Can’t Pay, Will Pay: Historical Change in the Management of International Debt Crises

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Abstract:
There is a widespread expectation today that even distressed sovereign borrowers will generally try everything in their power to repay their international debts. As this article demonstrates, however, it was not always so: prior to World War II, the most common policy response to an external economic shock tended to be a unilateral suspension of payments. The insistence on uninterrupted debt servicing is actually a relatively novel phenomenon going back to the early 1980s, which saw the emergence of a contradictory approach to international crisis management, governed by the principle that governments should always repay their debts—even when they cannot. This shift in approach raises an important question: how are creditors capable of bridging the gap between the new repayment rule and the continued risk of insolvency? The answer, the article suggests, is through the extension and institutionalization of international bailout loans as a mechanism for (a) mobilizing resources from taxpayers in the creditor countries to underwrite the investments of private creditors; (b) shifting the burden of adjustment inside the debtor countries onto more vulnerable segments of society as part of an attempt to free up domestic resources for continued debt servicing. The new approach to crisis management therefore has important distributional implications, which have generally tended to redound to the benefit of private creditors.

Keywords: *International Finance; Crisis Management; Sovereign Debt and Default; Austerity; Bailouts; International Monetary Fund.*

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Introduction: A Basic Contradiction

The contemporary approach to the management of international debt crises is governed by a basic contradiction. On the one hand, rising levels of public indebtedness and intense financial market turmoil have over the past four decades regularly left crisis-stricken governments unable to honor their international obligations: from Mexico in 1982 to Greece in 2015, countless heavily indebted countries have, as a result, come to the brink of default. At the same time, however, despite these increasingly frequent crises and the occasionally immense costs of repayment, there has been a widely-shared and firmly-held belief that even a distressed sovereign borrower always will—and, as a matter of course, generally *should*—try its very best to repay, irrespective of the costs involved or the unpopular nature of the austerity measures required.[1] Indeed, so deeply entrenched is this conviction nowadays that many have simply come to take it for granted. If Citibank CEO Walter Wriston could still be widely ridiculed in the early 1980s for declaring that "countries don't go bust," just months before dozens of them actually did, today his apparent *faux pas* appears to have been elevated to an article of faith for the international financial community as a whole: come what may, the debt must be repaid. In the words of Mexico's former director of public credit and current OECD Secretary General Angel Gurría: "There can be no default."[2]

Notwithstanding moral questions over the apportioning of blame for recurring debt crises, what makes this belief in the immutability of sovereign debt repayment all

[1] e.g., Dyson (2014, 323): "the absence of sovereign default became the norm."

[2] Interview with author (Gurría 2013). Buchheit and Gulati (2009, 1): "conventional wisdom is that sovereigns will rarely, if ever, default on their external debts in circumstances where it is clear that they have the capacity to pay."

the more puzzling from an International Political Economy perspective is the fact that it appears to be steeped in a profound sense of historical amnesia.[3] As I will seek to demonstrate in this article, the contemporary insistence on continued repayment during times of crisis is actually a relatively novel phenomenon, whose origins go back no further than the early 1980s, with the large-scale financial interventions by the US government and the International Monetary Fund into the developing country debt crises. Before that, during all the major financial conflagrations of the pre- and interwar period, the most common policy response to an external economic shock was almost always the polar opposite of the outcome we tend to see today: a unilateral suspension of payments followed by a lengthy moratorium and an eventual settlement on debtor-friendly terms.[4] So widespread were these unilateral debt moratoriums during the crises of the nineteenth century and the 1930s that observers at the time came to consider them as "normal" and "part of the rules of the game."[5]

My purpose in this article is therefore to place the contemporary approach to international crisis management in historical perspective, and thereby to demonstrate that the transformations of the global political economy over the past four decades have tended to lead to much more creditor-friendly outcomes overall, with far-reaching implications for the distribution of adjustment costs in times of crisis. In the first part of the article, I will set out to demonstrate how the nineteenth- and early twentieth-century approach to international debt crises was governed by a simple logic that can

[3] On debt and morality, see Graeber (2011). On the history of sovereign default, see Reinhart and Rogoff (2009).
[4] e.g., Eichengreen (1991, 154); Jorgensen and Sachs (1989); Papadia (2017)
[5] Ocampo (2013)

be summarized in the English title of the famous play by the Italian playwright Dario Fo: “Can’t Pay? Won’t Pay!” (*Non si paga! Non si paga!*). In fact, all of the international lending cycles prior to World War II ended in a wave of unilateral payment suspensions: from the continental European defaults on Amsterdam’s powerful investment bankers during the Napoleonic Wars of the early 1800s, to the Latin American and Mediterranean defaults on British bondholders during the stock-exchange panics of the 1820s and 1870s, to the mass defaults on US investors during the Great Depression of the 1930s (see figure 1). By 1933, then, Max Winkler, one of the first scholars to specialize in the study of sovereign debt, could safely write that “fiscal history ... is replete with instances of governmental defaults.” To people like him, it was common knowledge that “borrowing and default follow each other with almost perfect regularity.”[6]

Figure 1: share of countries in a state of default, 1800-1971

Source: Reinhart and Rogoff (2009)

[6] Winkler (1933, 1)

After briefly discussing the international political economy of the first three big default waves of the 1820s, 1870s and 1930s, the second part of the article then turns to the contemporary approach to international crisis management, which has been characterized by a semi-antonymous inversion of the title of Dario Fo's play, from "Can't Pay? Won't Pay!" to "Can't Pay? Will Pay!" The contradictory logic behind this new approach was neatly captured in an editorial on the Latin American debt crisis in the *New York Times* of November 30, 1987, which noted that "there is a consensus on two things. One is that the debt has to be paid, and the other is that the debt cannot be paid." Yet this observation raises an important question: How have creditors managed to bridge the resultant gap between the frequent *inability to pay* on the one hand, and the ever-firmer *insistence on repayment* on the other? How can sovereign default risk be kept at bay in the face of rapidly rising public debt levels?

Clearly, to make repayment possible in a context of record indebtedness requires the introduction of alternative resources from elsewhere to ensure that distressed borrowers do not fall into a cessation of payments. In practice, official attempts to overcome or at least to contain the can't-pay-will-pay paradox have taken a combination of two forms. The first is the historically unprecedented mobilization of taxpayer money from the creditor countries to underwrite the "bad loans" originally made by private creditors, which has led to a growing reliance on, and an effectively institutionalization of, ever-larger international bailout loans, primarily—but not exclusively—under the aegis of the International Monetary Fund. The second is the policy conditionality attached to these bailout loans, which generally aims to free up domestic resources for foreign debt

servicing through the pursuit of austerity, privatization and structural reform, thereby shifting the burden of adjustment away from foreign creditors and domestic financial elites, and onto workers, taxpayers and welfare recipients inside the debtor countries.

Taken together, I argue, this dual intervention enables official-sector creditors, wittingly or unwittingly, to "buy time" for private creditors to reduce their exposure to a crisis-stricken borrower and thus to escape ahead of an inevitable debt restructuring without incurring crippling losses.[7] The upshot is the emergence of a distinct pro-creditor bias in the official policy response to international debt crises that has in turn led to a set of considerably more creditor-friendly outcomes than the ones that had prevailed even at the height of the era of gunboat diplomacy. All of this provides fertile ground for scholars of IPE to further explore some the deeply entrenched conflicts and contradictions at the heart of the contemporary global financial architecture.

Can't Pay, Won't Pay (1800–1940)

Sovereign debt crises have been a fixture of international finance ever since the emergence of cross-border lending in the late-medieval and early-modern period. Often, such sovereign debt crises would result in painful losses for private lenders; an outcome that was famously exemplified by the default of King Edward I of England on the principal international bankers of the time, the Ricciardi of Lucca, during the financial crisis of the 1290s, and of his grandson Edward III on the Bardi and Peruzzi of Florence, which

[7] Streeck (2014)

is said to have contributed to the latter's eventual bankruptcy in the crisis of the 1340s. Similarly, in the sixteenth century, the Habsburg rulers of Spain repeatedly defaulted on their obligations to the Fugger and Welser banks of Augsburg, whose prominence in international finance suffered greatly as a result.[8] The mighty financiers of Amsterdam, who transformed themselves into the bankers of choice for some of Europe's most powerful sovereigns over the course of the eighteenth century, were similarly ravaged by the mass payment suspensions that rocked the continent during the Revolutionary and Napoleonic Wars.[9] Default, in short, was already a common recurrence in the pre-modern era. As Winkler notes, it was "in the course of this period that defaults were beginning to become more popular (with the borrower). Suspension of payment, reduction of interest and principal were frequent occurrences."[10] As we will see in this section, they were to become even more common with the emergence of global capital markets and large-scale sovereign lending in the nineteenth century. Indeed, each of the three major lending cycles before World War II ended in a wave of default (see table 1).

Table 1: the three historical waves of sovereign default:

	1828	**1877**	**1933**
COUNTRIES IN DEFAULT	15	17	24
AS % OF INDEPENDENT STATES	29%	37%	39%
SHARE OF BLOCKED CREDITS	22%	23%	35%

Source: Suter (1989). Countries with a population of less than one million in 1980 have been excluded.

[8] Braudel (1972)
[9] Riley (1980)
[10] Winkler (1933, 28-29)

The International Debt Crisis of the 1820s

In the wake of the Napoleonic Wars, the City of London displaced Amsterdam as Europe's leading financial center. The Rothschild bank underwrote the first foreign government loan denominated in sterling to the Kingdom of Prussia in 1818, and by 1822 the London Stock Exchange had become the heart of a burgeoning international financial system that funneled the surplus capital of thousands of British investors to dozens of governments overseas. Two-thirds of all international loans made in London during this period ended up going to the newly independent states of Latin America, to finance their wars of independence against the Spanish.[11] It did not take long for the speculative boom to turn to bust, however; by 1825 the London Stock Exchange had already dried up as a source of foreign credit for most European and Latin American governments. A wave of defaults inevitably followed: in April 1826, Peru suspended payments, shortly to be followed by its neighbor Colombia. At the end of the decade, practically all Latin American and Southern European countries were in arrears—only Brazil and Naples remained current on their foreign obligations.[12]

What makes the crisis of the 1820s particularly striking from today's perspective is the fact that bondholders were completely powerless in the face of this first wave of defaults. The leading historian of Latin America's debt crises, Carlos Marichal, writes that "default was not only inevitable but also virtually irreversible ... Despite repeated efforts by envoys of European bondholders to recover their monies, all governments

[11] Marichal (1989, 14)
[12] Flandreau and Flores (2009, 659)

(with the exception of Brazil) systematically refused to resume payments."[13] The payment suspensions were followed by lengthy moratoriums on debt servicing that lasted between 15 and 30 years, and the defaulted obligations were generally only settled at the initiative of the debtors, *after* their economies had recovered and new credit became available. This in turn allowed the debtors to extract relatively favorable terms from bondholders. As Marichal concludes, the predominant response thus seemed to indicate "an appreciable degree of economic autonomy from the great powers of the day."[14]

A similar set of outcomes prevailed in Southern Europe, where Greece (1826), Portugal (1828), Spain (1831) and several Italian republics defaulted on their foreign obligations, leaving their bondholders at a loss on how to reclaim these investments.[15] The British government went to the extreme of threatening Greece with military intervention if it did not pay up, but "despite these warnings and subsequent British remonstrances, not a penny of the debt service was met from the Greek treasury." In 1854, the French and British finally occupied the port of Piraeus "ostensibly on the ground that by supporting Russia in the Crimean war Greece was misapplying revenues pledged to the service of the guaranteed loan."[16] But even this could not ensure continued repayment, as Greece, with the exception of a small annuity in 1860, was to maintain its moratorium until 1878, when it finally reached a settlement with its bondholders.

[13] Marichal (1989, 43, 55, 67)
[14] Marichal (1989, 66)
[15] Reinhart and Rogoff (2009)
[16] Wynne (1951, 288-290)

During this period, the British government developed a particular approach to the management of international debt crises that stands in stark contrast to today's can't-pay-will-pay rule. In some cases, it sanctioned official government intervention to recover the defaulted loans made by British investors, either by exerting diplomatic pressure on a non-compliant government or by resorting to various forms of direct coercion, called "super-sanctions," which have historically included the resort to gunboat diplomacy, the establishment of foreign financial control over tax offices and customs houses, or—at the extreme—outright military occupation.[17] In the majority of cases, however, the government took a more hands-off approach and left investors to fend for themselves. The resultant foreign policy of "constructive ambiguity" in the arbitration of international debt disputes was famously encapsulated in the Palmerston Doctrine of 1848, according to which the British government reserved for itself the right either to intervene or *not* to intervene, depending on the nature of the situation, with official-sector intervention considered "neither a right of the bondholders nor a duty of the government," but a sovereign decision for the latter to take as it saw fit.[18]

The Palmerston Doctrine was thus clearly inflected with the ideology of classical liberalism, which was at least equally concerned with the risk of inducing moral hazard among private investors as it was with enabling opportunistic behavior by foreign sovereigns. The government furthermore had a material concern that subsidizing the export of capital by effectively underwriting investors' foreign loans might reduce demand for

[17] For more on super-sanctions, see the debate between Mitchener and Weidenmier (2010) and Tomz (2007).
[18] Borchard (1951, 240)

British government bonds and thereby cause its own borrowing costs to rise. Sir John Simon of the Foreign Office told investors that, if they "choose to buy foreign bonds with a yield of 10 per cent rather than British government bonds with a lower yield, they should not expect as a matter of right that the British government would intercede on their behalf in the event of a default."[19] While the Palmerstone Doctrine was by no means hostile to bondholders, it did seek to avoid a scenario in which the British government might be expected as a matter of principle to bail out private investors for "bad loans" made to foreign governments: "Swayed between political and financial considerations," Feis writes, "the government now resisted, now yielded to the pressure of the interested parties. ... Small wonder then that the record shows a fitful, hesitant policy, a tendency now to drift with events, now to act with sternness, now to evade."[20]

The purposefully ambiguous nature of the Palmerston Doctrine can be illustrated with reference to two prominent debt disputes of the era. The first concerned the debt repudiation by Mexico's republican forces in 1861, which prompted a particularly aggressive response on the part of the major European creditor powers, with the British, Spanish and French governments sending in a joint expeditionary force to invade the country outright. The French even went on to briefly occupy Mexico City, where they installed the Austrian Archduke Maximilian as "Emperor of Mexico"—but he was soon overthrown and the French forced to retreat after suffering a humiliating defeat at the hands of Mexico's resurgent republican forces, which immediately repudiated Maximi-

[19] Strong (2002)
[20] Feis (1930, 102-03, 104-05)

lian's debts.[21] The creditor powers drew important lessons from this experience. When a similar dispute arose in Venezuela several years later, in 1866, the British government refused to take military action and limited its intervention to diplomatic support for the "defrauded" investors.[22] The result was a situation in which bondholders were often left to guess about the security of their foreign investments. The Palmerston Doctrine thus presented a strong contrast to the "lender of last resort" theory that was to be developed by Walter Bagehot several decades later, which instead called for unambiguous official intervention, resting on the explicit guarantee of theoretically limitless financial support to private lenders in times of crisis. While Palmerston's deliberately ambiguous approach has long since become an artefact of economic and geopolitical history, Bagehot's proposal remains the foundational principle behind the management of international debt crises today—as exemplified by Mario Draghi's famous pledge in 2012 that the European Central Bank would do "whatever it takes" to save the euro.

Creditor Intervention in the Age of Imperialism

The late 1860s and early 1870s witnessed a new speculative craze on the London Stock Exchange, with many investors piling their cash into foreign government bonds. Just as in the 1820s, however, this boom soon turned to bust. After the Panic of 1873, many sovereign borrowers—including the Ottoman Empire, Egypt, Tunisia, Greece, Spain, Bolivia, Costa Rica, Ecuador, Honduras, Mexico, Paraguay, Peru, Venezuela,

[21] Marichal (1989, 61–66)
[22] Borchard (1951, 241-242)

Uruguay and Santo Domingo—responded by suspending payments and maintaining extended unilateral moratoriums on their external debt service. By 1883, 54 percent of foreign bonds issued in London were in arrears.[23] International capital flows briefly resumed in the late 1880s, mostly in the form of foreign direct investments, but by the 1890s renewed defaults by Greece and Argentina further deepened the crisis—the latter almost leading to the collapse of Britain's second largest bank, Baring Brothers & Co.

The crisis of 1873 was to become a major turning point for the global political economy, giving rise to intensified international competition between the leading capitalist powers, which expressed itself in the turn to imperialism. As a result, the next four decades were to be marked by a number of increasingly aggressive foreign interventions in the settlement of international debt disputes. The most prominent cases included the establishment of international financial control over the Ottoman Empire in the 1870s and Greece in the 1890s; the British invasion of Egypt in 1882; European "gunboat diplomacy" off the coast of Venezuela in 1902; and the occupation and control of the customs houses of a number of small Caribbean and Central American states by U.S. Marines over the course of the early twentieth century. The latter interventions, crucially, were the result of a direct challenge on the part of the U.S. government to European intervention in Venezuela: the very sight of British, Italian and German gunboats in its own "backyard" was enough reason for Theodore Roosevelt to promulgate his Roosevelt Corollary to the Monroe Doctrine, by which the U.S. government reserved for itself the right to act as an "international police power" in the Western hemi-

[23] Feis (1933, 105); Marichal (1989, 102); Luxemburg (1913, 405-406)

sphere and enforce bondholders' contracts at the force of arms.[24] While the importance of creditor state intervention remains an issue of debate among scholars of sovereign debt, one prominent study has found that defaulting governments risked a 30 percent chance of being subjected to such "super-sanctions" between 1870 and 1914.[25]

Most historians, however, agree that the turn to military intervention generally remained limited to two distinct regions: the eastern Mediterranean, which lay within the British sphere of influence; and the Caribbean, which had long been within a wider European sphere of influence, but which following Roosevelt's Corollary to the Monroe Doctrine of 1904 fell into the U.S. sphere of influence. Outside of these areas, creditor state intervention remained rare. As Feis notes for the 1870s, "On the whole, the resolution not to intervene was maintained during the decade of the seventies ... [I]n all cases except Turkey and Egypt, the government left the burden of negotiation with the debtors to the bondholders."[26] Marichal makes a similar observation for South America from 1870 onwards, where "the official response was muted."[27] Even at the height of the era of gunboat diplomacy, then, bondholders could not always count on a guarantee of state intervention. The doctrine of sovereign immunity, while regularly violated whenever it suited the imperialist powers, appeared to offer the debtors some limited protection as well. When British investors took the Peruvian government to court after its default of 1876, for example, the UK Court of the Chancery ruled that its "so-called bonds amount to nothing more than engagements of honor, binding, so far as engage-

[24] Winkler (1933, 137-138)
[25] Mitchener and Weidenmier (2010). The findings of their original 2005 paper have been contested by Tomz (2007).
[26] Feis (1930, 105)
[27] Marichal (1989, 121)

ments of honor can bind, the government which issues them, but are not contracts enforceable before the ordinary tribunals of any foreign government."[28]

Signs of "constructive ambiguity" therefore continued to abound during the age of imperialism. Venezuela's default of 1902 had led the British the join the Germans and Italians in shelling its naval defenses and blockading its ports to force it to pay up; but when Brazil similarly suspended payments in 1914, the UK Foreign Secretary Edward Gray simply declared that "British financiers have to make their own arrangements with the Brazilian government."[29] Public opinion—and sometimes even investor opinion, depending on who held the debt of the country in question—was equally fickle on the matter. When the British government announced its intention to participate in the establishment of a European regime of international financial control established at Athens in 1897, even the investor-friendly *Economist* complained that "it is no part of the business of our Foreign Office to audit the accounts of other nations and certify as to their solvency or insolvency."[30] In sum, the official response to international debt crises continued to be characterized by a contradictory reliance on gunboat diplomacy and *laissez-faire* bluster. The result was that neither debtors nor creditors really knew what to expect in the event of a default, as government intervention remained patchy, contested and unpredictable. What is clear, however, is that many debtors retained a significant degree of autonomy throughout this period, just as they had in the 1820s. Once again, they managed to extend their moratoriums for up to a decade or more,

[28] Cited in Kaletsky (1985, 7-8)
[29] Feis (1930, 109-11)
[30] Feis (1930, 110)

which “provided breathing room for [their] suffocating economies” and allowed them to recover before the debts could eventually be settled on relatively favorable terms.[31]

The Mass Defaults of the Great Depression

After World War I, New York displaced London as the world's leading financial center, and the United States quickly emerged as the main source of credit for foreign governments, initiating almost two-thirds of all international loans between 1924 and 1931.[32] The Wall Street banks originated foreign bond auctions worth billions of dollars, enlisting a small army of regional brokers and stock peddlers to convince up to a million unsuspecting retail investors across the US to pour their life's savings into these dubitable securities.[33] Soon the long-established pattern repeated itself anew, as the boom of the 1920s turned to bust with the Wall Street Crash of 1929. With the exception of Argentina and some of the smaller debtors that had remained under U.S. occupation or financial control through the early twentieth century, all Latin American borrowers suspended payments, as did the majority of European borrowers (see table 2).

[31] Marichal (1989, 121-122)
[32] Stallings (1987); Papadia (2017)
[33] Eichengreen (2008, 67-69)

Table 2: list of sovereign defaults during the Great Depression

Europe:		Latin America:	
Austria	1938, 1940	Bolivia	1931
Belgium*	1930s	Brazil	1931, 1937
Bulgaria*	1930s	Chile	1931
Czechoslovakia*	1930s	Colombia	1932, 1935
Denmark*	1930s	Costa Rica	1932
Finland*	1930s	Dominican Republic	1931
France*	1930s	Ecuador	1929
Germany	1932, 1939	El Salvador	1932, 1938
Greece	1932	Guatemala	1933
Hungary	1932, 1941	Mexico	1914, 1928
Italy*	1930s	Nicaragua	1932
Norway*	1930s	Panama	1932
Poland	1936, 1940	Paraguay	1932
Romania	1933	Peru	1931
Spain*	1930s	Uruguay	1933
Turkey	1931, 1940	Venezuela*	1930s

Source: Reinhart and Rogoff (2009) and Eichengreen and Portes (1985)[34]

Like the defaults of the 1820s and 1870s, those of the 1930s were unilateral and outright. Although there was great diversity in terms of their intensity and the degree of coercion brought to bear on foreign bondholders by the respective governments, the

[34] Source is Reinhart and Rogoff (2009) for all countries for which specific years are provided. With the exception of Bulgaria, which is marked a "heavy defaulter," all the countries marked with asterisk (*) are listed as "light defaulters" by Eichengreen and Portes (1985), and are not included in Reinhart and Rogoff's list. No specific dates are provided for these defaults, so the years are simply marked "1930s."

tendency was clear: countries that could not repay, would not repay. Over the course of the Great Depression, nearly half of all borrowing countries defaulted, and around one-third of the foreign bonds held by US investors, and up to three-quarters of Latin American bonds, went into arrears.[35] As Andrea Papadia puts it, "never had the scale of defaults been so large and their incidence so widespread. Up to this day, such rampant insolvency is unique."[36] Certainly there were exceptions; countries that somehow managed to honor their foreign obligations even in the depths of the crisis, including the aforementioned Caribbean and Central American states whose finances had remained under U.S. control, like Haiti, Honduras and Nicaragua.[37] Argentina was the most striking exception to the rule; the only major independent sovereign borrower in Latin America to repay. "Yet even in the Argentine case," Marichal notes, "negotiations with the foreign bankers were necessary," and for the remainder of the 1930s "all the Latin American governments were involved in complex readjustments of their debts with United States and European banks and bondholders."[38]

One of the most striking features of the politics of international debt during the Great Depression was the widespread acceptance of the defaults as a legitimate and justifiable policy response on the part of the debtors. Contemporaries largely seemed to consider the unilateral moratoriums an unavoidable outcome of the sharp decline in the terms of trade, which "made suspension of payments on debts a logical defensive

[35] Borchard (1951, 224)
[36] Papadia (2017, 9)
[37] Marichal (1989, 203-04)
[38] Marichal (1989, 103)

measure."[39] Winkler even concluded that "defaults are inevitable when attempts are made by lenders to take advantage of temporarily embarrassed borrowers by exacting all sorts of concessions and imposing all sorts of impossibly harsh terms."[40] Other observers pointed out that the debtors could hardly be blamed for an external economic shock that had originated on Wall Street. Borchard, for instance, noted that "although financial mismanagement in various forms helped engender the wave of insolvencies which disrupted the contractual relations between borrowing states and their foreign creditors during the early 1930s, that cataclysm was largely attributable to circumstances beyond the debtors' control."[41] President Franklin D. Roosevelt recognized as much when he personally and emphatically apologized to his Bolivian counterpart for Wall Street's "super-salesmanship" in the lead-up to the crisis, declaring that the original loans had been made under conditions of "financial exploitation" and that "of course ... Bolivia was unable to pay either the interest or the principal."[42]

Similar attitudes were to be found even on Wall Street itself, where at least some important players were quite aware that insisting on repayment in times of crisis could well lead to counterproductive outcomes. In 1925, Moody's had already warned investors "who are primarily interested in reaping unreasonable profits in their dealing with foreign borrowers, taking advantage of the pressing needs of the latter and their perhaps temporary fiscal difficulty," that pushing their borrowers too hard could end up backfiring: "to demand the "last pound of flesh" is decidedly wrong economically as

[39] Marichal (1989, 208); Fishlow (1989)
[40] Winkler (1933, xvi, 47)
[41] Borchard (1951, 143)
[42] Cited in Borchard (1951, 243)

it is wrong on ethical and moral grounds. It is financing of the above character and the inevitable results which do infinite damage to the foreign securities markets, tending to bring into disrepute all foreign bonds irrespective of their investment merit."[43]

These strikingly debtor-friendly attitudes, widespread in scholarly, financial and political circles at the time, were in turn reflected in official creditor policy. After WWI, military intervention was no longer considered legitimate in the settlement of foreign debt disputes, and the U.S. government did not respond to the defaults of the 1930s with anything like the level of aggression displayed by the European creditor powers in previous default episodes in Mexico, Egypt and Venezuela. In fact, where the U.S. government did actively intervene, it often took the side of the debtors—as in the case of Mexico's debt settlement, which saw U.S. bondholders accept losses of 90 percent on the nominal value of their claims.[44] These developments were part of a broader shift in U.S. foreign policy away from Theodore Roosevelt's interventionist, investor-friendly corollary to the Monroe Doctrine, to Franklin D. Roosevelt's non-interventionist "good neighbor" policy, which instead prioritized good relations with the wider region in light of the buildup to World War II and the administration's New Deal policy framework, both of which justified "subordinating the private economic interests of the bondholders to the political and military requirements of 'hemispheric cooperation'."[45]

The non-interventionist stance of the U.S. government was therefore a decisive characteristic of the Great Depression. As Charles Kindleberger would later famously

[43] Cited in Winkler (1933, 63-64)
[44] Marichal (1989, 228)
[45] Marichal (1989, 228)

remark, "there was no lender of last resort: Britain, weakened by the war, was unable to help; the United States and France were unwilling to."[46] Some observers therefore thought it "obvious that much of the responsibility for the present chaotic state of the international money market must be laid to the lack of effective supervision of any kind."[47] It was this very disorganization of the global political economy that later motivated the UK and U.S. governments to establish the IMF, whose very existence after 1944 was to fundamentally alter the course of future crisis management—a point to which we will return at greater length in the next section on the contemporary period.[48]

As for the period prior to World War II, however, it is clear that the prevailing approach to international crisis management was generally governed by the can't-pay-won't-pay principle. Not only did the unilateral moratoriums of this period provide the debtors with much-needed fiscal breathing room, allowing their economies to recover faster than those of countries that did not default; the debtors' significant bargaining power also ensured that the eventual settlements reached with private bondholders tended to result in relatively debtor-friendly terms.[49] Then, as today, the general rule was clearly revealed by its most important exception: Argentina. Whereas today that country arguably stands out for its recurring defiance of the injunction on default, in the 1930s it actually found itself in the opposite position, as the only borrower to insist on repayment. In fact, its commitment to continued debt servicing was so strong that

[46] Kindleberger (1988, 175)
[47] Winkler (1933, 51)
[48] Kindleberger (1988, 177, 179)
[49] On bargaining power and debtor-friendly outcomes, see Frieden (2015); Bértola and Ocampo (2012); Eichengreen and Portes (1990); Jorgensen and Sachs (1989); Fishlow (1985).

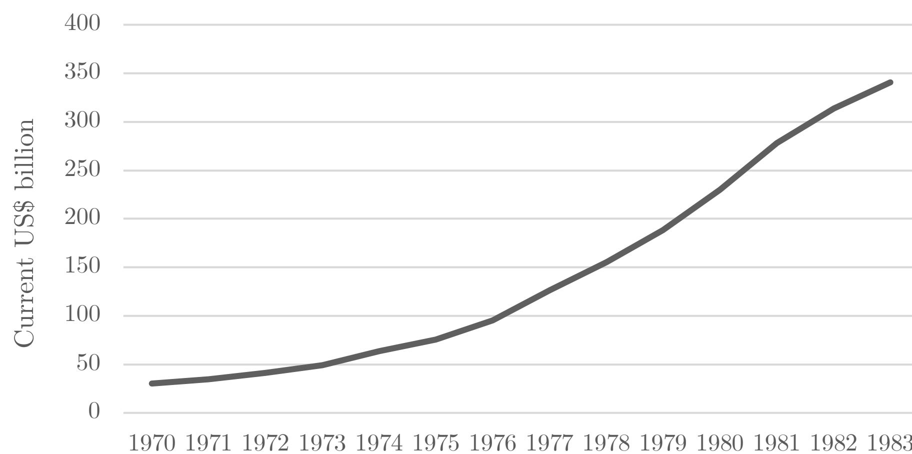
investors and commentators considered it somewhat bewildering. As one contemporary remarked, "it is astonishing to many observers that the country has been able to maintain service on its national debt so faithfully. The efforts and sacrifice involved have, in fact, been tremendous."[50] Clearly, then, default—not repayment—was the baseline assumption the international financial community was accustomed to dealing with in times of crisis. It was not until the early 1980s that this would begin to change.

Can't Pay, Will Pay (1980–present)

The defaults of the 1930s and the devastation of World War II caused international capital markets to collapse. After the war, the imposition of capital controls and strict financial regulations under the Bretton Woods regime generally kept investors "captive" within national borders; as a result, there was no real international lending for decades, until the emergence of the Euromarkets in the 1960s offered U.S. banks an opportunity to evade capital controls and begin lending to foreign governments anew. The collapse of the Bretton Woods regime in the early 1970s subsequently led to a dramatic increase in cross-border capital flows, and by the turn of the decade a familiar pattern of boom and bust was already well underway, with Latin American governments accumulating large dollar-denominated debts (see figure 2), fatefully contracted at variable interest rates. When the Volcker shock suddenly caused these rates to skyrocket, many debtor

[50] Cited in Tomz (2007, 105)

countries were pushed into acute fiscal distress. On August 20, 1982, Mexico's Finance Minister Jesús Silva Herzog was the first to announce that his country had run out of foreign exchange and was no longer able to service its towering $82 billion debt load, $53 billion of which was owed to the nine largest Wall Street banks alone. As Silva Herzog would later reflect on this moment, "the world was different after that."[51]



Source: World Bank (2017)

The Developing Country Debt Crisis of the 1980s

The Mexican finance minister was right: the world *was* different after 1982. The most important difference lay in the official policy response to the international debt crisis that would envelop most of Latin America and much of the developing world for the remainder of the decade. This policy response, as we will see in the following section, was diametrically opposed to the can't-pay-won't-pay principle that had been established in the nineteenth and early twentieth centuries. From the 1980s onwards, there

[51] Cited in Kraft (1984, 3)

was to be a firm insistence on full repayment; even for countries whose debt loads were demonstrably unsustainable. The new approach was summed up in a candid statement by U.S. Treasury Secretary Donald Regan, who declared that "I don't think we should let a country off the hook just because they are having difficulty. As debtors, I think they should be made to pay as much as they can bear without breaking them. You just can't let your heart rule your head in these situations."[52]

These harsh words by a leading U.S. government official were not just moralistic rhetoric for domestic consumption; they were undergirded by an important shift in the international balance of power. Barbara Stallings, for one, notes that the underlying change in creditor composition, from hundreds of thousands of small bondholders to a handful of powerful Wall Street banks, made it "much more difficult to call a moratorium in the 1980s."[53] Carlos Marichal similarly observed that "the combined power of the commercial banks and multilateral agencies is much greater than the power previously wielded by the foreign bankers involved in Latin American loans." In the 1930s, "Latin American governments frequently did default, and in the short run there was little the bankers could do about this. In contrast, in recent years few Latin American states have gone so far as to threaten default."[54] Indeed, from now on, the debtors would be expected to go through great pains to remain current on their financial obligations. David Harvey identifies this shift as a particularly important moment in the transformation of the global political economy, writing that it "demonstrated ... a key

[52] Cited in Quirk (1983, 10)
[53] Stallings (2013); see also Stallings (1987, 4)
[54] Marichal (1989, 236-37)

difference between liberal and neoliberal practice: under the former, lenders take the losses that arise from bad investment decisions, while under the latter the borrowers are forced by state and international powers to take on board the cost of debt repayment no matter what the consequences for the livelihood and well-being of the local population."[55] The result of this shift in the prevailing approach to international crisis management was a striking absence of payment suspensions during the 1980s.[56] Now that outright default had been excluded as an acceptable policy response, the debtors were condemned to work closely with their private and official creditors in a multilateral endeavor to reschedule the amortization of principal, refinance maturing obligations and avoid any disruption of the payment of interest.

This shift in the international policy response raises an important question: How did the dominant creditor power at the time manage to bridge the glaring contradiction at the heart of its new policy paradigm? How, in other words, did the U.S. government ensure that countries that *could not* pay, *would* repay? The short version of the answer is that it improvised, trying out different approaches on the go: from urging the Wall Street banks to extend the debtors' amortization schedules; to cajoling the same banks into "concerted lending"; to pushing for greater IMF involvement, insisting on stricter policy conditionality, and demanding further lending commitments from private banks under the Baker Plan of 1985.[57] If there was one thing in which these various attempts succeeded it was to "extend and pretend," buying time for private creditors to reduce

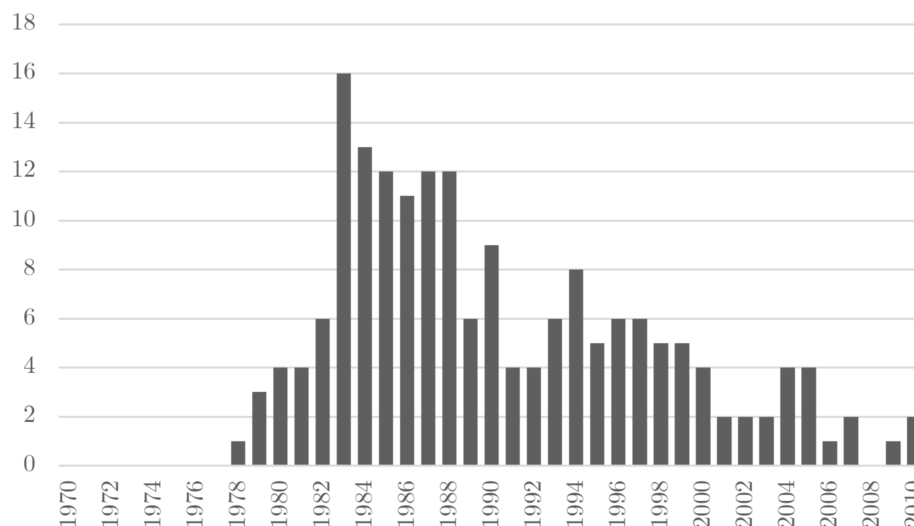
[55] Harvey (2005, 29)

[56] Griffith-Jones (1988, 7-8) writes that "the option of unilateral action (leading to default or extended moratoria) has not been officially adopted by any major debtor since 1982."

[57] For good overviews of the official policy response to the crisis, see Boughton (2001) and Kraft (1984).

their exposure and build up their capital bases ahead of an inevitable debt restructuring. If there was one thing in which these attempts did *not* succeed, however, it was to restore the debtors to solvency—that would not happen until much later, following the Brady Deal debt swap of 1989 (named after Treasury Secretary Nicholas F. Brady, but initiated by J.P. Morgan in December 1987, when it proposed to exchange its discounted loans to the Mexican government for securitized bonds, which it could sell on secondary markets, providing Mexico with some welcome debt relief while allowing J.P. Morgan thereby reduce its exposure to the Mexican government).[58]

Figure 3: number of debt restructurings
(bonds and bank debt), 1970-2010



Source: Das, Papaioannou and Trebesch (2011)

The repeated rescheduling of principal payments and the eventual restructuring of the debt, then, was one way in which the U.S. government sought to bridge the gap between the widespread inability to pay and its own insistence on repayment. As figure

[58] Aggarwal (1996, 334); Boughton (2001, 491)

3 shows, there was a large increase in multilateral debt restructurings during the 1980s, demonstrating that voluntary renegotiations were an important part of the U.S. debt strategy. As it turns out, however, the debt relief provided by these *ad hoc* arrangements was very limited, and outcomes generally tended to reflect creditors' demands much more closely than the interests of the debtors. Even the Brady Deal, which was widely credited with resolving the crisis from 1989 onwards, did not provide meaningful debt relief.[59] While the U.S. government and the Bretton Woods institutions officially called for a reduction in the developing world's debt burdens, in practice they generally took the creditors' side. As William Cline writes, "despite the high public profile of the IMF in calling for deep forgiveness, in the actual negotiations the institution did not press the banks."[60] Even Sweder van Wijnbergen, the World Bank economist in charge of many of the Brady Deal negotiations, therefore acknowledges that the initiative's most important contribution was not to provide the debtors with much-needed reprieve, but rather to restore market confidence and incentivize renewed private lending.[61]

In sum, even though multilateral "solutions" could partly offset the contradiction at the heart of the U.S. debt strategy, thereby preventing a wave of unilateral defaults, the general tendency of these negotiated debt deals clearly inclined towards much more creditor-friendly outcomes. While nearly 50 countries engaged in over a hundred debt rescheduling arrangements between 1980 and 1986, the terms of these deals were gene-

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[59] Net reduction for Latin America amounted to only 15 percent (Dooley, Fernandez-Arias and Kletzer (1994, 7).
[60] Cline (1995, 220)
[61] Claessens, Oks and Van Wijnbergen (1993, 1) conclude that "the main benefit of debt relief was not to lower expected payments but to reduce uncertainty." See also Cline (1995, 43).

rally designed to protect creditor interests.[62] Jorgensen and Sachs therefore highlight a clear contrast between the post-default settlements of the 1930s, when "the terms of the final agreements ... were highly favorable to debtors," and the multilateral approach of the 1980s, when creditor interests clearly prevailed.[63] For Lindert, the 1980s equally stand out as a watershed in the international approach to crisis management: "To the extent that the new regime of the 1980s has prevented outright default, it has helped insure creditors against massively negative rates of return."[64] While such creditor-friendly outcomes are now largely taken for granted in the management of international debt crises, it was only then, at the start of the neoliberal era, that "creditor clubs ... successfully replaced unilateral default with multilateral debt consolidation."[65]

Creditor Intervention during the Neoliberal Era

But multilateral debt renegotiation was not the most important novelty of the 1980s. The one key innovation that the U.S. government had stumbled upon over the course of the crisis, long before the Brady Deal settled it all, was the disbursement of large international bailout loans under strict policy conditionality. These aggressive financial interventions would not only come to define the political and economic reality of the developing world in the 1980s, leading to sweeping intrusions into their domestic affairs by IMF and World Bank officials over the course of the decade; they also ended

[62] Lindert (1989, 238)
[63] Jorgensen and Sachs (1989, 79)
[64] Lindert (1989, 227)
[65] Lipson (1981, 622)

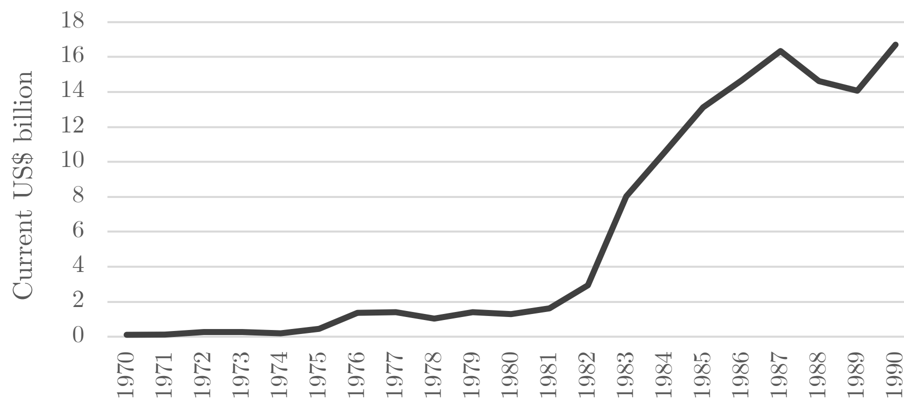
up providing a blueprint for the management of future debt crises elsewhere, from the emerging market turmoil of the 1990s and early 2000s to the Eurozone debt crisis of the 2010s—and beyond.[66] In this light, the existence—and transformation—of the IMF constituted arguably the greatest contrast to the crises of the pre- and interwar period. While the 1930s had been plagued by the absence of an international lender of last resort, the 1980s witnessed what one banker called "the IMF's triumphant return."[67]

Behind the IMF, however, ultimately stood the United States government. For it was the Reagan administration that, at the instigation of Federal Reserve Chairman Paul Volcker, who was "convinced that the banking system was about to collapse," convinced Congress to increase the U.S. contribution to the Fund when the crisis first broke in 1982.[68] It was also the Reagan administration that exerted strong pressure on the IMF—both through the Board of Governors, through its European and Japanese allies, and through more surreptitious political backchannels at the Treasury Department—to increase the conditionality on its loans, and to repurpose these conditions in such a way as to prioritize the freeing up of domestic resources and the maximization of foreign exchange earnings for uninterrupted debt servicing. The Baker Plan, with its insistence on a more central role for the IMF and the need for structural adjustment

[66] Admittedly, the resort to conditional lending was not entirely novel (e.g. Flandreau and Flores 2012); nor was the idea of intrusive financial surveillance, which is so central to the contemporary IMF bailout program, itself a completely new phenomenon (e.g. Martin 2015). Nevertheless, the scale of IMF lending, the scope of its policy conditionalities, and the range of its disciplinary force were all unprecedented phenomena in the early 1980s.
[67] Cited in Leslie (1983, 24)
[68] Lissakers (1983, 164)

in the debtor countries, acted as a catalyzing force in this respect, further contributing to the Fund's transformation into a much more "neoliberal" direction.[69]

Figure 4: Use of IMF credit by Latin America and Caribbean (excl. high income), 1970-1990



Source: World Bank (2017)

Taken together, these developments led simultaneously to a sharp rise in IMF lending to the developing world, especially Latin America (see figure 4), and to a large increase in the proportion of upper credit tranche IMF lending that was to be disbursed under policy conditionality, from less than one-third of all loans made in 1973 to 96 percent a decade later.[70] By 1984, as many as 66 developing countries were under IMF surveillance.[71] Both aspects of the IMF's role—the disbursement of bailout loans and the imposition, monitoring and surveillance of policy conditionality—entrusted its officials with the mobilization of other people's resources to bridge the basic contradiction at the heart of the can't-pay-will-pay principle. First, the bailout loans themselves mobilized resources from taxpayers in the creditor countries and used them to effecti-

[69] Kentikelenis and Babb (2019)
[70] Pastor (1989, 91)
[71] Chahoud (1991, 31)

vely underwrite the "bad loans" of private investors, ensuring that these would be repaid in full.[72] Second, the policy conditions on these bailout loans in turn mobilized the resources of workers, taxpayers and welfare recipients in the debtor countries through the pursuit of austerity, privatization and structural reform—to ensure that the debtor would be maximally capable of honoring not only its foreign obligations to *private* lenders, but now also to *official* lenders, most importantly the IMF itself.[73]

The new approach to international crisis management therefore had far-reaching distributional implications, which we will discuss in detail further on. For now, the key point is simply that official-sector intervention—principally in the form of IMF bailout loans—played a crucial role in preventing the type of unilateral payment suspensions that had characterized previous international debt crises. While official-sector intervention, as we have seen, was "ambiguous" and unpredictable for much of the nineteenth and early-twentieth centuries, after 1982 it would become a stable and reliable feature of international crisis management.[74] Jorgensen and Sachs conclude that "the existence of the International Monetary Fund as a referee for the extension of new credit is especially important in creating a cooperative environment for avoiding outright default."[75] Unsurprisingly, perhaps, the Fund's newfound role as a "disciplinary mechanism" for the debtors, as former Managing Director Johannes Witteveen called it, would lead to widespread criticism in the developing and the developed world alike. Karin Lissakers,

[72] Lissakers (1983)
[73] Pastor (1987; 1989)
[74] "Whereas intervention in the 1930s was sporadic," Eichengreen and Lindert (1989, 20) write, "in the 1980s it has been systematic."
[75] Jorgensen and Sachs (1989, 48)

a U.S. Treasury official who would later go on to become the United States' Executive Director at the IMF, vocally criticized the Fund for its role as an "enforcer of the banks' loan contracts," imposing socially regressive and economically counterproductive austerity on the debtors "to free foreign exchange in order to service debts."[76] As Lindert concludes, the years since 1982 thus "stand out as the era in which official intervention became global—and, so far, less concessionary."[77]

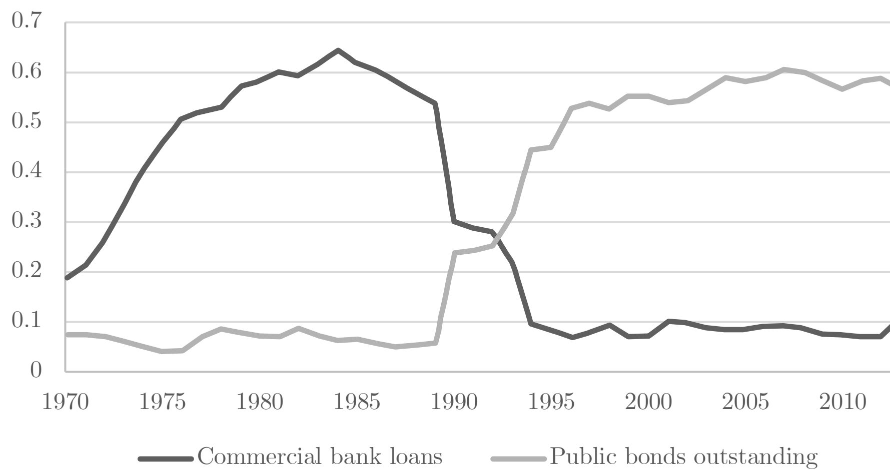
The Institutionalization of the IMF Bailout Loan

This reliance on IMF intervention—both in terms of the loans provided and the conditionality imposed—would only become more institutionalized with the next round of crises in the 1990s. Looking back at figure 3, we can see not only that restructuring deals increased in number in the 1980s, but also that they suddenly declined from the 1990s onwards. This was a result of an equally important shift in the international lending structure, caused at least in part by the Brady Deal, which exchanged the syndicated bank loans of the 1970s and 1980s for securitized government bonds (see figure 5). By contributing to greater fluidity and anonymity of debt holdings, the return to bond finance made it much more difficult to coordinate creditors for the renegotiation of distressed debts.[78] As a result, the amount of debt restructurings fell sharply, leading to a situation in which sovereign default in all its forms and guises—whether unilateral

[76] Boughton (2001, 290-91); Lissakers (1983, 167)
[77] Lindert (1989, 238)
[78] Anne Krueger, IMF Deputy Managing Director during the early 2000s, observed a contrast between the "generally orderly" crisis management of the 1980s, and more disorderly crises at the turn of the century, in which creditors "were increasingly numerous, anonymous, and difficult to coordinate." Cited in Cooper and Momani (2005, 316).

and outright, or voluntarily negotiated by the creditors as part of a multilateral debt restructuring—became increasingly rare across the board. Figure 6 clearly shows how the share of sovereign debt in a state of default has been declining steadily ever since, falling to a historic low of 0.2 percent in the wake of the global financial crisis of 2008. Indeed, even at the height of the Eurozone debt crisis, this share would never exceed 1 percent.[79] The few prominent debt restructurings that still occasionally make international headlines, like Greece's restructuring of 2012, are widely considered by leading experts to be "too little, too late" from the perspective of debt sustainability.[80]

Figure 5: bank loans vs. bonds (for 16 Latin American countries, aggregate), 1970-2013



Source: Kaplan and Thomsson (2017)

[79] Bank of Canada (2017)
[80] Guzman, Ocampo and Stiglitz (2016)

Figure 6: share of world public debt in a state of default, 1980-2016

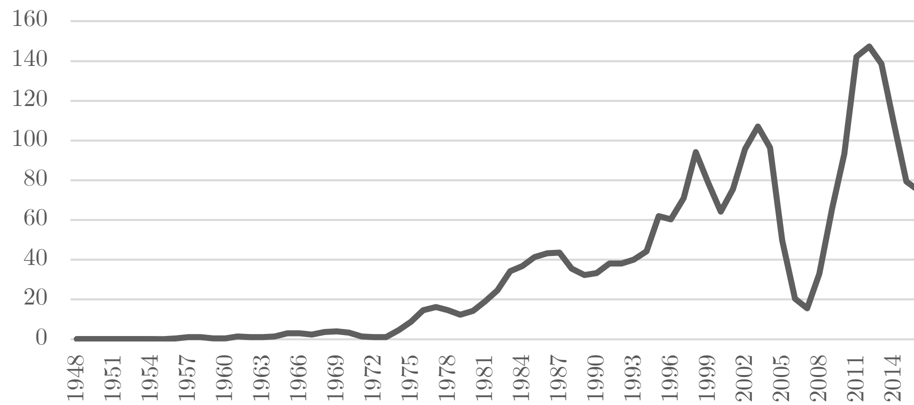
Source: Bank of Canada (2017)

Inevitably, the shift away from restructurings only heightens the contradiction at the heart of the official approach to international crisis management. If creditors consistently fail to provide timely relief, the only way to ensure continued repayment is to ramp up the reliance on IMF bailout loans and policy conditionality in order to introduce even more resources into the matrix from elsewhere. Looking at the data, this is exactly what appears to have happened. Figures 7 and 8 demonstrate how IMF lending massively increased during the crisis-ridden 1990s, and then—following a brief dip in the capital-abundant noughties—experienced another peak in the wake of the global financial crisis. The initial bump of the 1990s was largely made up of the Clinton administration's bailouts of Mexico, East Asia, Russia, Brazil, Turkey and Argentina (see figure 9); the second mostly a result of the IMF's unprecedented lending in the Eurozone, especially its participation in the three successive EU-IMF bailout programs of Greece, which at the time constituted the largest loan commitments the Fund had

ever made (until it outdid itself with Argentina's $57 billion rescue package of 2018).

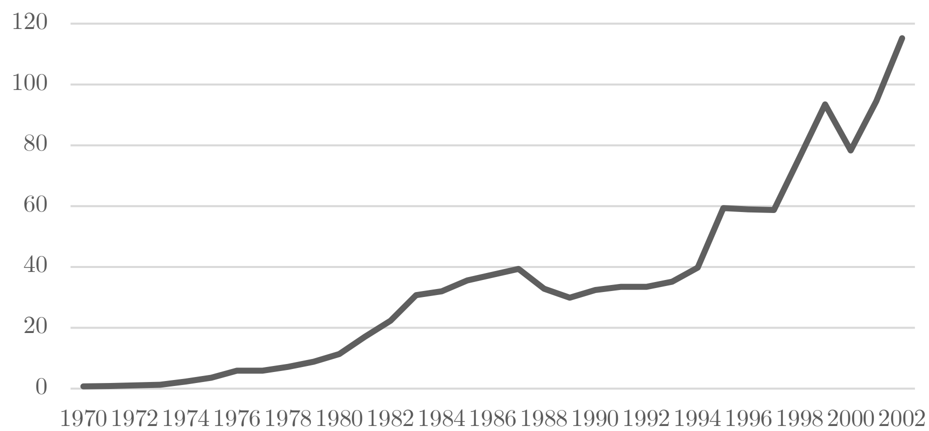
The sheer size of the European bailout loans comes out strikingly in figure 10.

Figure 7: total IMF credit and loans outstanding (US$ billion), 1948-2015



Source: International Monetary Fund (2017a)

Figure 8: low- and middle-income country use of IMF credit (current US$ billion), 1970-2002

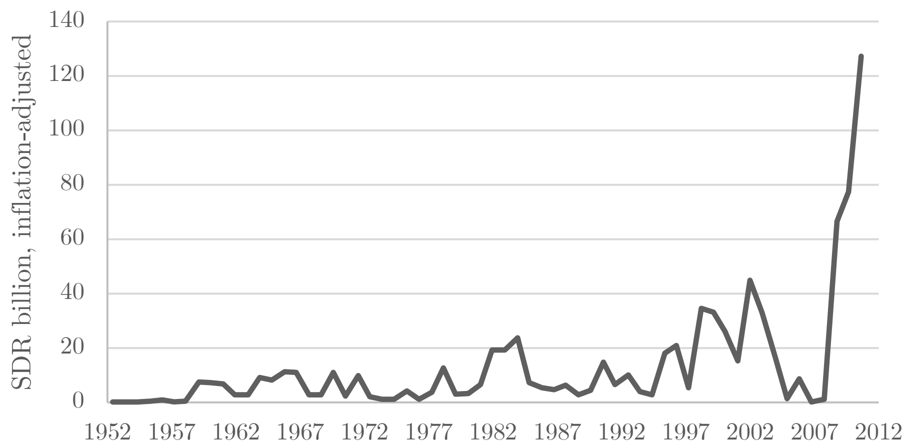


Source: World Bank (2017)

Figure 9: Use of IMF credit by selected countries (current US$ billion), 1990-2002

Source: World Bank (2017)

Figure 10: value of new non-concessional IMF lending commitments, 1952-2011



Source: Edwards and Hsieh (2011)

In both sets of crises, the IMF once again came in for widespread criticism for what many perceived to be its thinly-veiled indirect bailout of private creditors. During the late 1990s, this led Robert Wade to theorize the existence of a distinct "Wall Street-Treasury-IMF complex," highlighting the close ties between private and official credi-

tors, personified by former Goldman Sachs CEO Robert Rubin, who as Treasury Secretary under Clinton and one of the three members of what *TIME Magazine* called "the Committee to Save the World" had played an important part in orchestrating the new wave of international bailouts.[81] Writing about the East-Asian crisis of 1998, former World Bank chief economist Joseph Stiglitz lamented that:

> *During that crisis, the IMF, the U.S. Treasury, and other advocates of the neoliberal doctrines resisted what should have been an important part of the solution: default. ... They preferred to provide funds to governments to bail out foreign creditors ... At the same time, the IMF pushed policies with huge costs on innocent bystanders, the workers and small businesses who had no role in the advent of the crisis in the first place.*[82]

Occasionally, criticism of the Fund's approach also emerged from within, as in the wake of Argentina's record default of 2001, when Deputy Managing Director Anne Krueger proposed the creation of a Sovereign Debt Restructuring Mechanism (SDRM) to avoid the need for future bailout debacles.[83] The attempt was quickly shot down by Wall Street, which aggressively lobbied the U.S. Treasury Department to support a market-based contractual mechanism instead, the Collective Action Clauses (CACs), which eventually emerged victorious.[84] But while the Fund henceforth abandoned any attempts to create an institutionalized sovereign bankruptcy regime, individual IMF staff members did occasionally call for more *ad hoc* debt relief—most recently in the context of the Eurozone debt crisis, when a number of Fund officials, especially at the Strategy, Policy & Review Department, opposed the management's decision to take

[81] Wade and Veneroso (1998); see also Bhagwati (1998); Stiglitz (2002)
[82] Stiglitz (2001, xii)
[83] Krueger (2002)
[84] Krueger (2002); Brooks and Lombardi (2016)

the IMF into the EU's bailout of Greece, on the grounds that the country's debt burden was unsustainable.[85] Since the IMF's own rules, set up in the wake of the Argentine fiasco, prevent it from lending to a country whose debts cannot be considered "sustainable" with a reasonable degree of certainty, these staff members called for upfront debt relief instead. They were joined in their calls by the Executive Directors of a number of prominent developing countries, most notably Brazil, Argentina, China and India—but even the Swiss aired their displeasure at what they perceived to be a covert indirect bailout of the European creditor banks.[86] Nevertheless, as in the case of the SDRM, the creditor powers eventually got their way: calls for an *ex ante* debt restructuring were overruled in the name of systemic stability, largely as a result of strong pressure exerted by the French and German governments, whose own banks were highly exposed to Greek and peripheral Eurozone debt, and hence extremely vulnerable to the risk of financial contagion.[87] So while it would be overly simplistic to dismiss the Fund as an entirely homogeneous and *inherently* creditor-friendly institution, in practice the organization's response to major international debt crises has tended to be highly susceptible to political pressure exerted by the dominant creditor powers. Certainly such pressure played an important role in the expansions of IMF lending since the 1980s.[88]

The growing reliance on IMF bailout loans has in turn been matched by a parallel expansion of policy conditionality, to ensure that even the less "fiscally responsible" debtors would continue to pursue the kind of "sound policies" that would maximize the

[85] Blustein (2015, 6)
[86] Wall Street Journal (2013)
[87] Xafa (2014, 14); Blustein (2015).
[88] e.g. Pastor (1987); Thacker (1999); Vreeland (2003); Babb (2003); Broz and Hawes (2006); Copelovitch (2010).

likelihood of full repayment. Despite the Fund's frequent public claims to the contrary, Kentikelenis *et al.* have recently demonstrated that there is "little evidence of a fundamental transformation of IMF conditionality" in response to the calamitous bailouts of the 1980s and 1990s. Indeed, "the organization's post-2008 programs reincorporated many of the mandated reforms that the organization claims to no longer advocate and the number of conditions has been increasing."[89] To give just one particularly prominent recent example, the first memorandum of understanding that was signed between the Greek government and its EU-IMF creditors in 2010 required the Greeks to pursue one of the most extreme "front-loaded" fiscal adjustments in history.[90] In addition, the Greek government was expected to carry out far-reaching and highly intrusive market reforms, to reduce wages, pensions and unemployment benefits, to lay off civil servants, cut hospital budgets in half, and to eliminate job protections and collective bargaining rights. The measures demanded by the official lenders thus closely resembled—and if anything intensified—the ones the IMF had previously demanded in the Global South.

Recent developments therefore seem to have only further entrenched the pre-established pattern towards ever more creditor-friendly outcomes in the management of international debt crises. As the IMF's own evaluators concluded, in a biting review of the Fund's role in the first Greek bailout, the intervention had "only served to delay debt restructuring and allowed many private creditors to escape."[91] This has been a steady pattern in IMF programs since the 1990s, when the bailout loans and structural

[89] Kentikelenis, Stubbs and King (2016, 1)
[90] Independent Evaluation Office (2016)
[91] International Monetary Fund (2013, 27)

adjustment programs that had first been pioneered in the 1980s were effectively *institutionalized* as a crisis management mechanism at the global level.[92] The result has been to create a set of stable expectations among market participants that investors will always be shielded from losses, no matter the costs for the debtors. This in turn induces a risk of "asymmetrical moral hazard," whereby private lenders are incentivized by the very existence of the IMF and its dependable pattern of creditor-friendly intervention to make "bad loans" to highly indebted sovereign borrowers, always under the credible assumption that—come what may—the debt will be repaid.[93]

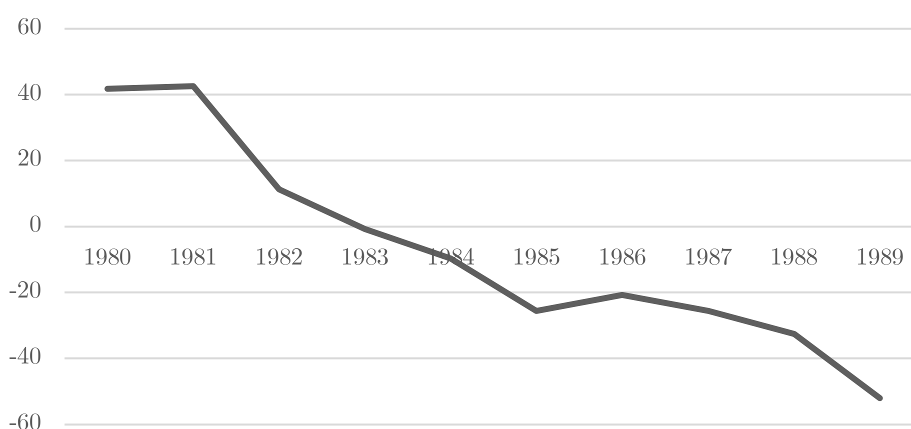
Conclusion: Distributional Implications

As was already alluded to above, the institutionalization of official-sector intervention and the associated policy conditionality has inevitably had far-reaching distributional implications. At the international level, it has led to a largely uninterrupted flow of capital "upstream": from heavily indebted countries in the periphery to private creditors in the advanced economies of the core. Figure 11, for instance, shows how the management of the 1980s debt crisis caused net financial transfers from the Global North to the Global South to go into reverse in the mid-1980s, as incoming investments and loans gave way to the outflow of large interest payments on foreign debts owed to private creditors in North America and Northwestern Europe. The developing world

[92] Lipson (1981) was early to spot this development.
[93] Lipscy and Lee (2019)

thus became a net exporter of capital to the developed world, with the former spending $52 billion more in debt servicing costs than it attracted in fresh foreign capital.[94] In total, the years since 1982 have seen developing countries transfer an estimated $4.2 trillion in interest payments to their creditors in the North—much more than they received in official-sector development aid during this period.[95]

Figure 11: net financial transfers from Global North to South (US$ billion), 1980-1989



Source: New Internationalist (1990)

In Latin America during the 1980s, the result of this dynamic was a protracted economic recession that, for many countries, was considerably deeper and much longer in duration than the Great Depression.[96] Poverty rates rose to almost 50 percent, and by the end of the decade the gross domestic product of a major debtor like Mexico was still 11 percent below the level it had been at the start of the decade—notwithstanding the fact that Mexico's population had increased by 15 million during this time.[97] It

[94] New Internationalist (1990)
[95] Hickel (2017); for up-to-date numbers, see World Bank (2017)
[96] Ocampo (2014)
[97] Bertola and Ocampo (2012, 18)

was with good reason, then, that the 1980s became known throughout the continent as "the lost decade." The popular sector—workers, peasants and the urban poor—bore a disproportionate share of the adjustment costs, while the wealthy moved their money abroad to avoid the costs of taxation, inflation and repeated devaluation.[98] It has been estimated, for instance, that by 1988 the richest 10 percent of Mexicans had invested between $64 and $80 billion into foreign stocks, bonds, deposits and real estate, allowing them to "utilize income from these assets to advantage by transferring funds back into pesos whenever frequent devaluations allowed the elite to maximize its buying power."[99] One study found that the interest on capital flight returned to wealthy local elites equaled roughly 40 percent of the cost of total debt payments.[100] Due to its "off-shore" nature, this private wealth could not be properly taxed by the debtor country governments, which instead forced the burden of debt servicing onto the poor.

Furthermore, to offset the ramifications of the economic recession and the often very high inflation rates on private sector profits, many Latin American governments imposed strict wage controls and draconian cuts in public spending, leading to sharp declines in living standards. Again, taking Mexico as an example, per capita income fell at an average rate of 5 percent per year between 1983 and 1988, while real wages (accounting for inflation) fell by nearly half.[101] The purchasing power of the minimum wage fell even further, by 66 percent, which meant that 80 percent of the country now had to subsist on 2.5 times the minimum income or less, although it took at least 4.8

[98] e.g. Frieden (1991, 218)
[99] Cypher (1990, 155)
[100] Pastor (1989, 98)
[101] Lomnitz-Adler (2004, 47), cited in Harvey (2005, 100)

minimum wages for a family of four to meet its basic needs.[102] Further evidence of the regressive character of the neoliberal approach to crisis management in the Mexican case can be derived from the labor share of income, which fell from 35.9 percent in 1982 to 26.6 percent in 1987.[103] Similar outcomes have been demonstrated to hold true for IMF and World Bank structural adjustment programs throughout the developing world, with a number of studies providing strong empirical evidence for the claim that the IMF's financial interventions since the 1980s have had profoundly regressive distributional implications.[104] World Bank chief economist Stanley Fischer recognized this when he stated that "most of the burden has been borne by wage earners in the debtor countries."[105] The head of UNICEF remonstrated the creditors: "it is hardly too brutal an oversimplification to say that the rich got the loans but the poor got the debts."[106]

One only needs to consider the outcome of the recent sovereign debt crisis in the Eurozone to see how this pattern of creditor-friendly crisis management has been firmly upheld in more recent years. Once again, the burden of adjustment was overwhelmingly borne by workers, pensioners, the youth, small businesses, the unemployed and the poor more generally. In Greece, for instance, the poorest experienced a 333.7 percent increase in their tax burden between 2009 and 2013, compared to just 9 percent for the upper income decile.[107] Extreme austerity measures demanded by the "Troika"

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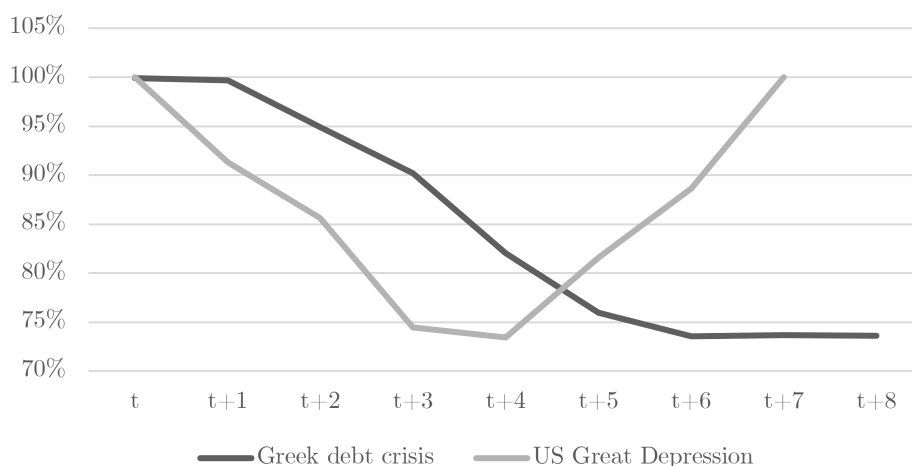
[102] Robinson (2004, 144)
[103] Middlebrook (1989, 198-99)
[104] e.g. Pastor (1987); Garuda (2000); Vreeland (2001); Stuckler and Basu (2013); Forster, Kentikelenis, Reinsberg, Stubbs and King (2019)
[105] Fischer (1989, 363); see also World Bank (1983)
[106] UNICEF (1989, 11)
[107] Giannitsis and Zografakis (2015, 17)

of foreign lenders—made up of representatives from the EU, ECB and IMF—deepened the recession and contributed to skyrocketing unemployment rates of over 25 percent (over 60 percent for those under the age of 25), while wages were cut by more than a quarter.[108] As a result, the average income of the poorest Greeks fell by 45.2 percent between 2008 and 2013. In its review of the first bailout, the IMF's own economists were again forced to acknowledge that "the burden of adjustment was not shared evenly across society."[109] Crucially, the Fund's evaluators recognized that this was a direct consequence of the insistence on continued repayment, noting that "earlier debt restructuring could have eased the burden of adjustment on Greece and contributed to a less dramatic contraction in output."[110] Another IMF report pointed out that the Fund's intervention had contributed to an economic collapse that was even more protracted than the one the U.S. had experienced during the Great Depression (see figure 12).



Source: International Monetary Fund (2017b)

[108] Giannitsis and Zografakis (2015, 36, 63)
[109] IMF (2013a, 21-27)
[110] IMF (2013a, 33); see also Independent Evaluation Office (2016)

What do these findings tell us? As I have sought to demonstrate in this article, there has been an important shift in the international approach to crisis management over the past four decades, from an ambiguous adherence to the "can't-pay-won't-pay" principle of the pre-World War II period, to a contradictory instance on full and timely repayment since the 1980s. In a context of rapidly rising public debt levels and in the absence of an overarching sovereign bankruptcy regime or a clear creditor commitment to *ex ante* debt restructuring, this has raised the question how creditors are able to ensure that countries that *cannot* pay, *will* repay. As I have argued, bridging this gap would not have been possible without the dramatic expansion and effective institutionalization of international bailout loans, primarily—but not exclusively—under the aegis of the IMF, and the parallel imposition of strict policy conditionality on the debtors. Recent changes in official policy response have therefore had far-reaching distributional implications, which have generally tended to redound to the benefit of private creditors.

By placing these developments in historical perspective, I have sought to make a contribution to broader interdisciplinary efforts to *denaturalize* and *repoliticize* the repayment rule at the heart of the global debt regime. While this rule is often taken for granted as a logical self-evidence, history teaches us that there is nothing inevitable about sovereign debt repayment. If a more equitable distribution of adjustment costs was possible in the past, it may well be possible again in the future. It is therefore to be hoped that further IPE scholarship on the subject will continue to probe into the deep-seated conflicts and contradictions at the heart of the global financial architecture, so that their effects on the most vulnerable may be better understood—and opposed.

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