needed if Brazil was to regain financial stability. As 1985 drew to a close, there was little prospect of an early resumption of Brazil's access to Fund resources: access that Brazil needed, not so much for its own sake, but to regain the credibility that would unlock access to official and private creditors around the world.

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[47]See memorandum from Reichmann to the Managing Director (June 18, 1985); in IMF/RD Managing Director file "Brazil—1985, Vol. II" (Accession 88/179, Box 7, Section 517). The level of consumer prices in Brazil more than tripled in 1985, and the rate of inflation had been on a rising trend for three years.

[48]Presgrave (1993), p. 184, discusses the turn in Funaro's attitude at that time.

[49]Minutes of ICMS/Meeting 25 (October 6, 1985), p. 8.

Argentina

Argentina had made a promising start in implementing its adjustment program in the first half of 1983 (see Chapter 8), but the effort would turn out to be difficult to sustain. Throughout the next three years, the staff and the authorities would struggle to keep the program from collapsing.

Stalemate with the Banks: June–November 1983

By mid-1983, although macroeconomic policies and conditions were reasonably well under control, the program was already in difficulty because of the dispute between Argentina and commercial banks regarding the treatment of payments to the United Kingdom (see Chapter 8, pp. 331–32). Since April 1982, Argentine law had prohibited financial transfers to British residents, including banks and corporations. Lloyds International was the largest single bank creditor to the Argentine government, and Guy Huntrods of Lloyds (see footnote 28, p. 375) was a cochairman of the banks' Advisory Committee, so maintaining a good working relationship with U.K. banks was a sine qua non for reaching any agreement. Furthermore, a commitment to eliminate discriminatory foreign exchange restrictions had to be reached by the end of July, as a performance criterion for future drawings under the stand-by arrangement with the Fund.[50] The government thus had to find a way around the strong domestic political pressure to maintain the restrictions.

In early June 1983, shortly after Argentina had drawn SDR 300 million ($320 million) from the IMF as the second installment of the stand-by arrangement, the authorities sought to deal with the restrictions problem quietly and administratively. Julio González del Solar, the president of the central bank, met secretly with Gordon Richardson, governor of the Bank of England, at the BIS governors' meeting in Basel, Switzerland, and assured him that they would find a way to pay British banks. That assurance helped reassure the Advisory Committee, and a tentative rescheduling agreement was reached in New York on June 23.[51] The next day, however, when González del Solar stopped in Washington on his way home, to meet with de Larosière at the Fund, the Managing Director reminded him that the Fund arrangement required Argentina to lift *all* discriminatory foreign exchange restrictions: those against commercial firms and individuals as well as those against banks. Two weeks later, González del Solar and Jorge Wehbe, the

[50] "Argentina—Staff Report for the 1982 Article IV Consultation and Request for Stand-By Arrangement" EBS/83/8 (January 10, 1983), p. 44.

[51] On the surface, British banks were covered, because the syndicated loan agreements not only required Argentina to pay all participating creditors proportionately, but also required the creditor banks to share any payments in the event that they were not made proportionately (see Chapter 8). The problem was that the British share was large enough that a refusal to repay U.K. banks would leave all creditors significantly short. In addition, a refusal to repay trade credits to British firms would indirectly affect those firms' banks.

minister of the economy, formally requested an extension until mid-August of the deadline for removing restrictions. The Managing Director agreed to this request; although the loan agreement with commercial banks was scheduled to be signed on August 12, the next scheduled drawing was not due to be made until the end of that month.

On Monday, August 8, the authorities cabled both the Fund and the Advisory Committee that they were now ending all discriminatory practices and that they intended to sign the bank agreement on the 12th as originally planned. When the committee bankers requested further information from the Fund, however, the staff informed them that the Argentine action was purely administrative; the discriminatory legislation remained on the books. The Committee then decided to postpone the signing.

That Thursday, the Acting Managing Director, William Dale, called an extraordinary meeting of the Executive Board for the following Monday, to discuss the single question of whether to grant a waiver for the end-August drawing on the basis of the assurances provided by the Argentine authorities. The use of Fund resources was dependent on the settlement of arrears with commercial banks, which required Argentina to sign agreements with the banks for both a $300 million bridging loan and the $1.5 billion medium-term loan that had originally been planned for April. If the Fund was satisfied that Argentina was no longer discriminating against another member country, then it appeared that the logjam could be broken.

At the August 15 meeting, the Executive Director for the United Kingdom, Nigel Wicks, noted that discrimination by one member country against another was "against the fundamental spirit of the Fund." Although the United Kingdom had imposed restrictions against Argentina during the war in the spring of 1982, it had since eliminated those restrictions and had repealed the enabling legislation. His authorities were concerned that the Argentine legislation remained in place, but they were prepared to wait to see if payments were nonetheless made promptly.[52] After further discussion, the Board agreed that the criterion should simply be whether discrimination was actually being practiced. Tenuous as this agreement was, it sufficed to enable Dale to assure the banks that Argentina would be eligible to draw as soon as it eliminated arrears or reached agreement with foreign commercial creditors on a means to settle them.

For the moment, it appeared that a crisis had been averted. Later that week, however, a staff team led by Christian Brachet (Assistant Director of the Western Hemisphere Department) went to Buenos Aires to conduct a more general review of compliance with the performance criteria of the stand-by arrangement. The mission found that the payments arrears were not the only problem: the authorities had lost control of wage policy and thereby of both their own budget and the country's international competitiveness, there were signs of excessive monetary growth, and a new multiple currency practice had been introduced in the form of

[52]Minutes of EBM/83/120 (August 15, 1983), p. 5.

a rebate on auto exports. Since the Executive Board had agreed only to waive the arrears test, the Fund now had no choice but to deny Argentina the drawing of SDR 300 million that had been scheduled for the end of August.

The miseries confronting the Argentine authorities continued to grow. On September 8, González del Solar called on the Managing Director to request a waiver for the missed performance criteria and was told that he would have to show more substantial progress first. When he returned to Buenos Aires, he was immediately jailed by a provincial judge on the grounds that by negotiating with foreign creditors he was violating an Argentine law prohibiting giving foreigners jurisdiction over public sector debt. Although he was released after only a few days, one of his first presents as a free man was a September 12 cable from the Advisory Committee (sent also to Wehbe and de Larosière) stating that they were not prepared to extend the repayment of the bridge loan (due September 15) or to sign the medium-term loan until the legislation enabling discrimination against U.K. banks was repealed.

There was little prospect of tightening macroeconomic policy in the fall of 1983, because the presidential election that would end nearly eight years of military rule was to be held at the end of October. A new government would take power in December, and only then could any progress toward stabilization begin. In the meantime, if no agreement could be reached with commercial banks, Argentina's arrears to commercial creditors would accumulate to a level that could pose a serious threat to the international banking system.

On October 14, de Larosière cabled Rhodes to say that the main reason for the delay in reactivating the program was the banks' refusal to sign an agreement with the authorities.[53] In his view, the banks were holding up the Fund, not the other way around. Three days later, he gave essentially the same message to Executive Directors in an informal meeting. Policies were off track and if not modified would prevent the authorities from meeting the performance criteria for the scheduled end-November drawing, but reaching a settlement with the banks was an essential first step toward getting back on track. Perhaps not surprisingly, the banks saw the matter differently: without a strengthening of policies, and without a more ironclad assurance of nondiscrimination in repayments, they would be assuming undue risk in raising their exposure in Argentina.

On October 30, while the country was without a bank agreement and while its arrangement with the Fund was still suspended, Argentina elected Raúl Alfonsín to be its first civilian president since the coup that had overthrown Isabel Martínez de Perón in 1976. For the next month, the authorities concentrated efforts on securing a bank deal before the oft-extended bridge loan expired on November 30. At the last possible moment, after marathon negotiations had forced the banks to keep the interbank clearing system (CHIPS) open for a record 3½ hours beyond its normal closing hour to accommodate the massive settlements that fell due on that date, the bank loan was finally signed.

[53]IMF/CF (C/Argentina/150.1 "Fund Relations with Commercial Banks, 1975–1983").

Stalemate with the Fund: December 1983–June 1984

Alfonsín was inaugurated on December 10, 1983, and he appointed Bernardo Grinspun (minister of the economy) and Enrique García Vásquez (president of the central bank) to head his economic team. On the 21st, García Vásquez went to the IMF and declared to de Larosière that massive capital flight and dollarization of transactions in the last few months had left Argentina essentially a country without a currency.[54] What a few months ago had seemed to be primarily a political and diplomatic dilemma had overthrown the fragile stability of the country's finances to the point that a major reorientation of policies would be required to restore it. The Managing Director proposed starting negotiations for a longer-term program that could be supported by a financial arrangement under the EFF. The governor countered that speed was of the essence and that a new stand-by arrangement might be preferable, at least as an interim step. They agreed that a mission would go to Buenos Aires in February to begin negotiations, and that the terms of an arrangement could be settled by that time.

Grinspun could not wait two months to begin to restore financial stability. In early January, he went to New York to tell the Committee bankers that he was seeking a new financial arrangement with the Fund and to ask that they redouble their efforts to complete the syndication of the medium-term loan that had been agreed to some six weeks earlier. He then met with the Managing Director in Washington to convey directly his intent to reach an agreement both with the banks and the Fund. With nothing yet in place to demonstrate a commitment to stronger policies, however, this initial effort at persuasion was largely in vain. On January 23, the existing stand-by arrangement (on which SDR 900 million, roughly $915 million, had not been drawn) was formally canceled, clearing the way for a fresh start on a new program.[55]

The Fund mission, headed by Joaquín Ferrán (Senior Advisor in the Western Hemisphere Department) and later by Wiesner, arrived in Buenos Aires on February 6 for what would turn out to be an extraordinarily long and fruitless attempt to negotiate a program for 1984. Economic conditions had worsened dramatically in the run-up to the October election and had continued to deteriorate, the new authorities had not been able to design a consistent set of policies for 1984, and Grinspun appeared to have neither the inclination nor the political backing to correct the situation. After a wasted month, Wiesner returned to headquarters and reported to the Managing Director on the extent of the impasse, at a meeting that was also attended by senior U.S. officials. Real wages were still being raised in defiance of economic realities, he reported, interest rates were negative in real terms, inflation was eroding the competitiveness of the exchange rate, and the official ex-

[54]Memorandum for files, attached to memorandum from Beza to the Deputy Managing Director (January 5, 1984); in IMF/RD Managing Director file "Brazil—1984, January–February" (Accession 85/231, Box 2, Section 177).

[55]The cancellation of the stand-by arrangement was timed to save Argentina from having to pay a fee of some $50,000 for continuing a financial arrangement on which they were not expected to draw.

change rate was far from the rate that prevailed in the parallel market.[56] In short, it was a classic case of fiscal and monetary excess as the new government appeared to be trying to consolidate its political power before regaining control of the economy.

These economic mistakes were compounded by what nearly everyone concerned saw as an attempt by the government to cover up the extent of the problem and to negotiate as if the solution lay in the hands of foreign creditors rather than domestic policymakers. The day after the mission's return to Washington, Rhodes called Dale around midnight and asked him to come to New York the next morning to meet with him and a few of his colleagues on the Committee. Arriving in New York, Dale was told that the bankers were not being kept informed by the Argentine authorities and that consequently they were getting increasingly frustrated and angry. It was now clear that no progress could be made on financing until a much stronger adjustment program was agreed with the Fund and was put in place.

Alfonsín then made what appeared to be a positive move by sending the eminent (and octogenarian) Argentine economist Raúl Prebisch as his personal representative to meet with the Managing Director in Washington. Prebisch spent eight days at the Fund (March 23–31, 1984), talking extensively with the staff as well as management and generally trying to help calm the situation as best as he could.

While Prebisch was in Washington, Grinspun crossed the Río de la Plata from Buenos Aires to Punta del Este, Uruguay, for the annual meetings of the Inter-American Development Bank (IDB) on March 25–27. The IDB meetings provided a forum for the Argentine authorities to find a way to avoid a default if the banks refused to reschedule $500 million in interest payments that were coming due at the end of the month. To that end, the Mexican finance minister, Jesús Silva Herzog, proposed to his colleagues from Venezuela, Brazil, and Colombia that they jointly lend Argentina $300 million for up to three months. Both Mexico and Brazil faced serious debt problems of their own at the time, but Silva Herzog successfully argued that the greatest danger to the financial stability of the whole region was the risk of losing the good working relations that they had gained with international banks. All countries in Latin America thus had a stake in avoiding a collapse in the Argentine negotiations.

A critical element in putting together the four-country loan was establishing confidence that Argentina would soon succeed in negotiating a new financial arrangement with the Fund, a prospect that in fact was by no means certain. Although Wiesner participated in the IDB meetings on behalf of the Fund, and although negotiations with the Fund were then at a very preliminary stage, the loan agreement was predicated on the assumption that the $300 million would be repaid in June, following an anticipated resumption of IMF lending. U.S. treasury of-

[56]Memorandum from Beza to the Managing Director (March 21, 1984); in IMF/RD Managing Director file "Argentina, January–April 1984" (Accession 85/231, Box 2, Section 177).

ficials—notably Deputy Secretary Richard T. McNamar and Assistant Secretary David C. Mulford—also participated in the discussions leading to the four-country loan, and they agreed to arrange for the United States to lend Argentina another $300 million once Argentina signed a Letter of Intent, as a further bridge to the expected drawing on the Fund.

The Punta del Este meetings ended on March 27, which left just three days to work out the formalities of the lending agreements so that Argentina could make its interest payments on the 31st. Grinspun and Silva Herzog briefed Wiesner on the package as they all flew together to Buenos Aires on the 28th. Wiesner then telephoned the Managing Director, whose meetings with Prebisch were ongoing, to inform him that the lenders were asking for a positive progress report on the negotiations as a precondition for completing the deal. With that motivation in mind, de Larosière and Prebisch set out to reach an accord on at least the outlines of a policy package before the deadline expired.

After a series of further discussions, Prebisch and other Argentine officials gathered in the Managing Director's office at 5:00 p.m. on March 30, along with Brachet and a few other Fund staff members. Mario Teijeiro, the Alternate Executive Director representing Argentina at the Fund, was present and was frequently on the telephone to the Finance Ministry in Buenos Aires to get instructions or support. After five hours, they were on the verge of an agreement, until Teijeiro returned from a telephone call to say that Grinspun was insisting on policies that were substantially looser than those in the draft outline. The meeting then continued until just after 11:30 at night, at which point de Larosière and Prebisch both felt able to sign a report that could be issued to creditors.

The Prebisch–de Larosière agreement included several key points. First, the fiscal deficit was to be reduced from 18 percent of GDP in the last quarter of 1983 to 6 percent by the first quarter of 1985. Second, wage policy would be restructured so that adjustments would be based on prospective rather than past inflation. Third, interest rate policy would be tightened so as to maintain positive real interest rates; cuts in interest rates would be implemented only after a decline in inflation and in the fiscal deficit. Fourth, exchange rate policy would aim to strengthen competitiveness of exports sufficiently to achieve a balance of payments target that was consistent with external financing constraints. The specific policy measures that would be needed to meet these general goals were to be worked out in the course of continuing discussions between the staff and the authorities.[57]

As of March 31, 1984, when the text of the agreement was released to the press, Argentina had managed to pull back from the very brink of default.[58] They had obtained $300 million from the four Latin American countries ($100 million each

[57]The "progress report" was circulated to Executive Directors via a memorandum from Teijeiro (April 17, 1984); in IMF/RD Managing Director file "Argentina, January–April 1984" (Accession 85/231, Box 2, Section 177).

[58]U.S. Treasury Secretary Regan, describing the agreement to reporters on March 31, characterized it as aimed at avoiding both a "crisis of government" in Argentina and an international banking crisis; see the *New York Times*, April 1, 1984, pp. A1, A16. For a detailed account of the negotiations in Buenos Aires and in Washington, see *Clarín* (Buenos Aires), March 31, 1984, pp. 2–4.

from Mexico and Venezuela, plus $50 million each from Colombia and Brazil), at an interest rate of 1 percent over LIBOR. The 11 commercial banks represented on the Advisory Committee had kicked in a total of $100 million, at an even more favorable rate of ⅛ point over LIBOR.[59] Those sums, plus $100 million from Argentina's own foreign exchange reserves, were then used to pay the $500 million in interest due to the banks. Formally, the official and bank loans carried 30-day maturities, but everyone understood that the loans would be rolled over for up to two more months until the Fund arrangement was in place.

Negotiations between the authorities and the Fund continued in Washington throughout April but did not lead to any progress. During discussions held in the margins of the Interim Committee meetings, the authorities resisted a suggestion from the Fund staff for a devaluation aimed at stemming capital flight. In the view of the authorities, capital flight from Argentina reflected nothing more than uncertainty over the availability of external financing, not an inadequacy of the policy stance.[60] Later in the month, the authorities even proposed raising fiscal expenditures from 43 percent to 49 percent of GDP, raising questions about the seriousness of their negotiating stance.

Matters got even worse in May when Wiesner returned with a staff team to conduct the annual Article IV consultations in Buenos Aires. The Fund staff insisted that financial stability could be restored only by halting and then at least partially reversing the rise in public sector real wages that had been recorded since Alfonsín had assumed the presidency. Alfonsín, however, had publicly committed himself to increasing real wages by at least 6 percent through the year, and he was determined to keep that pledge. Grinspun informed the staff that he could agree with their technical analysis, but the course that they were insisting upon was politically unacceptable and could not be achieved. By the end of May, the commercial banks had agreed on financing terms, conditional only on a Fund-approved Letter of Intent, and official creditors had agreed to roll over their credits for another 30 days. The pressure on the Fund to approve a program was intense, but the negotiators were getting nowhere.

The bottom of this vortex was reached in June 1984. Grinspun and the planning minister, Juan Vital Sourrouille, having prepared a draft Letter of Intent that apparently had the blessing of Alfonsín, took the unusual gambit of going public with it and submitting it to the full cabinet for approval on June 9, before they had even submitted it to the Fund staff for consideration (which they did on June 11).[61] On

[59]The authorities obtained this low rate by granting a lien against an equivalent amount of their foreign exchange reserves held at the Federal Reserve Bank of New York, to be activated on June 30 unless a further agreement were reached or the loan were repaid. See the testimony by Anthony B. Solomon before the Subcommittee on International Finance and Monetary Policy of the U.S. Senate Committee on Banking, Housing, and Urban Affairs. S. Hrg. 98-782, hearings on "Details and Implications of U.S. Government Involvement in Both the Argentinean and the Larger Latin American Debt Crises," May 3, 1984.

[60]Memorandum from Beza to the Managing Director (April 25, 1984); in IMF/RD Managing Director file "Argentina, January–April 1984" (Accession 85/231, Box 2, Section 177).

[61]Report by the Managing Director at EBM/84/92 (June 13, 1994), pp. 7–8 .

the 12th, Argentina's ambassador to the United States, Lucio García del Solar, called on the Managing Director to explain the extremely charged and sensitive political environment then prevailing in Buenos Aires: Isabel Perón had made a temporary but tumultuous return from exile in Spain, and her Peronist party (the main political opposition to Alfonsín's Radical party) had mobilized an estimated two million workers in a general strike as a means of pressuring the government to get tougher in negotiations with the Fund. The government was severely constrained in what it could accomplish for the economy, but it needed the endorsement of the Fund to regularize its relationships with both private and official creditors. By the end of June, some $1.6 billion in principal and interest would be due, and Argentina could not pay without help from the Fund. Sympathetic though he may have been to the government's plight, to the Managing Director there was simply no question of the Fund giving a positive signal to creditors until a credible policy program was in place.

In the last week of June, Grinspun came again to Washington, in the hope of getting the Managing Director to overrule the staff and approve the draft Letter of Intent. Almost simultaneously, Alfonsín issued a statement in Buenos Aires reaffirming his commitment to increasing real wages by 6–8 percent for the year, thereby undermining his minister's mission. Nonetheless, both de Larosière and Rhodes found enough encouragement in Grinspun's explanations to warrant asking creditors to roll over existing credits for another month and thereby once again staving off the financial and political consequences of default.

Rebuilding Credibility: July–December 1984

The rebuilding process began tentatively in July 1984, when a technical mission, headed by Brian C. Stuart (Deputy Chief of the River Plate Division in the Western Hemisphere Department), visited Buenos Aires to discuss budgetary issues. Much of that mission's work focused on wage policy. The staff argued that stabilizing the budget was practically impossible as long as wages were indexed to past inflation. The authorities, like those in Brazil, insisted that indexation was a political issue, and they argued that the program should be developed around the main macroeconomic aggregates, principally the overall budgetary and external balances. When those talks made little progress, Grinspun decided to take his case directly to the Managing Director. On August 8, he arrived in Washington with a large contingent of other senior officials and plunged into three days of meetings at the Fund.[62] That effort also failed to produce agreement on a Letter of Intent, and as a result the commercial banks refused to roll over a $125 million loan that was due on the 15th, forcing the government to repay it.

Grinspun then virtually demanded that the staff return to Argentina to continue the negotiations. De Larosière agreed, and a mission was sent out in late Au-

[62]Memorandums to management from Stuart and Wiesner (July 27 and August 28, 1984, respectively); in IMF/RD Managing Director file "Argentina, July–August 1984" (Accession 85/231, Box 2, Section 177).

gust, headed by Ferrán. Inflation, the staff found, was continuing to worsen, but the authorities indicated their determination to tackle it through a combination of fiscal restraint, tighter credit, and further wage negotiations with labor and management groups.[63] As soon as the mission returned, the Executive Board met on September 4 to conclude the annual Article IV consultations. Tom de Vries (Alternate—Netherlands) considered that inflation—then in excess of 20 percent a month—was so high that the economy could be stabilized only through a major additional adjustment effort. Guenter Grosche (Germany) found it regrettable that the negotiations had been subjected to so much public debate that both the authorities and the Fund were being put under great pressure. Overall, however, the discussion was low-key, as most Directors were content to wait until the ongoing negotiations were concluded before passing judgment on the situation.[64]

Adding to the pressure on the Fund and the authorities, the commercial banks evidently were not inclined to extend maturity dates further in the absence of an agreed adjustment program. To generate some forward momentum, Grinspun decided to come to Washington early for the Annual Meetings and to make one more effort at finding a compromise. This time the effort succeeded: the Fund agreed to accept the continuation of wage indexation, in return for additiona1 tightening of budgetary and monetary policies aimed at reducing the fiscal deficit from 11½ percent in 1983 to 5½ percent in 1985 and a commitment to adjust the exchange rate so as to achieve a substantial depreciation in real terms by the end of the year. A Letter of Intent was then signed on the opening day of the Annual Meetings, September 25.[65]

Almost immediately after returning home, Grinspun announced that wages would be increased by 14 percent a month for the final three months of the year, a commitment that the Fund staff concluded would make the achievement of the program's targets all but impossible. De Larosière sent Grinspun a cable to that effect,[66] as a result of which García Vásquez came back to Washington for further discussions. It was now the middle of October, and it was clear to de Larosière that the Fund had obtained all the adjustment that it could under the circumstances. Now the Fund either could go ahead with a weak—and weakly implemented—program, or it would leave Argentina without external financing and forced to default on its obligations.

For the rest of 1984, the Managing Director's efforts on Argentina were directed toward securing as much additional financing as he could. The condition of the program left no room for slippage on that front. Argentina, the staff calculated, would need $3.1 billion in external financing in 1985 to cover its balance of pay-

[63]Report by the staff at EBM/84/132/R-2 (September 4, 1984), p. 1.

[64]Minutes of EBM/84/132–133 (September 4, 1984).

[65]"Argentina—Request for Stand-By Arrangement," EBS/84/203 (September 26, 1984). The exchange rate commitment was an oral agreement and was not included in the Letter of Intent; see related memorandums in IMF/RD Managing Director file "Argentina—Vol. II" (Accession 88/274, Box 11, Section 269).

[66]Cable from the Managing Director (October 3, 1984); in IMF/CF (C/Argentina/1760 "Stand-by Arrangements, 1984–1985").

ments deficit; another $3.2 billion to clear arrears to commercial banks, suppliers and other commercial creditors, and official creditors; perhaps $0.5 billion to reconstitute foreign exchange reserves from their depleted level; and more than $1 billion to repay outstanding swap operations and bridge loans. That left a total of approximately $8 billion to be financed.[67]

That amount was too large to be financed by the Fund and the commercial banks alone; a substantial participation by creditor countries would also be needed. On October 22, however, Alfonsín and Grinspun, meeting with French officials in Paris, were told not to expect such an official package. In response, de Larosière set out to generate the necessary support himself.[68]

Following a series of bilateral meetings with officials of creditor countries, de Larosière called together the Executive Directors representing G-10 countries and asked for their help in assembling $1 billion in export cover guarantees to be available in 1985. The United States, it appeared, would provide about one-fourth of that amount if the others would come up with the rest.[69] The Fund could provide close to $1.2 billion under a stand-by arrangement, but only if the Executive Board approved the arrangement before the end of the year, after which access limits were to be reduced.[70] Another $275 million could be made available through the CFF if a case could be made that Argentina had experienced a shortfall in export receipts owing to factors outside the authorities' control (a shaky proposition, since exports were by then already recovering). The World Bank and the IDB were discussing loans that could total around $600 million in 1985, and a rescheduling of official credits through the Paris Club could be counted upon to bring in another $730 million. If all of those amounts materialized, there would remain a gap of about $4.2 billion that would have to be covered by commercial banks.[71]

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[67]The figures are from a table (undated but apparently prepared by the staff around end-November 1984) in IMF/RD Managing Director file "Argentina, November 1984" (Accession 86/34, Box 29, Section 209).

[68]Memorandum from Wiesner to the Managing Director (October 25, 1984), with handwritten response; in IMF/RD Managing Director file "Paris Club" (Accession 88/274, Box 7, Section 269).

[69]There were two logical difficulties with this approach to closing the financing gap. First, since official export cover would be provided in response to specific requests and would be evaluated by the agencies concerned on a case-by-case basis, governments could give only notional indications of amounts that might be made available up to specified ceilings. Second, increased availability of such guarantees could easily lead to increased imports and thus add commensurately to the gap that had to be filled. There was, however, no alternative source of funds available at the time.

[70]In 1984, member countries were permitted to draw up to 102 percent of their quota a year. In cases of exceptional balance of payments need and where an exceptionally strong adjustment program was being implemented, access could be granted up to 125 percent. On November 16, 1984, the Executive Board decided to reduce the limit to 95 percent, or 115 percent in exceptional cases. (See Chapter 17 for details.) Argentina's quota at the time was SDR 1,113 million (and approximately the same in U.S. dollars), so the new limit would reduce Argentina's access by about $76 million. Though this reduction would have been small in relation to Argentina's total financing needs, it sufficed to make end-December an effective deadline for approving the arrangement.

[71]The figures are from a report by the Managing Director at EBM/84/172 (December 3, 1984), pp. 3–4.

The struggle to keep bank creditors on board revealed the first great rift in the concerted-lending strategy. Despite the banks' fatigue with the process, they had little choice but to approve a new-money loan once the stand-by arrangement was approved, but the magnitude of the gap they were being asked to fill was a problem. $4.2 billion would imply an increase in exposure to Argentina by about 15 percent, much larger than in most other cases. De Larosière therefore decided to take the case directly to the chairmen of the 11 Advisory Committee banks, and he arranged for a meeting at the Federal Reserve Bank of New York on November 26, 1984, with the top two Federal Reserve officials—Volcker and Anthony Solomon (president of the New York bank)—present. Also invited were A.W. Clausen and Antonio Ortíz Mena, the presidents of the World Bank and the IDB, respectively. Opening the meeting at 8:30 a.m., the Managing Director asked the banks if they could give him written assurances before Christmas that they could provide $4.4 billion in new financing for 1985—an amount that would close the gap without resort to the dubious call on the CFF. Without such assurances, he explained, he could not call a Board meeting to approve the stand-by arrangement, and any delay would bring the program under the new lower access limits.[72]

After a lengthy discussion of the adjustment program and its financing requirements, Sir Jeremy Morse, the Chairman of Lloyds Bank, called for a caucus of the bankers in the room. When they returned, they insisted that the requested amount was impossible, simply because they did not believe that they could sell it to the 300 or so other banks that would have to participate in the lending syndicate. There would be a significant dropout rate among smaller banks, and the package would fail. The only hope, in their view, was to keep the loan below $4 billion. Clausen and Ortíz Mena explained their institutions' lending plans and limitations, and de Larosière explained the difficulties with requesting compensatory financing through the Fund's CFF. The financing gap, he concluded, was $4.4 billion, and they could not escape that fact. After a second caucus around noon, the bankers agreed only to consider the matter further.

Over the next week, the bank committee held intensive meetings, including sessions with the Managing Director, at the end of which they agreed to a $4.2 billion loan, which they would propose to the banking community. For his part, de Larosière agreed to support the idea of a drawing under the CFF to close the gap. Thus, relative to the initial bargaining positions, the banks would commit an additional $600 million, while the Fund would contribute an additional $270 million.[73]

The Executive Board meeting to consider the program was tentatively scheduled for the very end of the halcyon days, December 28, a date that left only four weeks to secure a "critical mass" of commitments to ensure that the banks could come up with the promised $4.2 billion. As with earlier such packages, the goal

[72]Speaking notes and draft minutes ("Notes for the Managing Director's Statement on Argentina, November 26, 1984") in IMF/RD Western Hemisphere Department file "Argentina—General Correspondence, 1984" (Accession 89/35, Box 3, Section 236).

[73]Minutes of EBM/84/172 (December 3, 1984), pp. 3–4.

was to have 95 percent of the money committed by the date of the Board meeting. The Deputy Managing Director, Richard D. Erb, set off on December 8 on a round-the-world trip to meet with bankers in San Francisco, Tokyo, Bahrain, Zurich, Frankfurt, and Paris. De Larosière went to New York on the 13th to meet with bankers, together with García Vásquez. Other meetings involved the staff, Executive Directors, and senior Argentine officials. By the morning of December 28, as the Board meeting began on schedule, the Managing Director was able to report that 91 percent of the package was complete. Though this was slightly below target, it was sufficient to enable U.S. treasury officials to assure the Fund that they would provide a bridge loan until the loan was finally signed, and it was "an amount that, in the [bank Advisory] Committee Chairman's view, adequately demonstrated the international banking community's commitment to do its part in further assisting Argentina."[74]

Executive Directors expressed a number of concerns during the restricted session, but most speakers were nonetheless supportive of the program. The most dubious element of the package was the CFF drawing to which the Managing Director had agreed only in desperation. Jacques Polak (Netherlands) refused to support the requested CFF drawing, on three grounds. First, the shortfall in export receipts had resulted largely from an overvalued exchange rate and from high domestic consumption demand: factors that the authorities could have controlled. Second, although there were external contributing factors—weak demand in neighboring countries and protectionism by industrial countries—those factors were not temporary, as required by the terms of the facility. Third, if the latest available data had been used to calculate the shortfall, it would have been too small to warrant the drawing. Other Directors also expressed reservations, but none declined to support the request. In response, the staff acknowledged that exports were now recovering but insisted that the request did meet the CFF criteria under the procedures established by the Board. Furthermore, the external factors depressing exports were substantial and would prove to be temporary if the world economy grew in line with staff projections.[75]

A.R.G. Prowse (Australia) raised a technical objection to the way exchange rate policy had been formulated in the program. Rather than allowing the exchange rate to float, the authorities were targeting the real exchange rate: "the real appreciation of the recent past is to be reversed and thereafter the exchange rate is to be adjusted at least sufficiently to compensate for the difference between changes in domestic and international prices." Prowse was concerned that in view of the considerable degree of government intervention in the Argentine economy, including constraints on imports, this form of exchange rate policy might not be consistent with market forces. He would have preferred that the Fund encourage the authorities to float the rate. In response, the staff noted that it was customary for the Fund to encourage countries in similar circumstances to target the real ex-

[74]By the start of the afternoon session of the meeting, the total had risen to 92.8 percent. See minutes of EBM/84/190/R-1 (December 28, 1984), p. 1.

[75]Minutes of EBM/84/190–191 (December 28, 1984).

change rate, and the Managing Director added that the program as a whole de-emphasized the pursuit of real rather than nominal targets.[76]

The Board approved the stand-by arrangement, but with somewhat less enthusiasm than was its custom. As the Managing Director noted in summing up the discussion, there was "no room for slippages and no margin for maneuver," while the declared policies "should be seen as a minimum . . . desired performance" and were in need of "more precise formulation." For the moment, Argentina would be eligible to make its first conditional drawing in more than a year and a half.[77]

The Austral Plan: 1985

In early January, the Fund began encouraging the authorities to strengthen the adjustment program, especially by more aggressively depreciating the exchange rate. Following a staff visit, the Managing Director cabled Grinspun that without a further real depreciation, exports were likely to fall well short of the program's requirements.[78] On the whole, however, optimism still prevailed that the existing program could be sustained. On January 16, the Paris Club, at the conclusion of a meeting at which Ferrán made a detailed presentation on the program and the Argentine economy, agreed to reschedule more than $2 billion in official credits, including some $1.3 billion that was then in arrears.

Matters deteriorated sharply a few weeks later, when Ferrán led a review mission to Buenos Aires and obtained more specific information that policies were no longer consistent with the program. Neither wage policy nor exchange rate policy was on course, and several performance criteria were not being met. Most critically, the government was attempting to control interest rates at artificially low levels, and rates were now highly negative in real terms. Severe tension arose between the staff and the authorities in the course of this mission and came to a head at a meeting on February 18. Ferrán set out the staff view that the only sustainable way to reduce real interest rates was first to implement tougher fiscal and monetary policies. In response, Grinspun insisted that interest rates could be maintained independently of the macroeconomic stance and that to raise either interest rates or public sector prices would aggravate inflationary pressures. These two positions

[76]"Argentina—Request for Stand-By Arrangement," EBS/84/251 (December 3, 1984), p. 35; and minutes of EBM/84/190/R-1 (December 28, 1984), pp. 38–39 (Prowse), and EBM/84/191/R-1 (same date), pp. 28–30 (Managing Director).

[77]Minutes of EBM/84/191/R-1 (December 28, 1984), p. 34. The last drawing under the 1983 stand-by arrangement had been made in May of that year. In December 1983, Argentina had drawn SDR 78 million against its reserve tranche following the quota increase obtained through the Eighth General Review. The decision taken on December 28, 1984, enabled Argentina to borrow SDR 236.5 million under the stand-by arrangement in January, and simultaneously to draw SDR 275 million under the CFF. The total amount available under the 15-month stand-by arrangement was SDR 1,419 million (127.5 percent of quota), which was equivalent to an annualized access rate of 102 percent. (All of these amounts were, at the time, approximately the same in dollars as in SDRs.)

[78]Cable from the Managing Director (January 23, 1985); in IMF/RD Managing Director File "Argentina—Vol. II" (Accession 88/274, Box 11, Section 269).

were so strongly held that negotiating a compromise became futile. Ferrán informed the authorities that he did not anticipate that the Fund would grant any waivers for the next scheduled drawing without a substantial tightening of policies—a tightening that Grinspun was insisting he could not make. The meeting was adjourned with a plan to meet again two days later but with no real hope on either side for meaningful negotiations.

Following the meeting, Grinspun and García Vásquez went to see Alfonsín to report that negotiations were at an impasse. The president had little choice: if the adjustment program was to succeed, he would need a new approach and new leadership. He dismissed both officials on the spot and replaced them with a team that presumably would be more open to change.[79]

The new minister of the economy, Juan Vital Sourrouille, requested that the Fund staff return to Buenos Aires as soon as possible to renegotiate the program. Unfortunately, when Ferrán and his team arrived on March 8, the two sides fell into disagreement over how seriously to interpret the fiscal overruns at the end of 1984. Negotiations never got started, and the mission was aborted after just four days.[80]

Alfonsín was scheduled to make a state visit to Washington starting March 18, and he seized the opportunity to try to mend fences with Argentina's creditors. He brought along his new economics team, led by Sourrouille. That team (including J.J. Alfredo Concepción, the new president of the central bank) met with the Fund staff, after which Alfonsín hosted a breakfast meeting with de Larosière and Erb at the Madison Hotel on March 20. Alfonsín desperately needed the support of the Fund for his policies; without it, he had learned, neither the U.S. government nor the commercial banks would provide financing. The Managing Director refused to consider a waiver for the fiscal overruns in the absence of strong prior actions to reduce the deficit, but he did agree to break precedent by issuing a statement of support to the banks merely on the understanding that Alfonsín would give his full support to negotiating a sustainable program for the rest of 1985. This meeting marked the beginning of an intense effort, not just to put the program back on track, but to develop a new and far more radical approach to economic stability in Argentina.[81]

Ferrán and his staff team returned to Buenos Aires on March 26 for three weeks of discussions, after which Sourrouille and his team came to Washington to present their policy proposals directly to the Managing Director and to the U.S. au-

[79]García Vásquez was retained by Alfonsín as a counselor, and in that capacity he participated in meetings with the IMF in the following months.

[80]See memorandum from Ferrán to the Managing Director (March 18, 1985), in IMF/RD Deputy Managing Director file "Argentina, 1985 (2)" (Accession 90/104, Box 6, Section 415).

[81]De Larosière reported on the various meetings to the Executive Board at the afternoon meeting on March 20; see the minutes of EBM/85/46, p. 3. Erb conveyed the Managing Director's support to the banks' Advisory Committee at the committee's meeting in New York the next day; and de Larosière sent a written message to bank creditors on the 22nd (in IMF/CF (C/Argentina/150.1 "Fund Relations with Commercial Banks, 1984–1985"), acknowledging the lapses in implementation but also noting the government's preparedness to move forward and concluding that the completion of the bank financing package was "of the utmost importance."

thorities. In an extraordinary meeting on April 15 in the Managing Director's office that began at 5:00 p.m. and lasted for four hours, Sourrouille sketched out for de Larosière, Volcker, and Mulford his intention of implementing a shock program in June.[82] In the meantime, he would decontrol prices and wages so that relative prices could seek equilibrium levels before a freeze was put in place. Volcker argued that the key to success would not be in the effectiveness of a price freeze, which in any case would have to be strictly temporary, but in whether the fiscal deficit could be financed outside the banking system. To make a financing plan credible, he suggested—and Sourrouille concurred—that the central bank be made more independent and prohibited from financing the government. The plan was yet only an outline, but both the Fund and the Americans were enthusiastic about it, and now it had momentum.

After that meeting, the authorities went to New York to try to persuade the bankers on the Advisory Committee to be patient while they continued to negotiate with the Fund. Argentina was not yet able to stay current on its interest payments to the banks, and a Fund agreement was essential before they could restore regular financial relations. Obviously, absolute secrecy would have to be maintained regarding the plans for implementing a shock program, so the authorities and the staff began an elaborate charade of negotiating a conventional gradual-adjustment program.[83] From late April through early June, almost continuous negotiations took place, alternately in Buenos Aires and Washington. Throughout that period, the technical staffs would meet regularly so as to appear to be hammering out details for gradually restoring stability, after which a small set of senior officials would meet secretly to discuss plans for the shock program.

On June 7, the Managing Director informed the Executive Board that the staff had reached a general agreement on a new (conventional) program. In addition, a group of official creditors, led by the United States and also including the BIS and three Latin American countries (Mexico, Brazil, and Venezuela) had agreed in principle to lend Argentina the funds needed to clear arrears to the commercial banks, thereby clearing the way for the Executive Board to consider a resumption of drawings under the stand-by arrangement.[84] On June 11, Sourrouille and Concepción signed the Letter of Intent. The next day, the U.S. Treasury issued a press release welcoming the agreement and announcing that a bridge loan was being negotiated for $450 million. To all appearances, the program originally approved by the Fund six months earlier was about to be revived.[85]

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[82]On the context of this meeting, see Machinea (1990). Details are from background interviews.

[83]In mid-April, Sourrouille proposed that a conventional program built around a sharp fiscal adjustment be announced by Alfonsín at the beginning of May, conditional on the Fund's willingness to publicly support it; a wage-price freeze and monetary reform would then be announced in mid-June. When that schedule proved to be too ambitious, the alternative emerged of negotiating the conventional and shock programs simultaneously while keeping the latter as a closely held secret.

[84]Statement by the Managing Director at EBM/85/91 (June 7, 1985), p. 3.

[85]See *Clarín* (Buenos Aires), June 12, 1985, pp. 2–5; and June 13, pp. 2–3. On neither day was there any hint of consideration of a more drastic reorientation of policies.

The shock program, which was scheduled to be announced on Sunday, June 16, and to be put in place the next morning, was still a closely guarded secret. The few Fund staff who were involved in the planning were sent home on leave for the days leading up to the announcement to guard against inadvertent leaks, especially as the bank creditors with whom the staff were in regular contact were beginning to suspect that something unusual was afoot. In spite of the precautions, however, rumors surfaced in Buenos Aires a couple of days early, and the authorities were forced to announce what would become known as the Austral Plan on Friday instead of waiting for the weekend.

Because of the extreme secrecy that was required, the public perception of the Fund's role in the development of the Austral Plan was quite distorted. Press reports typically were predicated on the belief that the staff had naively negotiated a relatively weak program, only to be blindsided by the announcement of the shock program a few days later. One report even went so far as to quote an unnamed Executive Director resorting to "heavy irony" in a strong complaint to "the acutely embarrassed . . . de Larosière" (who, incidentally, was not even in town at the time) at the August 9 Board meeting where the program was approved. By that time, Executive Directors were all well aware of the background to the Plan, and no dissent was expressed.[86]

The centerpiece of the Austral Plan was a new currency, the austral, which was set equal to 1,000 pesos or US$1.25.[87] Prices were temporarily frozen, central bank financing of the fiscal deficit was to be ended, and the deficit for the second half of the year was to be limited to just 2½ percent of GDP. Most dramatically, in contrast to previous practice, contracts were to be deindexed. In practice, this policy could stick only if inflation fell close enough to zero that agents could have confidence in the value of nominal contracts.

Initially, the Austral Plan worked much as intended. Aided by the "Tanzi effect," real fiscal revenues surged temporarily once inflation subsided under the price freeze, and the fiscal deficit appeared to be on target.[88] Although the banks remained reluctant to sign a new agreement until more lasting and concrete measures were in place, the bridge loan from official creditors gave Argentina some respite.[89] The authorities signed a new Letter of Intent on July 22, and the Executive Board met on August 9 to embrace the new policies enthusiastically. As Erb (the Acting Chairman) summarized the meeting, "I believe it is fair to say, without creating a sense of unwarranted euphoria, that the spirit and the tone of the

[86]The report was in the *International Currency Review*, Vol. 17 (December 1985), p. 44; it was later cited by Stiles (1987, p. 77), who similarly misinterpreted the situation.

[87]This was the second currency reform in two years. One austral was equivalent to 10 million of the old pesos that had been in circulation before June 1983.

[88]The exposition of this effect was developed at the Fund by Vito Tanzi when he was a Division Chief in the Fiscal Affairs Department. The Tanzi effect predicts that in a country such as Argentina, a sudden drop in the inflation rate will raise the real value of tax collections because of substantial lags between the receipt of income and the payment of taxes. See Tanzi (1977, 1978).

[89]The bridge loan, provided by a group of 12 countries, was finalized in late June and totaled $483 million.

discussion today were quite different" from the last Board meeting the previous December. "All Executive Directors warmly welcomed the new economic program. . . . Directors have qualified the program as bold, courageous, and imaginative."[90] The Board's approval reactivated the stand-by arrangement, allowed Argentina immediately to draw the SDR 236.5 million ($245 million) that had originally been scheduled for May, and unlocked the negotiations with the banks, who signed the new-money loan in New York on August 26. A late-August review mission found the situation to be under control, enabling Argentina to draw a further SDR 236.5 million at the end of September.

This initial success did not last. Fiscal policy was kept formally on track but was undermined by a surge in off-budget spending. More important, monetary policy was loosened by the Central Bank through an explosion of rediscounting.[91] Inflation was greatly reduced from the first half of the year but was still running at 2–3 percent a month, a rate that was incompatible with the maintenance of deindexed contracts. Public sector workers demanded wage increases, and the freeze could not hold. Privatization plans were scrapped when announcements were met by protests and strikes. By November 1985, Argentina was in arrears to official creditors under the terms of the Paris Club agreement of January.

Congressional elections were held in Argentina on November 3, and the ruling Radical Party held control for Alfonsín. Shortly thereafter Ferrán led a mission to see if the program could be kept on track, but he returned discouraged. The government apparently had been waiting for the elections to be over before taking action to restore stability, but now they seemed to be confident that they could stay on the present course. Once again Argentina was out of compliance with its own program, and the scheduled December drawing would not take place.

Debt Strategy Through 1985

Case-by-Case Approach

The key phrase to describe the IMF's strategy for coping with the debt crisis of the 1980s is "case-by-case." That phrase became both a mantra and a cliché, but it also conveyed the essence and the core of the strategy: never was serious consideration given to imposing a uniform solution on the indebted countries or the financial markets. There was to be no restructuring of debts except through market-based negotiations, and the role of the IMF was to be limited to providing a relatively small portion of the indebted countries' financing needs, promoting the adjustment of economic policies so as to reduce those needs, and "catalyzing" the provision of additional financing by other creditors. To that extent, the strategy

[90]Minutes of EBM/85/125 (August 9, 1985), p. 8.

[91]Machinea (1990, pp. 33–38) discusses the problems with monetary control during this period. Also see Heymann (1991) for an overview of the Austral Plan and its aftermath.

Table 9.1. IMF Lending Arrangements with Heavily Indebted Middle-Income Countries, 1979–89[a]
(In millions of SDRs or percent of quota)

	Date	Type[b]	Length (Months)[c]	Amount Approved[d]	Percent of Quota	Amount Used	Peak Debt (percent)[e]
Latin America and the Caribbean							
Argentina	January 1983	SBA	15	1,500	187	601	260
	December 1984	SBA	17	1,419	127	1,183	
	July 1987	SBA	15	1,113	100	782	
	November 1989	SBA	18	1,104	99	506	
Bolivia	February 1980	SBA	12	66	148	53	
	June 1986	SBA	13	50	55	33	139
Brazil	March 1983	EFF	36	4,239	425	2,743	292
	August 1988	SBA	18	1,096	75	365	
Chile	January 1983	SBA	24	500	154	500	246
	August 1985	EFF	36	750	170	750	
	August 1988[f]	EFF	12	75	17	56	
	November 1989	SBA	12	64	15	64	
Colombia	None						0
Costa Rica	March 1980	SBA	24	61	98	16	
	June 1981	EFF	36	277	450	23	
	December 1982	SBA	12	92	150	92	272
	March 1985	SBA	13	54	64	34	
	October 1987	SBA	18	50	59	0	
Ecuador	July 1983	SBA	12	158	150	158	
	March 1985	SBA	12	106	70	106	268
	August 1986	SBA	12	75	50	15	
	January 1988	SBA	14	75	50	15	
	September 1989	SBA	18	110	73	39	
Jamaica	June 1978	EFF	36	200	270	25	
	April 1981	EFF	36	478[g]	431	403	553
	June 1984	SBA	12	64	44	64	
	July 1985	SBA	12	115	79	42	
	March 1987	SBA	15	85	58	85	
	September 1988	SBA	20	82	56	41	
Mexico	January 1977	EFF	36	518	140	0	
	January 1983	EFF	36	3,411	425	2,503	
	November 1986	SBA	18	1,400	120	1,400	335[h]
	May 1989	EFF	36	3,263[i]	280	3,263	
Peru	November 1977	SBA	26	90	55	10	
	September 1978	SBA	15	184	112	64	
	August 1979	SBA	18	285	174	248	
	June 1982	EFF	36	650	264	265	285
	April 1984	SBA	24	250	76	30	
Uruguay	March 1979	SBA	12	21	25	0	
	May 1980	SBA	12	21	25	0	
	July 1981	SBA	12	32	25	32	
	April 1983	SBA	24	378	300	151	
	September 1985	SBA	18	123	75	123	208
Venezuela	June 1989	EFF	36	3,703	270	1,852	55[j]

Table 9.1 ***(concluded)***

	Date	Type[b]	Length (Months)[c]	Amount Approved[d]	Percent of Quota	Amount Used	Peak Debt (percent)[e]
Other regions							
Côte d'Ivoire	February 1981	EFF	36	485	425	447	517
	August 1984	SBA	9	83	50	62	
	June 1985	SBA	12	66	40	66	
	June 1986	SBA	24	100	60	24	
	February 1988	SBA	14	94	57	7	
	November 1989	SBA	18	176	106	147	
Morocco	October 1980	EFF	36	810	540	129	
	April 1982	SBA	12	281	125	281	
	September 1983	SBA	18	300	133	300	391
	September 1985	SBA	18	200	65	10	
	December 1986	SBA	15	230	75	230	
	August 1988	SBA	16	210	68	210	
Nigeria	January 1987	SBA	12	650	77	0	0
	February 1989	SBA	15	475	56	0	
The Philippines	April 1976	EFF	36	217	124	217	
	June 1979	SBA	6	105	50	91	
	February 1980	SBA	24	410	195	410	
	February 1983	SBA	12	315	100	100	320
	December 1984	SBA	18	615	140	403	
	October 1986	SBA	18	198	45	198	
	May 1989	EFF	36	661	150	236	
Yugoslavia	May 1979	SBA	12	69	17	69	
	June 1980	SBA	18	339	82	200	
	January 1981	SBA	36	1,662	400	1,662	481
	April 1984	SBA	13	370	60	370	
	May 1985	SBA	12	300	49	300	
	June 1988	SBA	12	306	50	122	

[a]Includes arrangements approved earlier that were still in effect in 1979.
[b]SBA = ordinary stand-by arrangement; EFF = extended arrangement.
[c]Initial length. Some arrangements were extended or canceled prior to expiration.
[d]Initial approved amount, except as noted below.
[e]Peak level of the Fund holdings of the member's currency in excess of quota, in percent of quota. Includes effects of other loans through special facilities from the General Resources Account. (Also see notes 8 and 10).
[f]Extension of the previous EFF arrangement.
[g]Approved initially for 236; augmented to 478 in June 1981.
[h]Obligations from the 1989 arrangement peaked in 1990 at 411 percent.
[i]Approved initially for 2,797; augmented to 3,263 in January 1990.
[j]Obligations from this arrangement peaked in 1991 at 166 percent.

would remain constant throughout the decade. What would change would be the focus of the adjustment effort (toward longer-term and more structural programs) and the tactics to keep the banks "in the game" (moving eventually away from concerted lending, toward broader menus for restructuring debts, and finally toward directly reducing the stock of debt).

The case-by-case approach did not mean that the Fund would provide assistance only to the better performers and leave others aside. Of the 17 middle-income developing countries that came to be recognized as "heavily indebted," all

received assistance from the Fund in some form during the 1980s.[92] As is shown in Table 9.1, all but two drew on Fund resources at least once, and most had active stand-by arrangements for much of the 1980s. Of the two that did not use Fund financing, one (Colombia) had a "shadow program" monitored by the Fund (see below), and the other (Nigeria) had two stand-by arrangements on which the authorities chose not to draw.[93]

During the initial phase of the debt strategy (1982–85), in addition to the three major cases discussed above, the Fund engaged in lending arrangements with ten other heavily indebted countries. Without attempting to describe those arrangements in detail, it is worth noting a few key points.[94] First, these were all cases where the initial imbalances were large enough to constitute an economic crisis. Either the current account deficit was too large to be financed without extraordinary measures, or domestic economic activity was seriously depressed; often, both. When Chile, Peru, Uruguay, and Côte d'Ivoire sought the help of the IMF in this period, they were experiencing output declines of 10 to 20 percent. Chile and Côte d'Ivoire, as well as Costa Rica, Jamaica, and Morocco, faced current account deficits of more than 10 percent of GDP.

Second, in nearly every case, approval of the Fund arrangement was a precondition for financing agreements with commercial and official creditors.[95] On several occasions, however, especially by 1985, final agreements with banks took a year or more to conclude after the Fund arrangement was in place. Hence many of the negotiated programs were underfinanced, and the countries were forced either to intensify their policy adjustments or seek waivers and modifications to the original terms.

Third, during this period, adjustment was mostly confined to tightening monetary, fiscal, and wage policies, while attempting to maintain the exchange rate at a competitive level, often through devaluation. Other, more structural, reforms—liberalization of prices, privatization of state enterprises, simplification of regulations, etc.—which would later be seen as crucial to the restoration of growth, were not ignored but were not yet given the same emphasis.

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[92]This grouping comprises the "Baker 15" countries (see Chapter 10), which were specified as heavily indebted in the *World Economic Outlook* classification from 1986 on, plus Costa Rica and Jamaica. The Fund, of course, also had financial arrangements with many of the less heavily indebted developing countries during this period.

[93]The Nigerian authorities indicated in the Letters of Intent for these arrangements that they did not intend to use the resources and were seeking only the Fund's endorsement of their structural adjustment program for the purpose of securing agreements with other creditors. "Nigeria—Stand-by Arrangement," EBS/86/246, Sup. 3 (December 17, 1986), pp. 14–15; and "Nigeria—Stand-by Arrangement," EBS/89/2, Sup. 1 (February 8, 1989), p. 7.

[94]The Chilean crisis was described in Chapter 8, and Costa Rica is examined below, in Chapter 11. The Philippines is discussed in the more general context of Fund conditionality in Chapter 13, while Peru is discussed in the context of the arrears problem, in Chapter 16.

[95]Commercial bank creditors, led by an Advisory Committee chaired by Chase Manhattan Bank, made an exception for Venezuela in 1983. Negotiations for a stand-by arrangement were not succeeding, as the staff concluded that adjustment was needed but was being delayed by impending presidential elections. Creditor banks nonetheless agreed to reschedule public sector debts falling due in both 1983 and 1984. No concerted lending was involved, so this agreement simply maintained the existing level of bank exposure.

Fourth, where the initial problems were severe, financing was delayed, and badly needed reforms were not undertaken, the Fund-supported programs usually failed. Of 25 arrangements approved with these countries in 1982–85, only 11 were fully utilized, and several of those required substantial modification before they were finished. The difficulties experienced in implementing programs in Mexico, Brazil, and Argentina have already been seen. Serious implementation problems were also encountered in programs with Côte d'Ivoire, Peru, the Philippines, and Uruguay, among others.

Fifth, notwithstanding the obstacles, almost all of these arrangements were repaid on time and in full. Peru developed protracted arrears, and later in the decade Argentina occasionally fell behind in payments for short periods. The others remained current, even as many of them went into arrears to other creditors. Abandoning the Fund was tantamount to giving up on regaining access to international financial markets. The debt strategy might not have been a complete success, but few of the indebted countries were prepared to turn their backs on it.

A primary goal of the debt strategy that emerged in the second half of 1982 was to reestablish normal financial relations between creditors and debtors, on the grounds that both groups would benefit and that a systemic crisis would thereby be averted. As the above brief review of the case-by-case approach suggests, the Fund's strategy to promote this objective was to assist countries in adjusting policies to a sustainable stance and to encourage commercial creditors to continue to provide enough financing until the indebted countries could get their economies back to a sustainable path.[96] The first half of that strategy involved little more than an intensification of the Fund's traditional role vis-à-vis member countries. The second half, in contrast, required a sharp break with the Fund's traditional arm's-length relations vis-à-vis private creditors. By 1985, a major preoccupation of the Fund was the search for a means of closing the strategy, of restoring normality so that the temporary surge in reliance on the Fund could be quickly ended.

Concerted Lending

Concerted lending agreements by commercial bank creditors played such a key role in the early years of the debt strategy, and the difficulty of continuing with these agreements played such a key role in forcing changes in the strategy later on, that it is worth a pause to review how they fit in with the overall structure.

Before the debt crisis hit in 1982, the standard practice in the Fund was to calculate a borrowing country's financing requirements: in part by determining how much the country could expect to borrow from commercial, as well as official, creditors; and in part by determining how much debt the country reasonably could take on without straining its ability to repay. Typically, one or more lead banks would have formed informal lending syndicates, and the banks' intentions were easily ascertained through informal contacts. (For notable exceptions, see Chapter

[96]For a summary of the Fund staff's view of the debt strategy, see "Implementation of the Debt Strategy—Current Issues," EBS/87/38 (February 20, 1987).

6, p. 275.) In problem cases, bank loans were often made conditional on the country entering into and complying with a stand-by arrangement with the Fund.[97] That strategy collapsed, at least for the most heavily indebted countries, with the Mexican crisis of August 1982.

As recounted in Chapter 7, Mexico's largest creditor banks agreed within a week of the blowup—with the tacit blessing of their national regulatory authorities—to organize an Advisory Committee to negotiate with the Mexican authorities on behalf of all of the banks in the various existing syndicates. A similar committee was formed for Argentina in November 1982, and a more complicated committee structure was attempted for Brazil a few months later (see Chapter 8). In forming these committees, the banks hoped to find a way to gradually reduce their loan exposure in each country without precipitating a default or a financial crisis. That goal, however, put the banks in direct conflict with the IMF: any additional lending by the Fund would be offset by greater withdrawals by the banks and would produce no benefit to the member country. Within the traditional structure of relationships, the only ways to avoid that result were for official creditors to provide still more financing (which would then be used indirectly to repay the banks) or for the country to refuse to repay its debts.

The turning point came at the November 1982 meeting in New York (see Chapter 7), at which the Managing Director informed the banks that the Fund would not approve Mexico's requests for an extended arrangement until the banks provided him with written assurances that they would increase their exposure by enough to cover a substantial fraction ($5 billion) of Mexico's scheduled interest payments for 1983. The threat was credible, because although the banks knew that the Fund had to help Mexico as best it could, they also knew that without the requested commitment from them, Fund lending would not help the country.

The concerted-lending process brought the Fund and the banks into a close working relationship. Fund staff occasionally attended the (usually monthly) meetings between the Advisory Committees and the authorities. Bankers often came to the Fund to review developments with the staff. After the banks set up their own monitoring organizations such as the Institute of International Finance (located just one block from the IMF headquarters in Washington), the staff regularly exchanged information with them. The Managing Director and the Deputy Managing Director spoke and met frequently with the chairs of the Committees and occasionally with other key bankers as well. Both staff and management met frequently with officials of the United States and other major creditor countries with regard to pending bank agreements.

As necessary as this coziness may have been, it gave rise to two problems. First, as an ironic twist to a policy aimed at ensuring that commercial banks would not withdraw support from countries in trouble, it gave the banks a virtual veto over the approval and financing of adjustment programs. With smaller countries where the banks' exposure did not threaten their solvency, and even in some larger coun-

[97]For a summary of pre-1982 relations with creditors, see "The Role of the Fund in Assisting Members with Commercial Banks and Official Creditors," EBS/85/173 (July 23, 1985), pp. 1–5.

tries where the banks had a strong interest in altering the outcome, they were able to use this power to force significant modifications to the program, often badly delaying approval and implementation.

This difficulty was illustrated in Chile in 1984. The stand-by arrangement that had been approved in January 1983 had gone off track twice in its first year, and negotiations were held in late 1983 and early 1984 on a program that could serve as the basis for resuming the arrangement. Negotiations were protracted, because the economy was sliding into recession, the Pinochet government was facing a rising tide of social unrest, a new team of economic officials was brought in through a cabinet shuffle at the beginning of April, and the new authorities were pushing for a greater easing of fiscal and monetary policies than the staff thought was warranted.[98] Meanwhile, the banks were insisting on the continued government subsidization of the servicing of private sector debts (see Chapter 8), without which they refused to sign an agreement covering official payments due in 1984. The staff were reluctant to approve that practice, which was being implemented through a preferential exchange rate and which raised the fiscal deficit substantially. The Fund was not prepared to approve an arrangement without a bank deal at hand, so it faced a Hobson's choice. Rather than testing the resolve of both the banks and the government, the staff agreed to allow a greater easing than it otherwise would have, and the Executive Board approved the continuation of the multiple currency practice and the resumption of drawings in May.[99]

The second problem was that concerted lending was seldom effective for smaller countries, where the banks had less of a stake in the outcome. This asymmetry complicated the Fund's efforts to treat all member countries evenhandedly. In a number of heavily indebted countries—including Costa Rica, Jamaica, and Yugoslavia—programs were negotiated in 1982–83 on the understanding that banks would contribute to the financing of the program through rescheduling agreements, but without a requirement that firm assurances be provided to the Fund.[100] In other cases, the Executive Board expressed grave doubts about generalizing the practice. At a meeting to review the debt strategy in April 1983, the Board endorsed the staff suggestion that the use of concerted lending should be limited to exceptional cases of debt-servicing difficulties:[101]

> In a relatively few circumstances of exceptional character where the difficulties encountered by major debtors have had broader implications for the orderly function-

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[98]For the Chilean side of this story, see Escobar (1991), Chapter 11.

[99]See "Chile—Staff Report for the 1983 Article IV Consultation and Consultation Under Stand-By Arrangement," EBS/84/50 (March 9, 1984) and minutes of EBM/84/76 (May 14, 1984). The story had a happy ending. The bank agreement was finalized in June, and the government was able to get spending under control in the second half of the year. The stand-by arrangement was successfully concluded, and the final drawing was made in December.

[100]For a set of case studies, see "Payments Difficulties Involving Debt to Commercial Banks," SM/83/47 (March 9, 1983), Annex III.

[101]The staff position is in "Fund Policies and External Debt Servicing Problems," SM/83/45 (March 8, 1983), pp. 44–45. The Board meeting to discuss the paper was EBM/83/57–58 (April 6, 1983).

> ing of the international financing system, the Fund management has taken the initiative, in concert with major creditors, in ensuring that before Fund resources could be committed, sufficient additional financial flows from both official and commercial sources were available. . . . In view of the exceptional nature of the initiatives, it would not be appropriate to formalize any general policy criteria concerning the precise role of the Fund in such situations. . . . [A] case-by-case approach . . . is suggested as the best course of action.

Concerns over the extent to which concerted lending was an appropriate adjunct to Fund lending arrangements came to a head when the Executive Board met on April 22, 1983, to consider a request for a stand-by arrangement with Uruguay. In response to a request from the authorities for Fund assistance in securing new bank loans to help close the projected financing gap, the Managing Director had asked for and had received assurances from bank creditors for a $240 million increase in exposure. Jacques Polak, supported by several other Directors, objected. Two weeks earlier, he had made a general plea for limiting the Fund's interference with private sector lending decisions. It was a mistake, he argued, to generalize the use of concerted lending to cases where good performance already made it in the banks' interests to lend to the country: "urging banks to extend credit . . . could not be a long-term activity of the Fund . . . [and] should remain limited to exceptional cases, and especially to those entailing risks to the international financial system. . . . In [my] view, the Fund has gone almost to the limit of what is proper. . . ."[102] Now he was ready to draw the line. Uruguay had a good record of conducting stable economic policies, and it had run into difficulty only because of adverse exchange rate movements and because of contagion from events in neighboring countries (Argentina and Brazil).[103] The banks, in this view, were using concerted lending as a "security blanket" and a substitute for their own business judgment. Uruguay, the banks, and the Fund would be better off in the long run if the banks were to reach a voluntary solution on their own. De Larosière responded that the approach was needed in this case, because the program could not succeed without exceptional financing from the banks. The Fund could not ask a small country to wait for the banks to come around voluntarily, while larger countries were receiving stronger assistance.[104]

[102]Minutes of EBM/83/57 (April 6, 1983), pp. 12–13.

[103]Uruguay at the time maintained a fixed exchange rate against the U.S. dollar. The combination of an appreciating dollar and devaluations by other Latin American countries had induced a sharp loss in international competitiveness. Some banks had then attempted to pull out of lending to Uruguay when they were forced to increase their exposure elsewhere in the region through concerted lending agreements. In addition, some of the largest creditor banks to Uruguay were located in neighboring countries and had also been cut off from access to international credits.

[104]The Fund staff later estimated that for the period 1983–86, the three largest heavily indebted countries (Brazil, Mexico, and Argentina) received $15 billion in net lending from international commercial banks. Over the same period, net lending to the 12 smaller heavily indebted middle-income developing countries (i.e., the rest of the "Baker 15") was negative (–$4 billion). Memorandum from L.A. Whittome (Director of the Exchange and Trade Relations Department) to the Managing Director (October 28, 1987); in IMF/RD Managing Director file "E.T.R.—July–December 1987" (Accession 89/72, Box 1, Section 164).

The Managing Director's view was accepted by the Board, and the use of concerted lending was endorsed for Uruguay.[105] The policy limiting it to exceptional circumstances remained in place, but no further attempt was made to delineate those circumstances.

Approval in Principle

In addition to concerted lending, a second element in the Fund's financing-assurances arsenal was to approve programs in principle but to withhold the provision of money until other financing agreements were in place. Frequently, the Fund found itself caught in a perverse Alphonse and Gaston routine in which each creditor insisted that the others make the first commitment. Waiting for the banks to secure a "critical mass" of commitments occasionally and with increasing regularity became counterproductive: the more the process was repeated, the more reluctant the banks were to participate; the absence of Fund approval made the critical mass even more difficult to obtain; and even once the critical mass (which might have covered anywhere from 85 to 95 percent of the required total) was in hand, the remaining commitments often took months to complete.

The tactic of approving a stand-by arrangement in principle began with Sudan, in January 1983.[106] In that case, the question was whether official creditors, acting through the Paris Club, would agree to provide an exceptional level of financing. The Fund was prepared to provide SDR 170 million ($187 million; 100 percent of quota) over 12 months, which left an estimated financing gap of $773 million. A Consultative Group meeting had generated some $300 million, and Saudi Arabia and Kuwait had promised to provide debt relief on terms comparable to those granted by the Paris Club. Sudan had accumulated substantial arrears to banks, but an agreement with banks was not expected and was not a precondition for program approval. The balance would therefore have to be covered by the Paris Club, which would not act until the Fund approved the country's adjustment program. Because the Fund could not be certain that official creditors would go along with the Sudanese request—Fund approval was a necessary condition, but it might not be sufficient—the Executive Board decided to approve the arrangement in principle, to become effective when "the Fund finds that satisfactory arrangements have been made for the reduction of Sudan's debt service obligations for 1983 to a level consistent with Sudan's program."[107] The Paris Club then agreed to provide the requested relief, and the Fund arrangement became effective in late February.

Over the next 18 months, the Board granted approval in principle for seven more stand-by arrangements (out of some 50 arrangements approved), usually to

[105]Minutes of EBM/83/65–66 (April 22, 1983).

[106]This case may be compared with the handling of Romania in June 1982 (see Chapter 8). When agreement with bank creditors was delayed in that case, the dormant stand-by arrangement was reactivated with a token drawing, and further drawings were left unscheduled pending settlement of arrears to banks.

[107]Minutes of EBM/83/21 (January 28, 1983), p. 35.

cope with similar uncertainties regarding official financing.[108] Only two of those—Ecuador and Côte d'Ivoire—involved commercial banks in a major way. In June 1983, negotiations between Ecuador and its bank creditors had been dragging on for months, and the Fund forced the issue by making its approval of a one-year stand-by arrangement conditional on the conclusion of those negotiations. The bank deal was completed as anticipated, and the arrangement went into effect in late July.[109] In May 1984, the Board approved in principle a one-year stand-by arrangement for Côte d'Ivoire, conditional both on financing arrangements and on policy actions being taken (increases in mass transit fares and water charges). Two days later, the Paris Club granted the expected debt relief, but the banks (through the London Club) reached agreement only in late July. The Fund arrangement became effective the following week.[110]

By that time, the Board was becoming concerned that the tactic was being used indiscriminately, without any clear governing principles. The staff were asked to develop recommendations, which the Board then approved in October 1984. Three main conditions were to be satisfied before the Fund would in future approve a program in principle rather than outright. First, the use of the procedure should be limited to exceptional cases, in which staff and management had been unable to obtain "reasonable assurances" from other creditors. That is, the traditional practice of acting on the basis of informal contacts between the staff and the Paris Club or bank advisory committees should continue to be the rule. Second, approval in principle should be used only to deal with financing problems. If prior policy actions were required (as in the Côte d'Ivoire case), they should be taken in advance of approval by the Fund (in principle or otherwise). Third, there should be a deadline on completion of external financing, normally 30 days. Otherwise, the effectiveness of the procedure in putting pressure on other creditors would be lost.

Those guidelines were generally adhered to, and approval in principle would be used in just eight cases over the next three years.[111] In most of those instances, the driving factor was the difficulty in getting to an agreement with commercial banks; relations with official creditors were no longer much of an issue. Overall, the practice was a success, perhaps largely because the 30-day deadline—which was applied in every case but one—was effective in putting negotiators on a short leash.[112]

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[108]The use of approval in principle during this period is covered in "Approval in Principle of Fund Arrangements," SM/84/217 (September 25, 1984).

[109]Minutes of EBM/83/77 (June 1, 1983), and "Ecuador—Stand-By Arrangement," EBS/83/91, Sup. 2 (July 25, 1983).

[110]See minutes of EBM/84/70–71 (May 2, 1984) and "Ivory Coast—Stand-By Arrangement—Effective Date," EBS/84/81, Sup. 3 (July 31, 1984). The arrangement became effective through lapse-of-time approval on August 3, 1984.

[111]For a review, see "Financing Assurances in Fund-Supported Programs," EBS/87/266 (December 14, 1987).

[112]The exception was the approval in principle of the stand-by arrangement with Argentina in February 1987 (Chapter 10). No deadline was set, negotiations continued for five more months, and the arrangement became effective only in late July. That delay clearly contributed to the early demise of the program.

Enhanced Surveillance: Looking After MYRA

Another possible way around the stress of having to negotiate new agreements with various groups of creditors every year was to persuade them to make longer-term commitments. If that could be achieved, then all parties would gain: the country would know its financing possibilities for several years ahead, the Fund could enter into extended arrangements with confidence, and the banks would be freed from having to negotiate again and again under pressure. Even more important, multiyear agreements could be designed to reduce the magnitude of "humps" in amortization schedules that occasionally put severe pressure on heavily indebted countries.[113] It was not obvious, however, that the banks would see such a proposal as a net benefit. If they rescheduled debts that were to come due in three years' time, how could they know that the country would stick to its policy regime, and how could they know that other creditors would not pull out and leave them holding the bag?

The path through this thicket of concerns was found in the first half of 1984, in the form of the Managing Director's proposal for a multiyear rescheduling agreement (MYRA) for Mexico (see above, pp. 364–69). A critical factor in getting creditors to accept that proposal was the willingness of the Fund to closely monitor economic developments after the Fund-supported program had been completed, and the willingness of the country to provide the Fund's assessments to its creditors. In essence, creditors—especially commercial banks—wanted the Fund to evaluate credit risks for them, or at least to provide the information on which they could readily evaluate the risks themselves. The challenge for the Fund was to develop a means of satisfying creditors enough to meet members' financing needs, while staying within and not weakening the institution's mandated role as advisor and financier to its members.

This issue arose in three cases during the first several months in which banks were negotiating MYRAs with developing countries. In the seminal Mexican case, the country had an active extended arrangement with the Fund, which was scheduled to expire at the end of 1985. The hope and expectation of all parties was that after that date, Mexico would no longer need financial assistance from the IMF. To help Mexico secure a MYRA from commercial bank creditors under which loan maturities would be extended out to 1994, the Fund agreed to "enhance" the consultation process after 1985 by holding semiannual rather than annual consultations. There was an understanding between Mexico and the banks that the authorities would make the consultation reports available in some fashion, but the means of doing so was left vague. In the event, this plan was never activated, because conditions worsened enough that Mexico faced a continuing need for Fund resources throughout the period covered by the MYRA.

[113]The Fund acknowledged this difficulty internally in December 1983, when the Managing Director summed up an Executive Board seminar on debt issues by recognizing "the problems of the 'bunching' of debt that are looming [and that] cast doubts on the viability of financial packages. . . ." The solution to that problem, he concluded, was "more consistent, more comprehensive, and more forward-looking treatment" in rescheduling exercises. Minutes of Executive Board Seminar 83/3 (December 12, 1983), p. 32.

In December 1984, the commercial banks' Advisory Committee for Ecuador approved in principle a MYRA on terms similar to those for Mexico. Ecuador was in the midst of negotiating a stand-by arrangement with the Fund (a 12-month stand-by arrangement for SDR 105.5 million—and approximately the same in dollars—equivalent to 70 percent of Ecuador's quota). To ensure that the Fund would continue to monitor the economy of Ecuador after the expected end of that arrangement, the banks made the rescheduling of loans maturing in 1986 contingent on approval of a follow-up stand-by arrangement for that year, and they made the rescheduling of 1987–89 maturities contingent on the implementation of enhanced surveillance by the Fund. As with Mexico, however, the procedure was not activated, because Ecuador continued to draw on Fund resources into the early 1990s.[114]

The only country for which enhanced surveillance was activated in this period was Venezuela.[115] As a major oil-exporting country, Venezuela had never had recourse to Fund resources, and in 1984 it had a substantial creditor position in the Fund.[116] Following the decline in oil prices in the early 1980s, Venezuela experienced both a worsening of its current account deficit and substantial capital flight. The consequent loss in foreign exchange reserves made it difficult to service foreign bank loans, and in 1983–84 the authorities managed to reschedule bank debts coming due in those years despite the Fund's reluctance to agree to an adjustment program or financial assistance (see footnote 94, p. 404). In September 1984, bank creditors agreed in principle to reschedule loans maturing through 1988, with new maturities extending to 1997, conditional on (inter alia) the Fund conducting enhanced surveillance through that date. The Executive Board—meeting to conclude the annual Article IV consultation with Venezuela—accepted the authorities' request for enhanced surveillance on May 30, 1985, thus in effect commencing the practice. The authorities, however, did not release the staff report to creditors, because they had not yet completed negotiations with the banks on the terms of the proposed MYRA.

Some six months later, on December 13, 1985, the Executive Board met to consider what had now become the semiannual consultation report on Venezuela. Although the balance of payments outlook was "relatively favorable" and negotiations with commercial bank creditors were nearly completed, the staff report suggested that the adjustment of policies—though moving in the right direction—should be accelerated and strengthened. The staff called for a more restrictive stance on macroeconomic policy and for a more rapid pace of deregulation and other structural measures. Executive Directors concurred with the staff view on

[114]When the Executive Board met in March 1985, to consider the request for a stand-by arrangement, some Directors (notably the Directors for Germany and the United Kingdom) were concerned that the staff or management might have made a commitment to the commercial banks regarding future financing or enhanced surveillance. The staff responded that no such commitments had been made. See minutes of EBM/85/39 (March 11, 1985). Ecuador successfully implemented the policy program that underlay the 1985–86 stand-by arrangement, and it made all of the scheduled drawings. Ecuador then had four more stand-by arrangements spanning the next six years.

[115]For a chronology of enhanced surveillance with Venezuela, see "Review of Enhanced Surveillance," EBS/88/247 (December 2, 1988), p. 30.

[116]In September 1984, the Fund's holdings of Venezuelan bolívares amounted to just 64 percent of Venezuela's quota.

macroeconomic policy, and they expressed even stronger concerns about what they perceived as a reliance by Venezuela on demand stimulus rather than structural reform as a means of restoring output growth. In the course of the Board meeting, Charles H. Dallara (United States) suggested that it might be appropriate for the next staff report issued to creditors to include a proposed timetable for the implementation of structural reforms, but that suggestion was resisted both by the staff and other Directors. Overall, this first case of enhanced surveillance had begun reasonably well, albeit with some caution being expressed.[117]

One other case related to enhanced surveillance came up in 1985: Colombia. Colombia had not drawn on Fund resources since the completion of a long series of stand-by arrangements in 1974,[118] and—like its neighbor to the east—it was determined to avoid going to the Fund when it ran into difficulties in the 1980s. After initially attempting to counter the effects of worsening external conditions through expansionary monetary and fiscal policies, the authorities shifted gears in the second half of 1984. To establish credibility with commercial bank creditors, they then sought the informal support of the Fund. After an exchange of letters between President Belisario Betancur and de Larosière, a visit to the Fund by Betancur in early April, and informal consultations by the Managing Director with Executive Directors and with the U.S. authorities, the stage was set for an unprecedented agreement.

Colombia was asking the Fund (1) to certify that its adjustment program was strong enough to qualify for Fund financial support if requested, (2) to monitor and evaluate progress exactly as if a stand-by arrangement were in place, and (3) to authorize the government to release both the staff report and the Managing Director's evaluation (based on the consultation discussion held by the Executive Board) to its creditors.[119] In other words, the authorities wanted to have the Fund's—the Executive Board's and not just the staff's—"seal of approval" without the stigma that might be associated with a formal stand-by arrangement. The request thus gave the Fund a role that was less than under a stand-by arrangement but greater than under enhanced surveillance.

The Executive Board approved Colombia's request on July 26, 1985, despite the fact that most Directors expressed some degree of reservation about it.[120] Almost

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[117]"Venezuela—Staff Report for the 1985 Article IV Consultation," SM/85/308 (November 15, 1985); and minutes of EBM/85/180–181 (December 13, 1985). Dallara's suggestion is on pp. 32–34 of meeting 85/180; further discussion is on pp. 15–19 of meeting 85/181. For later developments in this case, see Chapter 10.

[118]From 1957 through 1974, Colombia had 15 stand-by arrangements with the Fund. See de Vries (1985), pp. 362 and 427.

[119]"Colombia—Staff Report for the 1985 Article IV Consultation," EBS/85/149 (June 12, 1985), pp. 32–33.

[120]See minutes of EBM/85/114 (July 26, 1985). Some Executive Directors earlier expressed frustration at being presented with what they believed was a fait accompli. In that view, the Board should have established a general policy before the Managing Director undertook to bring a novel approach to them for approval. When those objections surfaced at a meeting on the work program in late May, de Larosière insisted that he had consulted fully with Executive Directors on an informal basis and that the only choice had been to proceed rapidly or not at all. Minutes of EBM/85/82 (May 29, 1985).

everyone would have preferred a standard request for a stand-by arrangement, accompanied by an indication that the authorities did not intend to use the money. They had little choice, however, because the banks had made the requested monitoring a condition for approval of the MYRA, and the Managing Director had already secured written assurances from the banks that they would provide more than $500 million in new credits to ensure that the Colombian program would be adequately financed. Several Directors indicated that they would not regard this case as a precedent if another member were to make a similar request.

Enhanced surveillance thus developed in an experimental and informal manner during its first year of existence. By the time the Venezuelan and Colombian requests came to the Board, it was already becoming clear that more requests would be coming in and that more formal criteria and procedures would have to be developed. That process and its consequences are examined in Chapter 10.

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