Banking on the public: market competition and shifting patterns of governance

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and ministries of social affairs) and in the international policymaking process (other stakeholders than the financial sector itself). The discussions in this global policy community drew on a limited range of arguments (skewed argument pool) with a strong voice of global representatives of large internationalised banks. This is also evident from the consultative papers process that was managed by the BCBS secretariat. Although seemingly offering an open and transparent policymaking process, in fact the responses to the second and third consultative paper were heavily skewed towards private sector preferences (over 60 per cent of responses) with less than 15 per cent of responses coming from actors outside of the policy community of financial experts. Only incidentally did other stakeholders manage to assert their preferences, as we saw with Schröder's intervention on behalf of the *Mittelstand*.

The common outlook on the way forward that had emerged fairly quickly (the use of internal risk models to set capital adequacy standards), did not mean the public sector just responded to private sector demands. On the basis of the intellectual arguments for market-based approach – based on a narrow range of economic theory - the public actors set the goal of a comprehensive approach in addressing risk. In practice, this meant the public actors pushed for an operational risk capital requirement in Basel II over the opposition of private banks.

To summarise the feedback loop that is illustrated by this case study: shifting patterns of governance under Basel I changed the constraints actors faced in their actions in the global banking system, in turn leading to changing market structures. These changes in market structures also led to adaptation of preferences for governance of both public and private actors and led to a renegotiation of Basel I to Basel II. The negotiations on Basel II took place in global level policymaking institutions with a strong bias towards the preferences of large internationalised banks.

Chapter 5

Governing sovereign debt crises: From Latin America to East Asia and back

In this chapter the policymaking process concerning the management and resolution of sovereign debt crises since the 1980s is studied and related to the developments in the market structure of sovereign debt markets. By doing this, this case study sheds light on the relationship between the market structure for sovereign debts and the patterns of governance of sovereign debt crises. Ever since states discovered the benefits of using credit to finance their activities (historically mostly to wage war; more recently to finance war and welfare states) there have been occasions of over-indebtedness and the accompanying inability or unwillingness to repay creditors. These sovereign debt crises are usually accompanied by periods of major domestic economic upheaval. The cumulative decline in economic output in the three years leading to a default is 8 per cent for domestic debt default and 1.2 per cent for external debt defaults. Inflation in the year of default is 33 per cent for external debt defaults and a whopping 170 per cent for domestic debt defaults.[1] Naturally, this economic dislocation has grave social consequences. Also in the current financial crisis, several countries on the periphery of the Eurozone (e.g. Greece, Ireland) have suffered the adverse consequences of economic recession and sovereign debt problems. The governance pattern for sovereign debt crises aims to reduce these costs through an orderly and speedy resolution of these crises.

The analysis in this chapter starts with the resolution of the Latin American debt crisis of the 1980s under the Baker and Brady plans and traces the developments in this policy domain through to the debate on statutory (SDRM) and contractual (CACs) approaches in response to the series of emerging market financial crises in the second half of the 1990s. Five core arguments will be made.

First of all, it will be argued that the governance pattern emerging to resolve the Latin American debt crisis can be characterised based on the three dimensions of governance as an international level, public pattern of governance that was stringent for debtor countries and to a certain extent also stringent for private creditors. The Latin American debt crisis was resolved on an ad hoc, case-by-case basis under two successive US-led plans (the Baker and Brady plans). These plans built on the initial reaction to the crisis, which was to initiate official

[1] Reinhart & Rogoff, 2009, p. 129. Note that this data applies to actual defaults, and hence does not take into account debt crises where no default takes place.

financing through IMF programmes with attached conditionality (implying domestic adjustment), accompanied by private sector refinancing of loans. The plans applied in principle to all debtor countries in crisis, which would mean the governance pattern was 'international' on the jurisdictional dimension (not global, as the plans applied only to crisis countries, not to all countries). Although the details of the plans were left to negotiations between debtor countries and private creditors, the framework was set and monitored by public actors (predominantly the US Treasury and the IMF) under the successive plans. Lastly, the plans were stringent in the sense that the official refinancing of debtor countries included conditionality, steering debtor countries' behaviour. Private creditors were persuaded to provide limited refinancing of debtor countries (alongside the IMF financing), and hence also experienced some stringency.[2]

Second, it will be argued that the policymaking process leading to this pattern of governance was focused on US public authorities. The preferences of the US authorities reflected the market structure that had emerged over the course of the 1970s (with syndicated bank lending responsible for an increasing share of sovereign debts) and were consequently closely aligned to the preferences of their domestic financial sector. The high exposure of banks to emerging market debts, which was specifically pronounced for the US money centre banks, initially led to exclusion from consideration of governance proposals that entailed debt reductions (as these would lead to capital adequacy problems for banks). As a result, the onus was put on debtor country adjustment to solve the crisis. Only in later stages, when many private sector actors were no longer involved with the debt crisis, and actors from outside the US (notably Japan) championed solutions including debt reductions, did the window of opportunity for the Brady plan open. Throughout the process, however, discussions were focused on policymaking institutions dominated by creditor countries (such as the IMFC), and often discussions centred solely on the US. The private sector was involved through close consultation with their public authorities at the domestic level. At the international level, the private sector was mainly involved through the creditor committees negotiating with the debtor countries, while being encouraged by the public sector to establish the IIF (see also chapter three).

Third, it will be argued that the shifts in governance following the Latin American debt crisis (notably the Brady plan) led to the emergence of secondary markets and increased access to capital market financing for emerging markets. In other words, the market structure for sovereign debt changed from credit being supplied by syndicates of banks to supply by capital markets (with banks acting as intermediaries). Especially the Brady plan encouraged the growth of capital market financing of emerging markets through securitisation of sovereign debts. Moreover, on the supply side banks decided to reduce emerging market exposures (possibly also due to the first Basel Capital Accord, see the previous chapter). This significant change in market structure led to new challenges for sovereign debt crisis resolution (an increase in coordination problems, for example).

[2] Although it should be noted that private creditors reduced their exposure to crisis countries, even while co-financing IMF programmes.

This point leads to the fourth argument: that this change in market structure led to a change in preferences of major creditor states regarding the governance pattern. During the Mexican and East Asian crises of the second half of the 1990s it became clear how this new and interconnected market structure could impose serious costs on creditor states if they were to refinance debtor states. This gave creditor states the impetus to seek shifts in the governance pattern, supported by the IMF which made the intellectual case for a shift in governance in response to the changing market structure. However, with the policymaking process increasingly taking place in global policymaking institutions, the influence of international private actors increased (specifically that of the IIF). In the ensuing policymaking process, two tracks emerged: the statutory SDRM approach championed by the IMF and the contractual approach championed by the private sector and US state agencies. In addition to the contractual approach, the private sector also championed 'Principles' (originally known as a Code of Conduct) for the relations between debtor countries and private creditors.

These proposals entailed a shift in governance 'upwards' on the jurisdictional dimension, either by setting a global standard for contractual clauses, or by establishing a new global level international organisation. The nature of governance would have been public in the case of the SDRM, and to a lesser extent also in the case of the standard for CACs (although implementation depended on debtor countries and private creditors). The Code of Conduct / Principles are of a more private nature. On the third dimension, the SDRM would arguably be more stringent than the Baker and Brady plans as it could enforce a standstill and impose a negotiation framework (including majority decision-making) on debtors and all creditors. CACs restrain the actions of debtors and creditors to a certain extent, in the sense that they regulate the negotiations between debtors and creditors. They are less stringent than the SDRM and Baker/Brady governance pattern, however. The Principles are comparable to the CACs in that they stipulate rules for the negotiations between debtors and creditors, but a majority of the restrictions is imposed on the debtor states.

Fifth and finally, it is argued that the defeat of the statutory approach in favour of the contractual approach combined with the Principles can be explained by the relatively strong position of the private sector in the relevant policymaking institutions, and by an argument pool that was skewed towards market-based solutions among the participants in these policymaking institutions. Yet, at the same time the successful implementation of the contractual approach and Principles can be understood as a result of the official sector's support for the SDRM in combination with reluctant acceptance of international harmonisation by the private sector. In other words, the preferences of public actors had an important influence on the outcome.

In developing this argument, this chapter makes three contributions to the overall purpose of the thesis and to the existing literature (see also the overview of current literature in the next section). First of all, it includes the developments in the market structure for sovereign debts and its relation to the shifts in governance pattern from Brady/Baker to CACs plus

Principles into the analysis. In the current literature, the developments in the market structure are usually a black box. By opening this black box a simultaneous explanation of the developments in market structure and the (failure of, in case of the SDRM) shifts in governance patterns can be provided. This builds on the current literature in an important way. Detailing an account of the interplay between market structure and governance pattern through the policymaking process will thus be a first contribution of this chapter, corroborating the added value of the theoretical model as it was developed in the second chapter.

A second contribution follows from the first: the feedback loop from shifting patterns of governance, specifically under the Brady plan, to changing market structures in the form of capital market financing of sovereign debt shows the importance of public sector officials in the developments of both the governance pattern and market structures. In other words, particular agencies of the state have a significant influence on the developments in the global financial system, even in the face of financialisation. Furthermore, the fact that the contractual approach was successfully implemented was to a large extent due to the intellectual case for a statutory approach made by the IMF. Although the SDRM failed to overcome private sector objections, the fact that parts of the public sector pushed it as a coherent solution led to the development and implementation of CACs and Principles. While intellectually perhaps second-best solutions, these were the solutions possible given the realities of power relations between public and private actors.

A third contribution, specific to this chapter's case study, is that it shows the relationship between governance and market structures in a three-way relationship of main actors: debtor countries; creditor countries and other official sector representatives (e.g. IMF); and private creditors. Different from the governance of bank capital adequacy discussed in the previous chapter, state actors are more directly involved in the market as the demand side for credit and are in that capacity also constrained by the governance pattern (whereas in the banking case, banks are constrained and the effect on states is only indirect). The chapter therefore shows how the feedback loop between governance pattern and market structure holds in different constellations of market actors. Furthermore, this case concerns crisis resolution, whereas the governance of bank capital adequacy concerns crisis prevention. Again, this shows the breadth of the realm of policy domains to which the theoretical framework can be successfully applied.

The chapter will proceed by giving an overview of the current literature in the following (first) section. In the second section, the policymaking process concerning the resolution of the Latin American debt crisis is discussed. The third section describes how this governance pattern fed back into the market structure and changed actor preferences. This sets the stage for the next step in our feedback loop in the fourth section, an analysis of the policymaking process regarding the governance of sovereign debt crises in the wake of the Mexican and East Asian crises. The final section provides an analysis of the developments in this policy domain.

Analysing the governance of sovereign debt crises

In light of the social impact of sovereign debt crises and their regular occurrence in history, the literature examining the shifting patterns of governance in this policy domain is surprisingly meagre. The literature discussing the broader developments in the global financial system after the Latin American debt crisis is substantial, as is the literature discussing the (lack of) shifts in governance following the 1997-1998 East Asian crisis (the 'New International Financial Architecture' debate).[3] However, literature examining the specific question of governance patterns for sovereign debt restructuring is mostly restricted to specific cases or episodes. In the following overview, the focus lies on contributions to the literature that took a more encompassing approach to the developments in the policy domain of sovereign debt restructuring (i.e. case studies of specific sovereign debt restructurings are excluded). First, a number of contributions focusing on one episode of sovereign debt crises are discussed, followed by contributions that have a more extended period of analysis.

Discussing the Latin American debt crisis, Oliveri (1992) argues that the governance pattern was characterised by higher available amounts of IMF credits, limited amounts of new private financing and debt-equity conversions, and liberalisation of domestic economies.[4] His explanation of the cooperation of both public and private actors in this regime is based on self-interest. For example, banks and large debtors both had an interest in the case-by-case approach, since both expected to have more negotiating power in case-by-case negotiations.[5] This interest-based approach offers only limited insight into why the balance as represented in this regime was chosen; Oliveri focuses on explaining the participation of actors in case-by-case negotiations, rather than on the outcome of these negotiations. The bias inherent in the policymaking institutions is mostly underexplored. In other words, it offers little analytical leverage on why the shifts in governance across the different dimensions took place.

The official historian of the IMF, Boughton (2001), follows a functionalist logic to explain the central role of the IMF in the Latin American debt crisis.[6] Bankers and debtor states needed a focal point, which was provided by the IMF. As such, this can be seen as an explanation focused on institutional factors. The domestic adjustment for debtor states subsequently follows from the conditions attached to the use of different IMF facilities. Naturally, Boughton focuses on the IMF, but it can be seriously doubted whether the IMF was central in the shifting patterns of governance. The focus on the IMF seems to miss an important part of the explanation, which relates to developments in the policymaking process outside of the IMF in the form of the Baker and Brady plans (that seemingly used the IMF mainly as a tool). Moreover, Boughton

[3] On the Latin American debt crisis, see, for example, Cline, 1995; Kahler, 1989; Griffith-Jones, 1989; Oliveri, 1992. For the post-Asia crisis debate see Agénor et al., 1999; Eichengreen, 1999; Robison et al., 2000; Underhill & Zhang, 2003.

[4] Oliveri, 1992, p. 60.

[5] Oliveri, 1992, p. 52-53.

[6] Boughton, 2001, p. 177.

decidedly focuses on public actors, and gives too little attention to the role of private actors.

Strange (1998), writing at the advent of the Asian crisis, attributes a lack of change in the governance pattern for sovereign debt crises to the difficulty of coming to an international agreement on the terms and conditions of a legally enforceable system of bankruptcy.[7] This is the case especially since the 1990s as the needs of debtor countries differed widely (ranging from East Asia to the emerging post-communist states to the HIPC countries). Although Strange's account is not elaborated, it seems focused on state interests as the main explanatory factor.

Coming to the post-Asia crisis debate, Frank (2004) argues that legitimate arguments exist for – in his words – 'radical reform' (in the form of an SDRM), limited reform (like CACs) or market-based solutions; and he continues to argue that it is the reluctant stance of the US administration vis-à-vis radical reform that determines the outcome.[8] He goes on – while acknowledging that it seems an unscientific conspiracy-type explanation – to attribute this US preference to a possible fear of an independent agency determining the causes of sovereign debt crises and ending up putting the blame on the US (through spillover of US domestic policy to emerging markets).[9] He does not provide any empirical backing for this claim, however. Moreover, his explanation for the post-Asia crisis' shifts in governance is state-based and lacks a substantive account of the policymaking process.

A number of contributions to the literature combine an historical perspective covering both the Latin American and the post-East Asia crisis episodes with a specific focus on the governance of sovereign debt restructuring. Rogoff & Zettelmeyer (2002) provide an intellectual history of proposals for sovereign debt restructuring mechanisms over the last quarter of the twentieth century. Two important developments in their explanation of the emergence of different proposals are firstly a shift in the definition of the problem of sovereign debt restructuring from coordination problems between the public and private sector to coordination problems among private creditors. Secondly, the attention shifted from inefficient debt workouts to self-fulfilling debt panics.[10] This fits with the increasing role of private creditors since the 1970s, and also with the subsequent shift to capital market financing. However, they do not provide an account of the policymaking process nor provide an explanation for why no mechanism has been implemented so far (providing such an explanation is not the purpose of their paper). They show how different proposals can be derived from advances in economic theory, and are consequently focused on the factor of ideas. However, they also argue that the changes in ideas were in turn partly a result of changing market structures. In that sense, their account could be seen as focusing on market developments and ignoring the active role of state actors and shifts in governance in these market developments.

Rieffel (2003) explores the restructuring of sovereign debt both during Bretton Woods

[7] Strange, 1998, p. 100.
[8] Frank, 2004, p. 711.
[9] Frank, 2004, p. 726.
[10] Roggoff & Zettelmeyer, 2002, p. 28.

and in the post-Bretton Woods period. He provides a comprehensive descriptive account of the proposals involved, including the role of under-researched actors like the London and Paris Clubs. The account is partially informed by his own experience as a practitioner in both the US Treasury Department and the IIF. However, he does not so much explain the governance patterns that de facto emerged as he argues his case for 'ad hoc machinery' as the superior pattern of governance. For example, regarding the resolution of the Latin American debt crisis, he just remarks that the governance pattern chosen was "close to the best that was politically feasible at the time and may have been the best for advancing global welfare in the long term,"[11] without elaborating.

Soederberg (2005) argues that the informal nature of the governance pattern for sovereign debt restructuring has added to the vulnerability and volatility of the market for sovereign credit. This serves to recreate the conditions for capital accumulation by masking the power relations and exploitation practices that underlie sovereign credit.[12] It is consequently the creditor states and, more importantly, the interests of (fractions of) the capitalist class that serve to explain the current informal regime of sovereign debt crisis governance. The neo-Gramscian perspective Soederberg applies includes both state and market actors, but she points out that state actions merely serve to legitimate the underlying process of accumulation.[13]

The most comprehensive contribution to the debate comes from Helleiner, who has studied proposals for sovereign debt restructuring mechanisms from the 1930s onwards.[14] He argues that a coalition of large debtor countries and private creditors, which was in opposition to statutory sovereign debt restructuring mechanisms, managed to neutralise occasional attempts by creditor governments or international organisations to develop such a mechanism. While Helleiner provides a convincing argument as to why statutory approaches are not implemented, he does not explain why we have seen the emergence of global level market-based forms of governance like the standard for CACs and the Principles. Furthermore, he does not explicitly address the relation between governance pattern and market structure.

Finally, Lavelle (2010) compares the actors in the policymaking processes on the G77 debt workout proposals of the 1970s and the SDRM to assess the participation in and accountability of the process. She notes how the difference in market structure in the two episodes leads to the involvement of different actors in the policymaking process, but argues that a similar coalition of lenders interested in repayment and debtors interested in continued access to finance blocked proposals for formal mechanisms. While noting the developments in the 1980s (i.e. the Brady plan), the link between this pattern of governance and the subsequent change in market structure (which is subsequently reflected in wider participation in the policymaking process) is not explicitly made.

[11] Rieffel, 2003, p. 153.
[12] Soederberg, 2005, p. 928.
[13] Soederberg, 2005, p. 928.
[14] Helleiner, 2008 and 2009.

The discussion above shows how a valuable contribution can be made to the literature by extending the analyses to both market structure and governance pattern in an integrated fashion. Most studies focus on either states or markets (and hence implicitly do not overcome the dichotomous view of the two). Helleiner does not suffer from this drawback, however, and uses an approach to the policymaking process similar to the one proposed in this thesis. He thus provides an excellent base to build upon by looking at the broader debate on sovereign debt crisis resolution and not limiting the discussion to statutory approaches. The next section will start the analysis of the governance of sovereign debt restructuring by looking at the Latin American debt crisis.

The Latin American debt crisis

Onset and first response

Although the Paris Club had been a reasonably well-functioning system of public governance for official (meaning state-to-state) debt crisis resolution, as the discussion in chapter three has shown, private debts became more and more important in the 1970s. When in the summer of 1982 Mexico was the first emerging market to declare it could no longer repay its private loans, and was followed by several other (mainly Latin American) emerging markets, it became apparent that the risk exposure of banks was excessive in relation to banks' capacity to meet losses. The international syndicates of banks were involved in the emerging markets with debt problems to an extent that outstanding loans were much larger than bank capital. Table 5.1 below shows the exposures of Western banks to the HD17, a selected group of emerging markets later included in the Baker plan.[15] As the numbers demonstrate, the global banking system was at risk.[16]

Table 5.1 Exposure of Western banks to the HD17 (% of capital)

	1982	1985	1987	1992
US	130.1	86.6	63.6	26.7
US (9 largest banks)	194.2	140.1	106.6	50.6
UK	85.0	68.6	42.4	n/a
Germany	31.4	50.7	33.5	18.5
France	n/a	126.6	62.8	22.7

Source: Cline, 1995, tables 2.10 – 2.14

[15] The HD17 refers to 17 highly indebted countries identified for inclusion in the Baker plan and exemplary for the resolution of the debt crisis (see below). These countries accounted for half of total developing country debts in 1982 and were: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ivory Coast, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia (Cline, 1995, p. 39 and table 2.1).

[16] Rieffel, 2003, p. 156 provides exposure figures including all emerging markets, showing that the US banks had 186 per cent of capital outstanding in developing countries in 1982 (with the nine largest banks having almost three times their bank capital outstanding in developing countries with 288 per cent).

As the table shows, problems were biggest in the US banking sector, followed by those in France and – at a distance – the UK and Germany. The high exposure of France in 1985 can be explained by the fact that French banks were egged on by their government in the early 1980s to provide additional credit to highly indebted countries (mainly in francophone Africa) in order to support French companies.[17] Although no comparable data exists for Japan, it seems that its exposure as a percentage of capital was not high (Latin American loans only accounted for 1.4 per cent of total bank assets in 1982, compared to 7.0 per cent for the US).[18]

The Latin American debt crisis served to underscore the change in market structure that had occurred in the 1970s in the market for sovereign debt (the rise of syndicated bank lending). This also led to a significant shift in the preferences of public actors regarding the governance of sovereign debt crises. Public authorities of creditor states had an interest in putting the burden on domestic adjustment, accompanied by official refinancing as necessary, so as to keep their private financial sector solvent.[19] The private sector unsurprisingly had a preference for as much repayment as possible, and the majority of the banking community was of the view that "with appropriate interim lending programs and country adjustment effort the debt on banks' books will be shown over time to be sound."[20] Only a minority in the private sector thought debt write-offs to be necessary. An important distinction should be made, however, between the large US money centre banks and smaller, regional banks. The former were inclined to stay in the market for sovereign debts, while the latter took the crisis as a signal to get out of the sovereign debt market completely.[21]

With the increasing role of private credit, it was clear to public sector authorities that the Paris Club as a policymaking institution was not suitable for this crisis. The US public authorities took the lead in the policymaking process, coordinating ad hoc responses to the debt crisis. When Mexico first declared it would no longer be able to service its debts, it would take the IMF some weeks to arrange a rescue package. In the meantime, bridging loans were provided by the US and – egged on by the US – the BIS.[22] While the US took the lead in coordinating the parameters for the initial response to the crisis, the debtor countries were to a large extent left responsible for organising the negotiations with their creditors and the IMF within these parameters.[23]

In effect, a strategy was designed that combined domestic adjustment with official refinancing and private sector debt rollovers. In October 1982, the IMF Managing Director (Jacques de Larosière) announced at a meeting with bankers that the IMF would only provide

[17] Wiegand, 1988, p. 26-27.
[18] Stallings, 1990, p. 7 and footnote 18.
[19] Sachs claims that: "The strategy of the creditor governments therefore coalesced around one principal goal: maintaining the servicing of commercial bank claims by the debtor governments." Sachs, 1986, p. 398.
[20] Bergsten, Cline & Williamson, 1985, p. 22.
[21] Oliveri, 1992, p. 55.
[22] Kraft, 1984. Kraft provides a fascinating journalistic account of the Mexican rescue, published by the G30.
[23] Oliveri, 1992, p. 114.

emergency financing to Mexico if the private sector did so as well. In subsequent finance packages for crisis countries, the IMF continued to emphasise co-financing by the private sector.[24] This meant the approach was limiting for both the debtor countries which had to adhere to conditionality and the creditors which were forced to rollover debt. The governance pattern was therefore quite stringent.

The co-financing by the private sector did not necessarily entail a net flow to the emerging markets, however. As can be seen in table 5.1 above, banks in fact reduced their exposure over time. This is also reflected in table 5.2 below that shows the net capital flows to Latin American countries, demonstrating that in fact an outflow of capital took place. Another effect was a steadily rising proportion of official debt in the debt stock of emerging markets.[25] This was further facilitated by a quota increase for the IMF which was agreed on by the IMFC in February 1983.[26] As the G7 communiqué of June 1984 stated: "In our strategy for dealing with the debt burdens of many developing countries, a key role has been played by the International Monetary Fund (IMF), whose resources have been strengthened for the purpose."[27] The same communiqué also confirmed the G7's commitment to the case-by-case approach.

Table 5.2 Net capital flows to Latin America, 1981 – 1985 (billion US$)

Year	Net capital inflow	-	Interest repayments and foreign profits	=	Net resource transfer
1981	49.1		27.8		21.3
1982	27.6		36.8		-9.2
1983	6.1		34.9		-28.8
1984	11.6		37.1		-25.5
1985*	4.1		36.7		-32.6

* preliminary data Source: Sachs, 1986, table 1 (p. 400)

The ad hoc responses were first and foremost focused on IMF programmes as these provided both official refinancing and domestic adjustment through conditionality. Using the IMF as the primary policymaking institution provided creditor governments with significant leverage due to their high voting weights in the IMF. Given this bias in the Executive Board and the IMFC towards creditor governments, it is not surprising that the outcome reflected creditor governments' preferences. With the interests of private creditors and public authorities of creditor countries closely aligned, the protection of the solvency of Western banks seems to have informed the selected balance between official refinancing, domestic adjustment and private debt restructuring. This balance tilted towards domestic adjustment in the debtor states combined with official refinancing.

The Baker Plan

By the mid-1980s, the effects of this initial round of IMF packages began to wear off, however. A deterioration in the terms of trade for debtor countries led to new liquidity problems, which could not be easily blamed on internal profligacy or external conditions.[28] The policy adjustments in the emerging markets did not provide the desired sustained economic growth while the relatively short-term IMF loans became due. In short: the ad hoc governance pattern that emerged in the immediate wake of the crisis did not resolve it. In reaction to these developments, a team working for the new US Secretary of the Treasury James Baker III (appointed in January 1985) set out to design a more systematic programme for dealing with the crisis countries.

At the time, there was much chatter about forming a debtors' cartel to strengthen the position of the crisis countries in the policymaking process. In early 1984, Argentina had managed to get an overnight rescue from four other Latin American countries (Brazil, Colombia, Mexico and Venezuela) to prevent it from being reclassified by the US as 'in arrears'. This loan was guaranteed by the US, on the condition that Argentina agreed on an IMF programme in a matter of weeks. When Argentina failed to do this even after some extensions of the deadline, the US withdrew its guarantee in June. This made some of the prospective members of a debtors' cartel liable for the loan and hence suddenly also part of the group of creditor countries. This successfully disrupted the consolidation of a common position at a debtors' summit in Cartagena. In effect the US had effectively pre-empted formation of a unified front amongst debtor countries.[29]

This is all the more relevant since on the creditor side there was a de facto unified front. A relatively small group of creditors participated in all the case-by-case negotiations in Bank Advisory Committees (London Clubs) with the debtors, and in that way gained a strong hand in the negotiations. They could ensure no unwanted precedents were set across cases. This way of addressing the debt negotiations through the policymaking institution of the London Club consequently provided negotiation leverage for private creditors.[30]

The policymaking process developing the broader governance pattern (including the case-by-case approach to the negotiations) was mostly focused on the new team in the US Treasury. In October 1985 they had thought out their approach and Baker and Federal Reserve Chairman Paul Volcker summoned leading New York bankers to discuss their plan.[31] The private sector seemingly had to make a significant contribution: the Baker plan laid more emphasis on lengthening the maturity of debts ('private sector involvement') and renewing capital inflows

[24] Cline, 1995, p. 205-206.
[25] See figure 3.1 in chapter three. The share of official financing in the early 1970s was much higher than any time thereafter, however.
[26] The Economist, 19 February 1983.
[27] G7, 9 June 1984.
[28] Sachs, 1986, p. 401.
[29] Oliveri, 1992, p. 173 – 174.
[30] Garay, 2010, p. 117-118.
[31] The Economist, 5 October 1985.

(amongst other means by a greater involvement of the World Bank and regional MDBs). The Baker plan encouraged banks to issue new loans to debtor countries to the tune of US$ 20 billion of increased exposure over three years. This would be accompanied by US$ 9 billion of new multilateral financing (including, of course, conditionality).

The debtor countries would be pushed into further reform in three areas: removing import barriers, removing restrictions on foreign investment and privatising loss-making state enterprises. The conditionality associated with these latter areas was at the time not part of the standard IMF conditionality.[32] This meant that debtor countries had to implement new, market-oriented structural reforms aimed at forcing debtor countries to conform to the policy agenda set by US public authorities coalescing with financial market actors. Although the Baker plan seemed to put the burden of refinancing on the private sector, it should once again be noted that in the period of the Baker plan banks continued to reduce their exposure and there was consequently no net inflow of private capital (see table 5.2 above). As Sachs puts it "the methods of the Baker plan were merely an intensification of earlier procedures."[33]

A week after his meeting with the private bankers, Baker outlined his 'Program for Sustained Growth' at the 1985 IMF Annual Meeting in Seoul. The Interim Committee's communiqué did not explicitly endorse the Baker plan, but did point out that to solve the crisis effective adjustment in debtor countries was necessary as well as appropriate flows of official and commercial finance. The communiqué also reaffirmed the central role of the IMF in the governance of the Latin American debt crisis.[34]

After a lukewarm reception by the private banks, the Managing Director of the IMF and the President of the World Bank put their weight behind the plan by issuing a joint statement on 2 December 1985 proclaiming their strong support.[35] Also, the governors of the G10 central banks came out in favour of the Baker plan. In response to that, banking groups from various countries indicated their support. The US banks sent a letter to the Secretary of the Treasury and heads of the IMF and World Bank dated 11 December declaring their support, "provided that all other parties, governmental, institutional and banking do the same."[36] The UK banks in a letter dated one day later also expressed their "willingness to play their part on a case-by-case basis," making the same provision as the US banks.[37] German banks followed on 21 January, emphasising the importance of conditionality but also creditor government policy to improve the debt repayment capacities of debtor states (e.g. creating more favourable conditions for trade).[38] Wiegand concludes that given the similarity in the statements of support (all including the caveat that all relevant parties should also play their part), coordination

[32] Oliveri, 1992, p. 64 mentions these items next to IMF conditionality.
[33] Sachs, 1986, p. 401.
[34] IMFC, 7 October 1985.
[35] IMF Archives, 27 November 1985.
[36] IMF Archives, 23 December 1985a.
[37] IMF Archives, 23 December 1985b.
[38] IMF Archives, 22 January 1986.

between international banking groups had taken place. At the same time, he notes that continental European banks were more muted in their support because they did not agree to the new financing commitments under the Baker plan.[39]

The US-designed Baker plan was clearly the central plank of the debt crisis governance pattern. At their first meeting after the Seoul Annual Meetings (May 1986), the communiqué of the G7 heads of state read:

> *We reaffirm the continued importance of the case-by-case approach to international debt problems. We welcome the progress made in developing the cooperative debt strategy, in particular building on the United States initiative. The role of the international financial institutions, including the multilateral development banks, will continue to be central (…) Sound adjustment programs will also need resumed commercial bank lending, flexibility in rescheduling debt and appropriate access to export credits.*[40]

The Baker plan did not entail significant shifts in governance over the earlier ad hoc responses, as it was quite similar to those responses. It was more a formal expression of a shift upwards to the international level that had already taken place. It extended the conditionality to a certain extent (making it more stringent for debtor countries) and talked about more extensive debt restructuring, without adding much additional stringency for private banks than they were already facing. The collective action problems in the Latin American debt crisis were thus in first instance solved by ad hoc coordination between creditors and, most importantly, the IMF imposing (limited) burden sharing. This did not include debt reduction yet, putting the highest burden on the debtor countries. During the period of the Baker plan, the first effects of the new governance pattern on the market structure became visible, however, which is the subject of the next section.

Banks reshaping their market position in response to the Baker plan

A first change in the market structure in response to the shifts in governance the Baker plan entailed was the emergence of a secondary market for sovereign debts. Banks got rid of their existing exposure through debt swaps, and once rid of their exposure were no longer forced to participate in the co-financing of IMF programmes. As early as in 1985, the value of this market was put between US$ 2.5 and 3.5 billion.[41] Discounts in the secondary market were significant, as table 5.3 on the next page shows. This reflects that market participants did not expect a full repayment of debts.

[39] Wiegand, 1988, p. 36.
[40] G7, 6 May 1986, para. 10.
[41] The Economist, 12 April 1986.

Table 5.3 Secondary market prices for selected debtor countries (% of face value)

	July 1985	Jan 1986	Jan 1987	Oct 1987
Argentina	60-65	62-66	62-65	34-38
Brazil	75-81	75-81	74-77	35-40
Chile	65-69	65-69	65-68	52-56
Peru	45-50	25-30	16-19	2-7
Poland	55-60	50-53	41-44	41-43
Romania	85-89	91-94	86-89	86-89
Yugoslavia	74-77	78-81	77-81	57-62

Source: Anayiotos & De Piniés, 1990, table 1 (p. 1660)

With the passing of the initial shock of the crisis and the start of the Baker plan, a second change lay in the fact that divisions within the banking community increasingly began to show. Inter-firm competition with respect to the preferred debt crisis strategy increased. At the time, the IIF did play some part in the international coordination of the private banks' position vis-à-vis the resolution of the debt crisis, but was not yet involved in advocating a coherent alternative policy at the international level (see also chapter three).

Although American banks provided on average 35 per cent of private loans to Latin American debtors, their representation on the creditor steering committees of the six major creditors ranged from 45 to 58 per cent. According to interviews with creditor committee participants done by Stallings, the American banks played the leading role in decision-making.[42] This dominant position of leading US banks did not sit well with their competitors. Furthermore, within the US, the big US money centre banks (which had the highest exposure) had a strategic interest in continued business with emerging markets, while smaller, mainly domestic US banks wanted to get out of the business completely (which they were able to do through the secondary markets).

Differences in tax and capital reserve policies between American, European and Japanese financial regulators led European and Japanese banks to be increasingly resistant to new lending. European banks were more inclined to capitalise interest payments coming due rather than provide new money.[43] Banks in continental Europe had already gradually built up reserves during the crisis, for various reasons (tax-deductibility, accounting and reporting standards, and a reduced emphasis on shareholder value concerns). Thus continental banks were only lukewarm supporters of the US-UK stance.[44] For example, around the October 1987 IMF Annual Meeting, Germany's biggest bank suggested it might consider forgiving a large part of Brazil's debt and get out of the debt talks altogether.[45]

42 Stallings, 1990, p. 12.
43 Wiegand, 1988, p. 9.
44 Wiegand, 1988, p. 15 and 20/21.
45 The Economist, 3 October 1987.

As pointed out above, the exposure of banks to debtor countries was slowly reduced due to net capital outflows from the countries. In addition to this, in May 1987 Citibank set aside some US$ 3 billion in loan loss reserves against the Latin American loans (25 per cent of its exposure). In first instance this astonished their colleagues, but soon other US and British banks followed the Citibank example. Over the course of 1987-1988 provisioning rose to about 50 per cent of outstanding developing country exposures.[46] Although partially aimed at showing the banks were prepared for a fight with the more assertive debtor countries (see below), it also sent the message that banks no longer valued the sovereign debts at full value (consequently driving down secondary market prices, see table 5.3 above). This move undercut the position of major US and UK banks that any restructuring should not lead to losses for banks and that the IMF-led case-by-case approach would be enough to restore creditworthiness. It also gave the banks more freedom to choose their strategic direction, no longer being held hostage by the sovereign debt crisis.

At the same time, the demand side in the form of debtor countries became more assertive. With the dangers to the (especially American) banking sector slowly diminishing, attention of the US government for the implementation and successful conclusion of the Baker plan diminished. This led debtor governments to take a more proactive stance.[47] Peru had already unilaterally declared its intention to limit debt servicing to 10 per cent of export receipts (which also explains its dismal secondary market value in table 5.3). Powerful opposition groups in several of the main debtor countries were pressing for similar initiatives from their home governments.[48] This culminated in Brazil declaring a moratorium on interest payments at the beginning of 1987.

Debtor governments also took the initiative by finding 'innovative' approaches to debt restructuring and new demand for credit. This included, for example, more capital market-based financing, and served as 'experiments' to restructure the market in ways both the demand side (debtor nations) and supply side (private creditors) could live with.[49] Banks increasingly made the strategic choice to act as intermediaries in sovereign debt, rather than as end holders.[50] This changed their terms of competition, as they were, for example, no longer competing with other sources of funding. The newly emerging capital market for sovereign debts also offered opportunities for primary debt sourcing.

In short, one of the effects of the Baker plan was that it facilitated a shift in the preferences of private banks regarding the resolution of the debt crisis. As banks reoriented their market position through the development of capital market financing of sovereign debts, their preferences lay less with full repayment of outstanding debts. The discount on the secondary

46 Rieffel, 2003, p. 165.
47 Shepherd, 1994.
48 Sachs, 1986, p. 403.
49 Rieffel, 2003, p. 165-166 points to innovative financing deals by Mexico and Brazil.
50 De Carmoy, 1987, p. 15. It turned out that this was a rather profitable business, see table 4.3 in the chapter on the governance of bank capital adequacy.

market in a way reflected the market acceptance of debt reductions. On the official side, creditor governments lost the sense of urgency due to the reduction of the risk of a financial system collapse. Debtor countries as the third party in this balancing act took a more assertive stance and started pushing for 'innovative' approaches to debt restructuring through more capital market-based financing.

Completing the resolution of the Latin American debt crisis: the Brady plan

As elaborated above, changes in the market structure led to shifting preferences of public and private policymakers. When these shifting preferences fed back into the policymaking process, a window of opportunity opened for new directions in the crisis resolution process, notably proposals entailing debt reduction. The manoeuvring by the commercial banks, but more importantly the struggle of public debtor and creditor state actors, was the prelude to the third and final phase in the resolution of the Latin American debt crisis: the Brady plan.

The possibility of debt reduction had already been advocated since the early 1980s by many academics, most notably and vocally professor Sachs of Harvard University and professor Kenen at Princeton.[51] This gained some traction in the policymaking process when in an August 1986 speech Senator Bill Bradley (New Jersey, not to be confused with Secretary of the Treasury Brady) proposed to maintain the case-by-case approach but include an 18 per cent debt reduction over three years, to be tied to trade liberalisation under the GATT.[52] This was the first time the possibility of debt reduction was taken up by a significant American policymaker. It offered few details or further innovations over the earlier approach, however.

Kenen had suggested setting up an 'International Debt Discount Corporation' (IDDC) that would buy debt at a discount and convert it to longer maturities.[53] This would mean a public-type governance pattern at the global level, ready for future sovereign debt crises. As the IDDC would benefit from official backing, it could be seen as an alternative way to provide official financing, with the most important difference over the market-based alternative being that the private sector would be taken out of the debt crisis resolution negotiations (as they would sell their debts to the IDDC, which would subsequently negotiate restructuring terms and conditionality with the debtor country).

The Kenen proposal was endorsed by two Democrat members of the House of Representatives (Morrison and LaFalce). They proposed an IDDC under the umbrella of the World Bank and managed, together with Representative Schumer (D), to put a clause in an omnibus trade bill in 1987 that instructed the Secretary of the Treasury to initiate international negotiations with the aim to establish what they called an International Debt Management Authority.[54] An important caveat in the clause, however, provided that the Secretary could refrain from such

[51] Rieffel, 2003, p. 169.
[52] See Cline, 1995, p. 216.
[53] See, for example, Kenen, 6 March 1983 for his proposal.
[54] Noteworthy, LaFalce and Schumer represented New York state constituencies, although not New York City.

negotiations if the Secretary judged they would negatively affect the current or future value of sovereign claims.[55] A variant of the plan was also endorsed by William Seidman, chairman of the FDIC in July 1989.[56]

As mentioned above, continental European banks had increasingly different preferences from their American counterparts. However, the US Treasury and IMF exerted pressure on the home governments of continental banks to continue to follow the US line. This was reinforced by the linkages of continental European banks to large US banks, providing another avenue of influence.[57] The Japanese banking sector, on the other hand, was led by the Bank of Tokyo which was the single largest international operator. Its preferences were closely aligned with the American banks and they supported the Baker Plan (they were even more cooperative than the American banks themselves, according to Stallings). However, the only domestic rival to the privileged position of the Bank of Tokyo, the Industrial Bank of Japan, publicly supported the Bradley plan.[58]

Japan started playing a more assertive role in the debt crisis debate, and developed its own plan (the Miyazawa plan), which laid the foundations for the Brady plan. The Miyazawa plan aimed to securitise part of the troubled debts against a lower interest rate and with collateral provided by official reserves of the debtor countries to be deposited at the IMF. Interestingly, the new Treasury Secretary Nicholas Brady attacked the plan when it was publicly proposed by Japan at the September 1988 IMF Annual Meeting in (West) Berlin.[59] However, the IMFC communiqué did endorse the possibility of debt reduction, and stated that the menu of options should be broadened to include "voluntary market-based techniques which increase financial flows and reduce the stock of debt without transferring risk from private lenders to official creditors."[60]

With the secondary market value of emerging market debts decreasing and the debtor countries increasingly assertive, the preferences of all the main actors had begun to shift in favour of debt reductions. In response to this, Brady developed a new comprehensive plan. Most of the intellectual work had already been done in the Treasury under the previous Reagan administration,[61] as well as by the Japanese. Given its origins in the Reagan administration it should not come as a surprise that market-based solutions were preferred over more public interventions like Kenen's IDDC proposal. This was in line with the neoliberal ideological conviction of Reagan's administration, as well as with bankers' interests.

[55] Cline, 1995, p. 226.
[56] Kenen, 1990, p. 15 (footnote 9).
[57] De Carmoy, 1987.
[58] Stallings, 1990, p. 19-20.
[59] Stallings, 1990, p. 25.
[60] IMFC, 26 September 1988.
[61] Rieffel, 2003, p. 168.

US Secretary of the Treasury Brady announced his plan during a speech at the Brookings Institution on 10 March 1989, and with this plan he swept aside the proposals of a more public nature coming from the House of Representatives (the aforementioned International Debt Management Authority) and ignored governmental voices from continental Europe that were in favour of those kinds of solutions as well. Different from the Miyazawa plan, the Brady Plan had a broader 'menu of options', for example, the discounting of loans when they were securitised. It basically built on the experience gained during the Mexican rescheduling of 1988.[62] As mentioned above, this Mexican package reflected innovation in the demand side of the market.

The Brady plan shifted the balance from domestic adjustment to debt forgiveness by the private sector and increasing official financing. However, the debt forgiveness under the Brady plan was premised on a voluntary, market-oriented approach to debt reduction:

> *Commercial banks need to work with debtor nations to provide a broader range of alternatives for financial support, including greater efforts to achieve both debt and debt service reduction and to provide new lending. The approach to this problem must be realistic. The path towards greater creditworthiness and a return to the markets for many debtor countries needs to involve debt reduction.*[63]

The Brady plan also suggested using funding by the IMF and MDBs to collateralise new bonds, which would include private sector debt reduction. Brady furthermore opened the door for official lending to countries in arrears even without concrete commitments from private creditors. This prevented the private sector from keeping official refinancing 'hostage' by refusing to co-finance. In concluding the speech in which he set out his plan, Brady re-emphasised the objective "to provide maximum opportunities for voluntary, market-based transactions rather than mandatory centralization of debt restructurings."[64]

Charles Dallara, the US Executive Director (ED) at the IMF (and later head of the IIF), presented the plan to the Board. He pointed out that debtor countries could use funds for direct buy-backs of loans, but that the US authorities thought securitisation was a better approach (hence providing a spur to sovereign debt markets). He furthermore emphasised that his authorities thought conditionality on foreign direct investment (in other words capital account liberalisation) was very important. The Japanese ED expressed the 'strong support' of his authorities for the Brady plan.[65]

Next to its central role in the different Brady programmes for debtor countries, the IMF proceeded to develop the 'Lending into Arrears' (LiA) policy. The experience up to date had led private creditors to conclude that being reluctant in good faith negotiations with debtors would also limit IMF funding, and hence would spell trouble for debtor countries.[66] The LiA policy addressed this brinkmanship and was one of the few enduring elements of the governance pattern addressing the Latin American debt crisis. Debtor nations could now obtain IMF refinancing while being in arrears to private creditors (which was not possible earlier). This increased debtor state (and IMF) leverage vis-à-vis private creditors. The LiA policy was agreed on in 1989 and was to provide Fund support to countries in arrears on a case-by-case basis provided that (1) Fund support was deemed essential for the successful implementation of the debtor country's adjustment programme and (2) negotiations between debtor country and creditors had started.[67]

After considerable pressure by the US Treasury on private banks, the first Brady deal was concluded with Mexico in July 1989, including a 35 per cent haircut (midpoint between the initial Mexican position of 55 per cent and the private sector's offer of 15 per cent). By May 1994, deals had been completed with or announced for 18 countries, heavily overlapping with the HD17. In the end, 17 countries actually concluded Brady deals between 1990 and 1997 with US$ 210 billion of commercial bank debt reduced by about US$ 85 billion (an average haircut of 40 per cent).[68] The Latin American debt crisis could be considered as resolved, as far as policymakers were concerned.

As the evidence from this episode shows, the governance pattern emerging in the wake of the Latin American debt crisis was an international level, public pattern of governance. However, it clearly diverged from the previous Paris Club workouts as it also included important channels of private sector influence. The Latin American debt crisis was resolved on an ad hoc, case-by-case basis under two successive US-led plans (the Baker and Brady plans). The policymaking process consequently focused on the US and to a lesser extent on the IMFC as policymaking institutions. Although the details of the plans were left to negotiations between debtor countries and private creditors, the framework was set and monitored by public actors (predominantly the US Treasury and the IMF) under the successive plans, restraining the actions of both debtor countries and private creditors.

The close alignment of official US preferences to the preferences of their internationally active banks led to plans that put the burden of adjustment primarily on debtor countries, accompanied by official refinancing (and limited private refinancing). Although there were mutterings of a debt cartel, debtor countries were too preoccupied with their domestic troubles to collectively advocate their preferred solutions in the relevant policymaking institutions. This strengthened the hand of private creditors in the negotiations, and can also serve as part of the explanation why the burden came to lie on domestic adjustment in resolving the crisis.

62 The Economist, 6 February 1988.
63 Department of the Treasury, 10 March 1989, p. 5.
64 Department of the Treasury, 10 March 1989, p. 8.
65 IMF Archives, 15 March 1989.
66 Diaz-Cassou, Erce-Dominguez & Vazquez-Zamora, 2008.
67 Boughton, 2001, p. 535.
68 Rieffel, 2003, p. 151.

Only belatedly, when domestic adjustment did not deliver enough results in terms of economic growth and the private sector had had time to adjust to the new reality by changing the market structure, did debt reduction become an option. This was to a large extent linked to the advent of the secondary market and the business decisions of banks to shift from the sovereign lending business and set up loan loss reserves. This changed the market structure, and hence the preferences regarding the governance pattern. The ensuing policymaking process resulted in the Brady plan, which reinforced these trends in the market structure (as will be discussed in the next section).

The close involvement of the private sector in the debt restructuring negotiations furthermore led to the emergence of an international policy community where internationally active banks were involved in the policymaking process, mainly through their domestic authorities and limited coordination amongst themselves. The private sector was egged on in this respect by public authorities to come to a global interest representation in the form of the Institute of International Finance.

At the same time, especially the Brady plan did lead to limited new global level, public-type governance in the form of the LiA policy and enhanced IMF conditionality. These elements of the governance pattern emerging in the wake of the Latin American debt crisis also endured after that crisis was resolved. This consequently entailed a shift in the stringency dimension, mostly for the debtor countries that could now be faced with more intrusive conditionality. This conditionality was in line with what later became known as the Washington Consensus of market-based reforms, which was emerging as the yardstick to measure economic programmes against.[69] In the next section, the impact of this governance pattern as formulated under the Brady plan on the market structure is discussed.

Bonding together: the Brady bonds and capital market financing

As figure 3.1 in chapter three has shown, bond financing of emerging markets increased significantly over the course of the 1990s. Brady bonds played an important role in this take-off, as early in the decade they accounted for over half of trading volume.[70] Table 5.4 below lists bond issues by emerging markets in the first half of the 1990s, showing how these steadily became a more important part of international bond market (although still small compared to developed country international bonds, at 12.6 per cent of the total market in 1994). Furthermore, the table shows how the private sector found their way to the global capital markets in the slipstream of public actors: the private sector share in international bond issues of developing countries steadily increased. Many private sector bond issues came from the

[69] See also chapter three for a discussion of the role of the Washington Consensus in the 1970s and 1980s.
[70] IMF Archives, 14 August 1995, p. 16. Brady bonds accounted for 61 per cent of trading in 1994.

financial sector, which is especially prone to implicit government guarantees (in other words, private credits might quickly convert into a sovereign debt crisis).

Table 5.4 International bond issues by developing countries (million US$)

	1991	1992	1993	1994	1995 (first half)
Sovereign	4,487	5,658	16,441	12,676	4,789
Public sector	4,419	7,256	16,906	13,078	3,787
Private sector	5,125	11,480	29,323	32,635	9,197
total	14,031	24,394	62,671	58,383	17,774
% of total international bond issues	4.5	7.0	12.5	12.6	7.5

IMF Archives, 14 August 1995, table 6 and 7

The impact of the Brady plan on the global financial system led the trade journal LatinFinance to include Brady in their top 40 of most important persons in Latin American finance of the twentieth century, noting that: “If anyone is entitled to take personal credit for the creation of the emerging market asset class, it is Nicholas Brady.”[71] In other words, the pattern of governance under the Brady plan provided an enormous boost to the secondary market in emerging market sovereign debt, as well as jump-started a primary market for these debts.

This diversification of the creditor base of states, however, could complicate the coordination between creditors in a possible sovereign debt crisis. This was already acknowledged by the IMF in the mid-1990s,[72] and led to preliminary shifts in their preferences regarding the governance of sovereign debt crises. The case for adjusting the governance pattern was brought home by the December 1994 Mexican crisis. This was only the first in a series of emerging market crises, which underscored that the capital market-based global financial system was also more crisis-prone.[73]

Under a fixed exchange rate regime, Mexico received large capital inflows in the beginning of the 1990s. When the sentiment of traders on the global capital markets changed due to domestic political turmoil and an unfavourable external macroeconomic environment, capital flight occurred. After an initial attempt to defend its peg, Mexico was forced to abandon its fixed exchange rate regime, in the meantime having incurred an unbearable level of external debt. As this financial crisis originated in the capital markets (and not so much in bank credits), it was dubbed the ‘first financial crisis of the twenty-first century.’

[71] LatinFinance, July 2003, p. 31.
[72] IMF Archives, 14 August 1995, p. 93.
[73] See also Bordo et al., 2001.

Shortly after the Mexican crisis had already hinted at the potential volatility of global capital markets, the 1997-1998 East Asian crisis shook the global financial system to its core by dipping an entire region in economic crisis and spreading all over the world (notably to Russia and Brazil) through 'contagion' on the capital markets. The East Asian crisis underscored the drawbacks of the 1990s capital market-based market structure that had already been brought to light by the Mexican crisis. In several cases, the quick withdrawal of private creditors led to sovereign debt problems or banking crises (which subsequently turned to sovereign debt crises as states tried to rescue their domestic banking system). Although moral suasion of banks could still work (notably in the case of Thailand), in other cases it was clear capital market financing brought new problems of creditor coordination, contagion and herd behaviour.[74]

The East Asian crisis led to a wide-ranging debate on a new 'international financial architecture'.[75] This debate concerned both crisis prevention and crisis resolution. The policymaking process in crisis prevention mainly focused on improving market efficiency through more transparency (leading to a variety of international standards aimed at increasing public actors' data disclosure[76]) or on bolstering countries against 'irrational' financial markets (e.g. by making the IMF a lender of last resort or by capital controls). The governance of sovereign debt crises was the most important plank of the debate on crisis resolution, with strengthening the effectiveness of IMF conditionality as a second track.

In this whirlwind of proposals, the common pro-market outlook of the policy community rapidly precluded some ideas, such as capital controls or a Tobin tax.[77] It also led to a strong emphasis on transparency as a way to improve the functioning of markets, with less attention to other planks of reform (e.g. regarding Private Sector Involvement, PSI). The new 'international financial architecture' turned out to be a pattern of governance based on market discipline. Proposals were measured against the yardstick of improving market efficiency. The specific proposals on the governance of sovereign debt crises are discussed in the following section.

Global turmoil and the redesign of the 'International Financial Architecture'

Due to the changes in market structure in the form of capital market financing of states, important realignments of preferences had taken place particularly among public officials in creditor states. Fear of moral hazard and 'bailing out the private creditors,' combined with the sheer magnitude of capital market finance (and hence the official refinancing needed) shifted

[74] See Blustein, 2003 for a gripping journalistic account of the East Asian crisis and the moral suasion in the Thai case.
[75] See for an overview Eichengreen, 1999.
[76] See Walter, 2008 for the results of these efforts.
[77] Cohen, 2003.

their preferences towards new patterns of governance. As mentioned above, the Mexican debt crisis brought the implications of the new market structure for the governance of sovereign debt crises to the fore. The dispersed, anonymous bond holders had to be included in the balance between official refinancing, domestic adjustment and private rescheduling somehow, lest the burden fall on debtor countries and official refinancing only – a burden the official financiers were unwilling to bear. However, also the policymaking process had changed: the main policymaking institutions now operated at the global level and had close ties to the private sector, as will be further discussed in this section.

Governance in the wake of Mexico – preliminary considerations

The initiative was seized by the G7 in the aftermath of the Mexican crisis, underscoring its role as an apex forum (the prime policymaking institution).[78] The G7 heads of state at their summit in Halifax (June 1995) commissioned the G10 to draft a report on the orderly resolution of crises: "recognizing the complex legal and other issues posed in debt crisis situations by the wide variety of sources of international finance involved, we would encourage further review by G-10 Ministers and Governors of other procedures that might also usefully be considered for their orderly resolution."[79] This meant that the possible shifts in governance in response to the crisis were to be discussed in a policymaking institution solely composed of public authorities of creditor states.

Notwithstanding this referral of the matter from the G7 to the G10, a shift in preferences had also taken place in the IMF bureaucracy as it realised its resources could not deal with these new capital market-induced crises. Only three weeks before the Halifax summit, it had issued a note on an 'International Debt Adjustment Facility for Sovereign Debtors' to the Executive Board.[80] The note, prepared by the legal department, mentions three issues that would have to be resolved for such a facility to work: (1) whether it should only cover sovereign debts, or also other public or even private liabilities; (2) how the facility would be 'triggered'; and (3) whether it should be part of the IMF or become a separate entity (and how it would relate to the IMF as creditor). The note was cautious in not actually proposing a mechanism, but just to point out that states and creditors might in some case prefer to turn to such a mechanism.[81] This was reiterated at the Executive Board meeting: the note was only a feasibility study and not intended to make a proposal or discuss the 'political, economic and philosophical issues involved.'[82]

The actual Executive Board meeting took place on 23 June, a week after the Halifax Summit, and somewhat dismayed some EDs representing G10 states. Schoenberg (Germany)

[78] See Baker, 2006 for a discussion of the G7 as apex policy forum.
[79] G7, 16 June 1995.
[80] IMF Archives, 26 May 1995 and 23 June 1995.
[81] IMF Archives, 26 May 1995, p. 4.
[82] IMF Archives, 23 June 1995, p. 3.

rather curtly noted the G10 had already committed significant resources to their G7 assignment, and that it "might have been useful to await the publication of this report before entering into another discussion in the fund."[83] Autheman (France) was rather candid: "One of the reasons why I prefer the discussion continue in the BIS forum [the G10] rather than in this forum is that we have a major interest at stake; and we should sometimes behave in a self-serving way."[84] However, most EDs of G10 countries, including most importantly Lissaker (US), encouraged the IMF to further develop their proposals in tandem with the G10. EDs Kaeser (Switzerland), Wei (China) and Tulin (Russia) already spoke out strongly in favour of the Facility, while most other EDs remained reserved. The general sentiment was that the legal department had 'jumped the gun' and that the political and economic issues had to be dealt with before establishing the feasibility of the Facility. The IMF staff had been given its homework.

In the meantime, the working group of the G10, headed by Jean-Jacques Rey (Executive Director of the National Bank of Belgium), proceeded with their work. An important part of this work consisted of consultations with private creditors, amongst others requesting the input of the private sector through two questionnaires executed by G10 member states' authorities. In their responses, most private creditors indicated that rules for sovereign debt resolution would increase moral hazard of debtor countries, and consequently in a situation of proactive market response lead to higher risk premiums (only a few conceded that an orderly resolution mechanism might reduce risks).[85] Furthermore, creditors pointed out that CACs would be an infringement of their rights. Interestingly, the IMF as the primary source of official refinancing was viewed with suspicion because it would favour debtor states (especially those with good ties to large IMF shareholders).[86] The idea of an international bankruptcy court was "almost unanimously rejected by the market participants as not being feasible and maybe even counterproductive. (…) They were also concerned that such a court might be inappropriately biased towards the debtors compared with present arrangements."[87]

In their May 1996 report (the Rey report) the G10 most significantly advocated adding collective action clauses (CACs) in international bond contracts. A second prominent recommendation was to revise the LiA policy of the IMF to include bond debts. In other words, the IMF would also be allowed to lend to debtor states in arrears on their bonds. Furthermore, the report reiterated the responsibility of debtors for 'sound economic policies' and a preference for a case-by-case approach.[88] The Rey report did not set an explicit global level standard, but was only a recommendation for market actors to implement CACs. In that sense, is seems hardly justified to interpret the Rey report as entailing shifts in governance in any significant way.

[83] IMF Archives, 23 June 1995, p. 4.
[84] IMF Archives, 23 June 1995, p. 50.
[85] G10, May 1996, p. 30-31.
[86] G10, May 1996, p. 34.
[87] G10, May 1996, p. 36.
[88] G10, May 1996.

Given the strong private sector input, it is not surprising that the creditor state authorities decided to opt for a market-based approach (a contractual approach). The report explicitly emphasised that "international bankruptcy procedures and other formal arrangements do not appear to provide, in current circumstances or in the foreseeable future, a feasible or appropriate way of dealing with sovereign liquidity crises."[89] It seems that the IMF staff heeded this explicit rejection of statutory approaches by its largest shareholders well, as the 'homework' of the Executive Board meeting on the Facility seems never to have been finished and discussed with the Board in this period.

The suggestion of CACs already went against the grain of many private creditors (as the responses above made clear), but at least signified progress for public authorities not willing to stump up ever larger amounts of official refinancing. CACs are a market-based solution, also in the sense that they require negotiations between the debtor state and private creditors as market actors. They do entail a small shift in power towards debtor countries (through the majority provisions), but at the same time force debtor countries to engage in constructive negotiations. CACs could be seen as a more stringent governance pattern, as they bind both debtor countries and private market actors to pre-established rules regarding the negotiations in case of a sovereign debt crisis. CACs were thought to be a 'practical' (achievable) solution, also because they were already market standard in the international bond market of London.

The Rey report met with quite a few negative reactions of market actors and received only lukewarm support from most debtor countries.[90] The possible shifts in governance through the implementation of CACs, as envisaged in the Rey report, did consequently not materialise. The Rey Report was duly ignored by the private sector and bond-issuing countries. This was also due to the discussion on the governance of sovereign debt crises being overtaken by current events at that time: the 1997-1998 East Asian crisis.

The immediate response to the East Asian crisis was quite similar to the response to the Latin American debt crisis: IMF-led financing combined with moral suasion of banks to rollover loans (most notably in the South Korean case). However, the sheer magnitude and domestic costs of this crisis brought global financial governance under increased public scrutiny. The scale of official refinancing necessary for resolving the East Asian crisis once again underscored that creditor state authorities were in danger of having to put up large amounts of taxpayers' money in case of large-scale crises. This gave a new impetus to discussions on the governance of sovereign debt restructuring. Public authorities in creditor states once again felt they had to bear too much of the burden. Economists pointed to the 'moral hazard' created by the IMF bailouts, encouraging the private sector to engage in risky lending practices and heightening the chances of sovereign debt crises.[91] In first instance, this led to a debate on 'Private Sector Involvement'.

[89] G10, May 1996, p. 5.
[90] National Bank of Belgium, 2002, p. 113.
[91] See, for example, Haldane & Scheibe, 2004.

Elusive Private Sector Involvement

A first concrete result of the debate on PSI was a follow-up on the recommendation of the Rey report concerning the Fund's Lending into Arrears policy. Although the IMF management was wary of extending the LiA policy to bond debts out of concerns for litigation by bond holders, pressure from several EDs (representing continental European G10 members) led to a proposal discussed by the Executive Board in February 1998.[92] It was decided to incorporate bonds under the LiA policy, meaning the Fund could provide official refinancing to debtor countries in arrears on their bonds. As an additional condition next to the two in the original LiA policy, debtor countries were now not only required to have started negotiations to resolve the arrears, but also to negotiate 'in good faith' with private creditors.[93] As with the establishment of the LiA policy during the Latin American crisis, this prevented bond holders from keeping IMF negotiations hostage and reflected the new market structure dominated by capital market financing of emerging markets.

In the further debate on PSI, however, it turned out to be an elusive term. It meant the possibility of forced debt reductions by private creditors for some, while others saw it as only aimed at 'moral suasion' of private creditors to help out in sovereign debt crises. The latter were, for example, exemplified by the US and UK authorities, but also the IMF itself, who initially took a very reluctant stance towards PSI.[94] In his report to the 1998 IMFC Spring Meeting, Managing Director Michel Camdessus noted that progress should be made with the contractual approach as advocated by the G10, but that most Executive Directors still thought a statutory mechanism impractical and saw no need to proceed further along this line. He was rebuked by the IMFC, however. In their spring 1998 communiqué the IMFC agreed that:

> *when warranted by crisis situations, ways needed to be found to involve private creditors at an early stage, in order to achieve equitable burden sharing vis-à-vis the official sector and to limit moral hazard. While noting the difficult issues involved, the Committee requested the Executive Board to intensify its consideration of possible steps to strengthen private sector involvement.*[95]

The IMFC communiqué mentioned the LiA and CACs as possible avenues for PSI, but not a statutory approach.

The IMF produced a first comprehensive paper in August 1998 that merely outlined possible avenues without aiming for concrete steps forward. Options considered were voluntary private credit lines, CACs, the organisation of creditor committees in advance of crises, and – as a sort of 'nuclear option' – a moratorium on debt payments. The CACs were in the background of the PSI discussion, however, and limited progress seemed to be made by the G10 or IMF (nor on actual implementation, for that matter, see table 5.5 in the next subsection).[96]

No concrete decisions had been made on PSI when the fallout of the East Asian crisis claimed another victim: Russia defaulted on its debts in 1998. This sent shockwaves through the private sector, especially since its bank debts had been rescheduled and securitised under a London Club agreement only in 1997.[97] Suddenly the realisation dawned that if a significant state was unwilling to pay the private sector had little actual leverage. What's more, the Russian default triggered the collapse of the Long-Term Capital Management hedge fund. This hedge fund turned out to be of systemic importance and necessitated a major rescue effort to prevent the collapse of major banks and possible a meltdown of the global financial system.[98] This illustrates the global and cross-sector integration of the financial system that had occurred over the course of the 1990s – and the risks it entailed.

The policymaking process on PSI continued through 1999, mainly in forums dominated by creditor countries. For example, the G7 summit in Cologne (June 1999) formulated 5 rather general and vague principles for PSI. One of the problems was a difference of viewpoint between Anglo-Saxon countries which argued for a case-by-case approach and continental European countries which supported rules-based approaches.[99] In the G7 statement made at the 2000 Spring Meeting the language was strengthened somewhat, demanding more concrete action on PSI.

This concrete action was delivered through the 'Prague Framework', which was the culmination of the policymaking process on PSI and was adopted during the 2000 IMF Annual Meeting in Prague. The IMFC agreed that this operational framework for PSI "must rely as much as possible on market-oriented solutions and voluntary approaches." The option of comprehensive debt restructuring was on the table, as were standstills ("in certain extreme cases").[100] The communiqué did not provide guidance on how this should be done, however. The Prague Framework resembled the recommendations of the Rey report by omitting concrete shifts in governance and consisting mostly of open-ended declarations. The Prague Framework differed from the Rey report, however, in that the official community put more pressure on the private sector to contribute to debt restructurings, and in that sense reflected an adjustment of public authorities' preferences.

In the summer of 2001, the IMF for the first time discussed the relationship of its PSI framework to the Paris Club. As noted in chapter three, the 'comparability of treatment' clause

92 Confidential document source.
93 IMF Archives, 30 April 1999, p.2.
94 Confidential document source.
95 IMFC, 16 April 1998.

96 Sometimes CACs were quite literally in the background: confidential IMF documents from 1999 show a paper on CACs providing 'background information' to the main note on PSI.
97 Gorbunov, 2010, p. 163.
98 Lowenstein, 2001 provides an interesting journalistic account of this affair.
99 Confidential document source. This seems to be in line with the analysis of Abdelal, 2007 who argues that the governance of the liberalisation of global finance can be explained by the dynamics of European policymakers seeking to implement rules and Anglo-Saxon policymakers seeking liberalised markets.
100 IMFC, 24 September 2000.

could have an important impact on the involvement of the private sector by forcing them to follow a Paris Club rescheduling or debt reduction. IMF staff considered the possibility of making the application of the comparability of treatment clause contingent on regaining market access. This was under the assumption that IMF programmes would restore the creditworthiness of debtor states and close the financing gap via the catalytic effect of an IMF programme (while comparability of treatment would deter the private sector from filling the financing gap). Several EDs from creditor states strongly objected to tinkering with the comparability of treatment clause, however, and also pointed out this was a matter for the Paris Club to decide.[101] The policymaking discussions in exclusive clubs were not to be opened up to the entire IMF membership. The staff's suggestion on comparability of treatment was therefore deleted from the published version of the paper.[102]

Putting all the chips on the table: the CACs, Code of Good Conduct, and the SDRM

A decisive turn in the policymaking process came with the election in 2000 of George W. Bush as President of the United States.[103] The financial policymakers he brought in (Paul O'Neill as Secretary of the Treasury and John Taylor as Under Secretary for International Affairs) were highly critical of IMF bailouts. At the same time, the deterioration of the economic situation in Argentina breathed new live in the debate on sovereign debt restructurings. As PSI was mostly voluntary and aimed at preventing a crisis from turning into an actual default, there was still no governance pattern to deal with an actual default in case of an assertive debtor country like Argentina. The worsening of the debt dynamics in Argentina (despite a controversial IMF programme agreed on in August 2001) led O'Neill to testify to the Senate Banking Committee: "We need an agreement on an international bankruptcy law (…) instead of socializing the cost of bad decisions."[104]

It did not take long for the hints by US public officials to be picked up by the IMF (which could build on their earlier 1995 note on a Debt Adjustment Facility for Sovereign Debtors) and in late 2001 First Deputy Managing Director Anne Krueger launched a new comprehensive proposal for a Sovereign Debt Resolution Mechanism.[105] At about the same time, the Banque de France launched its own governance proposal in the form of a Code of Good Conduct (CoGC). The different proposals now under discussion could be characterised on the 'nature of governance' dimension as ranging from 'mostly public' (the SDRM) to mixed (CACs) to 'mostly private' (CoGC). The developments in these three tracks of the policymaking process are discussed in turn below.

[101] Confidential document sources show that the Directors representing Paris Club creditors basically refused to discuss the technical specifics of the Fund's proposal.
[102] IMF, 6 December 2001.
[103] Helleiner, 2008.
[104] Cited by Helleiner, 2008, p. 108.
[105] IMF, 26 November 2001. See also IMF, 30 November 2001.

The SDRM aims to simplify the resolution of sovereign debt crises by creating a process for restructuring under a (temporary) standstill. It builds on an analogy with domestic bankruptcy courts. The initial proposal by Krueger had four key features: (1) prevention of seeking redress in national courts by creditors; (2) adoption of appropriate economic policies by the debtor country as well as starting negotiations with the creditors 'in good faith'; (3) preferred creditor status for new private credit (similar to debtor-in-possession financing); and (4) majority decision-making by creditors.[106] This proposal (even more than the CACs) addressed the situation of countries diversifying their sources of capital. It would cover all outstanding bonds of a country and subject them to an integrated restructuring, overcoming the increasing coordination problems in negotiations. As was to be expected from the IMF, it was the 'logical' response to the changes in the market structure underpinned by (neoclassical) economic theory. It also reflects how the IMF as a public actor formulated its preferences in global financial policymaking independent of market actors.

The original proposal of the SDRM implied first of all a shift in governance to the global level. It would imbue the mechanism with jurisdiction over all outstanding international debts, where the Baker and Brady plans applied to a specific set of emerging markets. It would secondly imply a governance pattern of a decidedly public nature, being based in an international organisation. Krueger was quick to suggest that this could be done by amending the IMF's Articles of Agreement.[107] On the third dimension of governance, it would be stringent for both debtors and creditors as it would impose conditionality on the part of debtors, and could impose majority decision-making on the part of creditors (even if, for example, their debt contracts currently did not include CACs facilitating this).

Anne Krueger subsequently went on a global tour to promote the idea with speeches in India (December 2001) and Australia (January 2002). Creditor member states of the IMF responded to the proposals quite positively, which is surprising given the earlier strong rejection in the 1996 G10 report.[108] It seems that the sheer magnitude of the series of emerging market crises of the late 1990s, combined with the intellectual force and standing of the IMF in the policy community changed the preferences of a significant number of policymakers. For example, in an interview a public official of a major emerging market remarked that the fact that the First Deputy Managing Director threw her weight behind the plan was important for their support of the proposal.[109] Some debtor countries on the other hand – notably Brazil – had already voiced strong opposition to the idea of an SDRM and claimed it would have an adverse effect on capital markets at a time when Brazil was in a very vulnerable position.[110] This illustrates the fear of emerging markets for their position as demand side on the market

[106] IMF, 26 November 2001.
[107] IMF, 20 December 2001.
[108] Confidential document source.
[109] Off-the-record interview with public actor, 2007.
[110] Off-the-record interview with public actor, 2008.

for sovereign debt, and the expected negative private sector reaction to more robust public governance of sovereign debt crises.

It was clear that many issues would have to be addressed in the further development of the SDRM. Fund staff worked expediently and in February 2002 provided a paper addressing how to assess the need for a standstill, the role of the IMF, the legal basis of the SDRM and the scope of its application (which debts would fall under the regime).[111] This paper already suggested a variant of the SDRM where not the IMF, but a majority of creditors would agree with the debtor on a standstill. In other words a shift towards a pattern of governance of a lesser 'public nature'.[112] Notwithstanding, the US ED (and several others) opposed any statutory mechanism in favour of the contractual approach (CACs).[113] Given the US' ability to block changes to the IMF's Articles of Agreement, this was bad news for those in favour of the SDRM. Opposition within the US official sector seemed to come from Under Secretary of the Treasury Taylor (O'Neill was still Secretary of the Treasury and had been in favour, as mentioned above). An off-the-record interviewee assured me that Krueger remained sure she could convince Taylor of the merits of the proposal and overcome his opposition.[114]

Interestingly, just before going public with the proposal, Krueger discussed it in the Capital Markets Consultancy Group (CMCG) of the IMF. This Group had been established after the East Asian crisis and brought top-level private sector executives together with top-level IMF bureaucrats to discuss the world economy and policy initiatives in global finance. At the 13 November 2001 meeting when Krueger tentatively introduced the SDRM, the private sector representatives in the CMCG responded more or less indifferently. It was their view that the complexity of establishing such an SDRM would prohibit the successful implementation of the proposal.[115] After the high-profile launching of the proposal by Krueger, the IIF was quick to voice condemnation, however.[116] At the next meeting of the CMCG (March 2002), private sector representatives had fallen in line with the IIF and pleaded for the contractual approach.[117] An SDRM would adversely affect their terms of competition, in the sense that their position vis-à-vis the demand side (debtor states) might be weakened. This would subsequently likely lead to a higher burden on private actors in sovereign debt crises, negatively impacting their profits.

[111] IMF, 14 February 2002.
[112] A public speech by Anne Krueger in April 2002 reflected this shift to a lighter role of the IMF (IMF, 1 April 2002).
[113] Confidential document source.
[114] Off-the-record interview with public actor.
[115] Confidential document source.
[116] IIF, 17 December 2001. A confidential document source reporting on a meeting with Dallara (Managing Director of the IIF) shows how shrill IIF opposition to the SDRM was. He called the SDRM a complete abrogation of creditor rights and an obstacle to globalisation (underscored in Dallara's view by the fact that 'anti-globalisation' NGOs like Jubilee 2000 were supportive of the proposal). This shrill tone in debates was also evident on two other occasions involving high-level IIF representatives (interview IIF, Washington, 25 June 2008 and presentation of Tom de Swaan to the first annual GARNET conference, 29 September 2008).
[117] Confidential document source.

By early 2002, it was clear that both the private sector and the US authorities were in favour of the contractual approach instead of the SDRM. Support by the European countries was unwavering, and the IMFC stated after the Spring Meeting that it:

> *welcomes the consideration of innovative proposals to improve the process of sovereign debt restructuring to help close a gap in the current framework. It encourages the Fund to continue to examine the legal, institutional, and procedural aspects of two approaches, which could be complementary and self-reinforcing: a statutory approach, which would enable a sovereign debtor and a super-majority of its creditors to reach an agreement binding all creditors; and an approach, based on contracts, which would incorporate comprehensive restructuring clauses in debt instruments.*[118]

Over the course of 2002, the proposals of the IMF were adjusted to exclude the IMF from being involved in judging the 'good faith' of the negotiations. The IMF would not have any formal role; instead an independent dispute resolution forum would be established.[119] Another of the outstanding issues concerned the coverage of debts under the SDRM. The private sector had already put into question the preferred creditor status of the International Financial Institutions and the possible exceptional position of bilateral loans under the SDRM. The Paris Club secretariat therefore took the initiative to clarify their relation to the SDRM in February 2003. Although no decision had yet been taken whether to include official bilateral claims in the SDRM, it was noted that there was an awkward relation between an SDRM agreement and comparability of treatment. An SDRM agreement could possibly force a restructuring on official creditors as well (known as 'reverse comparability of treatment', and strongly rejected by Paris Club representatives).[120] The Paris Club took the position that comparability of treatment and the sovereignty of official creditors should be preserved. The Paris Club debt should consequently stay out of the SDRM, and if an eventual SDRM agreement did not fulfil the comparability of treatment clause, the Paris Club agreement would be cancelled.[121] The SDRM would therefore only cover the 'private' part of the market for sovereign credit.

Pressure among the policy community to reach a conclusion had increased in the meantime: in its September 2002 communiqué the IMFC requested a concrete proposal for an SDRM at its next meeting (Spring 2003).[122] In the run-up to this concrete proposal negotiations and lobbying intensified. The private sector – led by the IIF – opposed the SDRM with increasing vehemence. The IIF lobbied the IMF directly, for example through its policy briefs in advance of the Fund's Spring and Annual Meetings. Also, the IIF broadened its coalition

[118] IMFC, 20 April 2002.
[119] IMF, 12 November 2002.
[120] Confidential document source.
[121] Confidential document source.
[122] IMFC, 28 September 2002, para. 11.

by joining forces with associations like the Emerging Market Creditors Association (EMCA) in what became informally known as the 'Gang of Six'. The emergence of the Gang of Six reflected an increasing integration of financial markets for sovereign debt (covering both banks and capital market parties) and had a strong preference for market-based solutions (which includes CACs) to sovereign debt crises.[123] In December 2002, the Gang of Six even threatened to withdraw its support and efforts with respect to the implementation of CACs as long as discussions on the SDRM continued.[124] Lobbying activity of the private sector increased in intensity in the official sector's preparations for the spring IMFC meeting. The traditional IIF position paper was being supported by visits of high-level domestic banking executives to finance ministers and central bank governors.[125]

Public officials of the G10 increasingly recognised that their support for the SDRM was developing into a leverage instrument to get the private sector to commit to CACs.[126] Emerging markets, in apparent reaction to private sector opposition, in the meantime seemed to oppose any regulation of international capital flows. They feared that their position on the demand side of sovereign credit would suffer from higher borrowing costs.[127] As another blow weakening the case for the SDRM, Mexico emitted the first international bond including CACs under New York law. The Mexican Finance Minister later admitted that the main reason to include the CACs was "to get rid of the SDRM."[128]

As requested by the IMFC, a concrete proposal was tabled in the 2003 Spring Meeting.[129] Given the opposition from all sides and the faltering support, the SDRM was shelved. This was partially the result of the voting weights in the IMFC. A majority of (European) EDs seemed to support the proposal. However, the US' veto power combined with the lesser voting weight of emerging markets defeated the proposal. The market-based CACs were to be the only substantial change in the governance of sovereign debt crises on the public side, and this track in the policymaking process is discussed next.

Coming to the second track in the negotiations, the G10 decided in response to the debate on the SDRM that it could provide added value to the discussions by developing 'model' CACs. A G10 working group under the leadership of Randal Quarles (US Treasury) was established in June 2002.[130] The working group held informal consultations with the private sector and received encouraging signals. Some private sector representatives indicated they were working on their own model clauses, but the G10 working group tried to co-opt that process

[123] The Gang of Six consists of the Bond Market Association, EMCA, Emerging Markets Traders Association (EMTA), International Primary Markets Association (IPMA), IIF and the Securities Industry Association.
[124] Gang of Six, 6 December 2002.
[125] For example, a delegation of ABN AMRO and ING (both banks closely involved in the IIF) paid a visit to the Dutch Finance Minister, which led to a slight softening of Dutch support for the SDRM.
[126] Confidential document source.
[127] Informal communications with emerging market representative.
[128] LatinFinance, December 2003, p. 24.
[129] IMF, 25 March 2003.
[130] G10, 26 September 2002.

by including them in their drafting exercise.[131] The actual drafting of the clauses was in any case subcontracted to private sector lawyers. The private lawyers were also expected to advise on the 'market acceptability' of the proposed CACs, meaning the degree to which financial firms would support including CACs in international bonds.[132]

In July 2002 the IMF discussed the state of affairs with respect to CACs (and considered its options to encourage greater use of CACs). The staff paper noted that the private sector (represented by the EMCA) tried to raise the majority threshold for decision-making as high as possible (to 95%), remarking that this would defeat the purpose of CACs. Furthermore, the official endorsement of CACs by the G10 and IMF had not yet had an impact on market practice by 2001. Even if CACs would become market standard, it would take decades for CACs to cover all outstanding bond debt. Despite this discouraging progress on CACs, the Fund only committed to encourage the use of CACs under its surveillance. The inclusion of CACs under programme conditionality (which would be quite effective) was rejected by the EDs. With the exception of the US, the EDs furthermore noted that given the long implementation time, proceeding with the SDRM was also adamant.[133]

In the negotiations on CACs, the private sector consequently set out mainly to limit the restrictions on their freedom of manoeuver (by setting a very high majority threshold). The IMF, on the other hand, was seeking ways to pressure debtor countries but did not obtain a stringent mandate to do so through conditionality.

The report with model clauses was presented as early as the September 2002 Ministerial G10 meeting (which is held parallel to the IMF Annual Meetings). The main objectives for the model CACs were (i) to foster early dialogue, coordination and communication among creditors and a state caught up in sovereign debt problems; (ii) to ensure that there are effective means for creditors and debtors to re-contract without a minority of debt holders obstructing the process; and (iii) to ensure that disruptive legal action by individual creditors does not hamper a workout that is underway, while protecting the interests of the creditor group. The report furthermore noted that the approach should build on market practices and build a consistent framework across jurisdictions. An important feature of the CACs was the majority decision-making threshold, which was set at 75 per cent according to practice under English law. Discussions with prominent emerging markets showed that these were still hesitant to implement CACs (as was the private sector).[134] During the meeting several G10 members (again, not including the US) emphasised that work on the 'other track' (the SDRM) should continue.

[131] Confidential document source.
[132] G10, 26 September 2002, p. 2.
[133] IMF, 26 July 2002, p. 4 and confidential document source.
[134] Confidential document source. The communiqué of the meeting emphasised that the statutory and contractual approaches were complementary. G10, 27 September 2002.

In January 2003 the 'Gang of Six' came up with its own counterproposal for CACs – despite its threat to withdraw support a month earlier, as mentioned above. Compared to the G10 standard, this proposal sought greater standardisation of the clauses, and set more stringent norms for transparency of debtor countries.[135] Also its majority voting thresholds were higher than the G10 model clauses (85 vs 75 per cent). Notably, the IMF did not commit to the G10 model clauses specifically, but endorsed clauses in general (including those developed by the private sector).[136] This reflected a rift between the European EDs (in favour of endorsing the G10 clauses) and the US and emerging market EDs (against endorsing a specific set of clauses).[137]

Around the same time, a landmark study by Eichengreen & Mody on the potential costs of CACs was published.[138] This study was based on the experience with CACs under English law. They concluded that CACs would not increase borrowing costs for more creditworthy emerging markets, but would increase spreads for less creditworthy debtor countries. In other words, the effect of CACs on the terms of competition would be limited. The demand side of the market would not unduly suffer from including the clauses.

Creditor countries were in the meantime also discussing in several different forums (G10 and the Ecofin) whether to 'lead by example'. The EU decided in September 2002 to do just that, but given the very limited issues of foreign currency bonds (about 3.5 per cent of the outstanding European stock), this was a bit of an empty gesture.[139] Nevertheless, as mentioned above, in February 2003 Mexico announced its plan to issue bonds with CACs that were based on the private sector's proposals as well as the G10 model clauses. These bonds included a 75 per cent majority voting threshold, and were closer to the G10 clauses than to the private sector's model according to the IMF.[140]

The G10 was pushed by the Bank of England to pursue monitoring of the implementation of their model CACs. In a study published by the BoE, it was concluded that although the use of CACs had increased significantly after 2002, the CACs used conformed only to the second objective of the G10 model clauses (effective means for debtors and creditors to re-contract), while the objectives of fostering dialogue and avoiding disruptive legal action were not addressed. While the rise in the use of CACs had started earlier, that was due to the increase in market share of London (which includes CACs), while the use of CACs in New York bonds was non-existent until 2003 (see table 5.5 below).

[135] Gang of Six, January 2003. See also IMF, 25 March 2003, p. 7.
[136] IMFC, 12 April 2003.
[137] Confidential document source.
[138] Eichengreen & Mody, 2004. Earlier versions of this paper had been circulating among policymakers since 1999 and a version containing the same empirical claim was published in 2001 as an IMF Staff Paper.
[139] IMF, 25 March 2003, p. 19. In January 2000, the UK did include a majority amendment clause in a euro-denominated treasury note, however, without effects on price and liquidity (IMF, 25 March 2003, p. 18-19).
[140] IMF, 25 March 2003, p. 20–22.

Table 5.5 Foreign currency sovereign bond issuance by governing law 1995 – 2004 (billion US$)

Governing law	'95	'96	'97	'98	'99	'00	'01	'02	'03	'04*
New York	7.1	21.3	22.0	18.0	22.2	34.7	37.2	36.3	46.7	33.4
(w CACs)									(21.8)	(31.1)
English	26.2	25.0	26.8	30.0	17.9	12.5	14.2	14.4	21.4	27.4
Other	26.6	34.0	25.3	31.6	17.3	16.5	13.5	2.7	6.6	13.6
Total	59.9	80.3	74.1	79.6	57.4	63.7	64.9	53.4	74.7	74.4
% of total w CACs	***50.8***	***42.7***	***39.6***	***40.0***	***33.0***	***28.1***	***28.2***	***27.3***	***58.4***	***79.8***

* 2004 to 30 September Source: Drage & Hovaguimian, 2004, table 1 (p. 3)

The CACs consequently turned out to be a successful track in the policymaking process. However, as mentioned above, there was also a third track in the governance of sovereign debt crises. Policymakers had concluded that there might be other ways of dealing with fostering early dialogue, to wit a Code of Good Conduct. The CoGC was initially proposed in 2001 by Jean-Claude Trichet, at the time Governor of the Banque de France.[141] He saw the Code as something to be embraced by both the public and private sector. At the 2002 IMF Annual Meetings Trichet pushed for the Code in his intervention ("we should without delay build upon work already done to write down a code of appropriate conduct for concerted and informal debt restructuring").[142] It was not taken up in the IMFC communiqué, however, which only focused on the twin tracks of SDRM and CACs (the latter to be developed by the official community, private creditors and sovereign debt issuers).[143]

However, outside of the G10 group calling the shots in the IMFC, Trichet found a listening ear in the private sector (notably the IIF) and at the G20 meeting of finance ministers and central bank governors. The latter supported further work on the Code in its 2002 communiqué.[144] It seems likely that this was mainly the result of support by the emerging market economies in the G20, as the G10 did not explicitly support the development (and it was also not taken up in the IMFC). Only in October 2004 did the G10 encourage "sovereign debtors and private creditors to continue their work on a voluntary set of principles on sovereign debt restructurings."[145]

In January 2003, the Banque de France presented an issues paper 'Towards a Code of Good Conduct on Sovereign Debt Re-Negotiation.'[146] This seemed mostly to be in response to

[141] Ritter, 2010, p. 225.
[142] Trichet, 29 September 2002.
[143] IMFC, 28 September 2002.
[144] Ritter, 2010, p. 226.
[145] G10, 3 October 2004.
[146] Banque de France, January 2003.

the loss of momentum on the crisis resolution policy domain (with the SDRM effort derailed and little apparent progress on CACs). The CoGC was presented as a complement to these two and echoed the Prague Framework for PSI. The CoGC therefore also mentioned a 'toolbox' for PSI, including rollovers, standstills and bond exchanges.

The Banque de France issues paper seemed to build on the expectation that this would be a proposal that would get the different parties around the table in a constructive dialogue again, as opposed to the confrontational debates with the private sector on CACs and the SDRM. It was even noted rather optimistically that: "The CGC rather fills the present vacuum and offers a workable way for allowing – as pragmatically and realistically as possible – all stakeholders to optimize their present behaviour and, perhaps, *to accept tomorrow what they do not accept today.*"[147] The paper called for inclusion of a wide range of stakeholders in the discussions (meaning public and private creditors, sovereign debtors, the financial community as a whole, and the IFIs) and called for a subsequent endorsement by these same parties.

The CoGC was supposed to lead to orderly solutions to excessive indebtedness through early engagement with creditors, fair information sharing, fair representation of creditors, comparable treatment among creditors, fair burden sharing, negotiation in good faith, preservation of the debtor's financial situation and restoring debt sustainability as soon as possible. After some discussion in the official policy community, further development of the CoGC was relegated to a working group led by the Banque de France and the IIF which included some important debtor countries.

The IMF was encouraged to contribute to the development of the CoGC.[148] The IMF reported in September 2003 that the mixed group of stakeholders had difficulty coming to operationalised principles. The Fund furthermore noted that although it participated in the CoGC discussions, its policies would remain a prerogative of the Board and not be affected by a CoGC.[149]

The lack of progress was apparently due to the intransigence of debtor countries, and it was not until mid-2004 that discussions were reignited. Interestingly, some creditor associations (EMTA/EMCA) seemed to be pushing for a more stringent CoGC with IMF monitoring (in the sense of being stringent for debtor countries, of course). This was opposed by the debtor countries.[150]

In October 2004 the IIF and IPMA agreed on a text with Brazil, Mexico, South Korea and Turkey. This core group subsequently started seeking wider support in the private sector and among debtor countries.[151] In November 2004 the renamed 'Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets' were presented by the IIF, IPMA

[147] Banque de France, January 2003, p. 2 (emphasis added).
[148] IMFC, 21 September 2003. As soon as the private sector became involved, the Code of Good Conduct was shortened to Code of Conduct; apparently the private sector does not have to be good…
[149] IMF, 5 September 2003, p. 11.
[150] Confidential market source.
[151] Confidential market source.

and the four emerging markets. The emphasis in the 'Principles' had shifted from actual debt restructuring to crisis prevention through more debtor transparency and dialogue with creditors. The PSI toolbox had, for example, largely disappeared. The principles were to be applied on a case-by-case basis and aimed to be market-based, voluntary and flexible.

The Principles were 'welcomed' and 'supported' the same weekend by the G20 finance ministers and central bank governors in Berlin. They were notably not 'endorsed', as some of the provisions seemed to restrict IMF action and, moreover, the public sector did not want to interfere in the 'voluntary and market-based' Principles.[152] Although the press release seemed enthusiastic enough (Trichet speaking of 'an important milestone'), interviews with public sector officials showed them on several occasions rather dismissive of the Principles.[153]

Although there was clear involvement of the private sector associations, it seems that in early 2005 working knowledge on the micro level (traders) of the Principles was limited and reservations still existed among the membership of the associations.[154] Implementation only took off in late 2005 when the Principles Consultative Group (PCG) and a Group of Trustees of the Principles were established.[155] Both are high-powered groups filled with top-level public officials and ex-officials who now work in the private sector. For example, as of 2010, the chairmanship of the Group of Trustees is shared by Jean-Claude Trichet (ECB President), Henrique de Campos Meirelles (Banco Central do Brasil Governor) and Toshihiko Fukui (former Governor of the Bank of Japan).[156]

To sum up, different patterns of governance were proposed in response to the new market structure of capital market financing of sovereign debts. All of these proposals shifted governance upwards to the global level, but implied rather different shifts across the other two dimensions. The three 'tracks' differ on the 'nature' of governance dimension from mostly public (SDRM) to mostly private (Principles). The stringency also ranges from more stringent (SDRM) to less stringent (the voluntary Principles). In the end, only the more market-based proposals had come to a successful conclusion (CACs and the Principles). The next section will provide an analysis of the policymaking process that has been described above and concludes this chapter.

[152] G20, 21 November 2004. A practical reason also seemed to be that the EU did not have the time to coordinate their position towards the Principles, and consequently the EU representative in the G20 simply could not endorse them. Furthermore, the Argentines were strongly opposed to the Principles. Confidential document source.
[153] Off-the-record interviews with public actors, 2007-2008.
[154] Confidential document source.
[155] Ritter, 2010, p. 228.
[156] An up-to-date list can be found on the IIF website. For 2010, other members include Brady (currently chairman of Darby Overseas Investments), de Larosière (currently Advisor to the Chairman of BNP Paribas Group) and Andrew Crockett (now President at JP Morgan, former Secretary-General of the BIS).

Analysis and preliminary conclusions

The process tracing above has shown the complex interplay between market structures and shifting patterns of governance. It was shown how the case of sovereign debt restructuring essentially involves bargaining between three main actors involved in global debt markets: debtor states, private creditors, and creditor state authorities and IFIs. As the terms of competition and the market structure changed, the positions of these different parties in this bargaining process strengthened or weakened, and preferences for governance of this bargain were revised. The ensuing policymaking process led to important shifts in governance. In the following two subsections, the analysis starts with addressing the first research question (how have the patterns of governance and market structures changed). The second subsection analyses the characteristics of the policymaking process (second research question) and the relation of the patterns of governance to the changes in market structure (third research question).

Shifts in governance from the Baker Plan to the Principles

As an opening remark, it might be noted that both the Baker and Brady plans were only 'temporary' governance patterns, in the sense that they were an ad hoc response to the Latin American debt crisis and as such they entailed a governance pattern that 'disappeared' after that crisis was solved. That being said, the pattern of governance of sovereign debt crises has since shifted in a number of ways. With respect to the first dimension of governance (jurisdictional level), both the Baker and Brady plans can be seen as international level governance patterns. The plans set rules guiding the sovereign debt restructuring of the emerging markets in crisis (while the problems were mostly concentrated in Latin America, emerging countries in all corners of the world experienced problems). What's more, banks affected by the governance pattern were spread all over the Western world. On the other hand, both plans were aimed at the crisis-ridden countries and their creditors only.

The post-Asia crisis governance pattern shows a shift towards more global level governance as the CACs and Principles apply to all countries issuing international bonds or debt and to all their creditors. The same applies to the prospective SDRM. In that sense, it was argued that a limited shift upwards on the first governance dimension had taken place. For the first time a governance pattern applying to all countries with (private) international debt was implemented.

Coming to the second dimension of governance, its nature, the Baker and Brady plans were public initiatives. Designed by US Secretaries of the Treasury and administered by the IMF. Within the framework of this public governance pattern, debtor states and private creditors negotiated a solution for the sovereign debt crisis. Thus, although private actors were naturally involved in the eventual negotiations (they were the creditors having to restructure debt, after all), the framework was administered by public authorities.

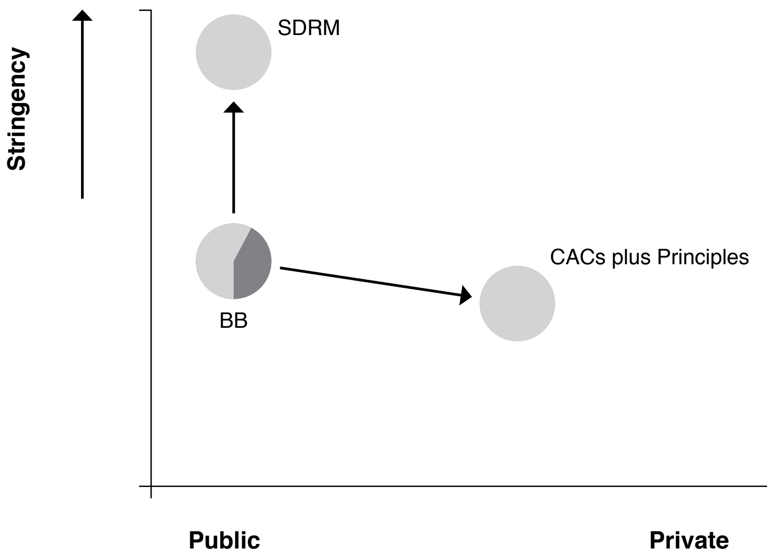
After the East Asian crisis had signalled the costs of new forms of risk to the market players, this ad hoc framework for sovereign debt restructuring changed significantly. The proposal with the most public nature (the SDRM, in first instance envisaged as an international organisation comparable to a bankruptcy court) was defeated by a combination of a standard for CACs (with a public nature) and the Principles (which are of a private nature). Although the standard for CACs is public, its actual implementation is left to the market and is voluntary (debtor states acting as the demand side of the market for sovereign debt and private creditors). The CACs can consequently be seen as a mix between public and private governance. This therefore entailed a shift towards more private actor-based governance compared to the Baker and Brady plans.

On the third dimension a particularly interesting shift takes place. The starting point after the Latin American debt crisis was based on IMF conditionality for the debtor countries (which restrains domestic policy space) and co-financing demands on private creditors. The co-financing demands were to a certain extent stringent for private creditors in the sense that pressure was exerted by the IMF and central banks and ministries of finance to fulfil them, and they consequently 'overruled' normal market processes (which would call for a reduction of lending). The LiA policy did not so much change the stringency of the governance pattern, but it did change the power balance between the three parties involved slightly in favour of the debtor states.

The governance pattern implemented after the East Asian crisis (CACs and Principles) has one thing in common regarding stringency: the two elements set rules for the negotiations between debtor and creditors, and not so much rules for the outcome (as Baker and Brady did to a larger extent). In that sense, the governance pattern is less stringent and more open-ended than Baker and Brady. This is especially the case for private creditors, as they are no longer forced to adjust their lending policies, but have a say on a possible restructuring. The majority clauses in CACs are somewhat constraining for private creditors (especially holdout creditors such as vulture funds). Had the SDRM materialised, it would have entailed a stringent governance pattern for both debtor and creditors alike, as it would be able to set binding terms for restructurings.

In figure 5.1 on the next page, the shifts in governance from the Baker and Brady plans to CACs plus the Code of Conduct are schematically illustrated. An assessment of the shifts in governance the SDRM would have entailed is also included. As in figure 4.1 in the previous chapter, the vertical axis represents the stringency dimension (the further from the zero-point, the more stringent), while the horizontal axis depicts the nature of governance dimension (public at the zero-point, adding more private elements the further we move away from the zero-point). The pie chart in the circles representing the different governance patterns reflects the jurisdictional dimension: a larger lightly shaded area represents a shift upward to the global level.

Figure 5.1. Shifting patterns of governance: Baker/Brady (BB) to SDRM vs CACs plus Principles.

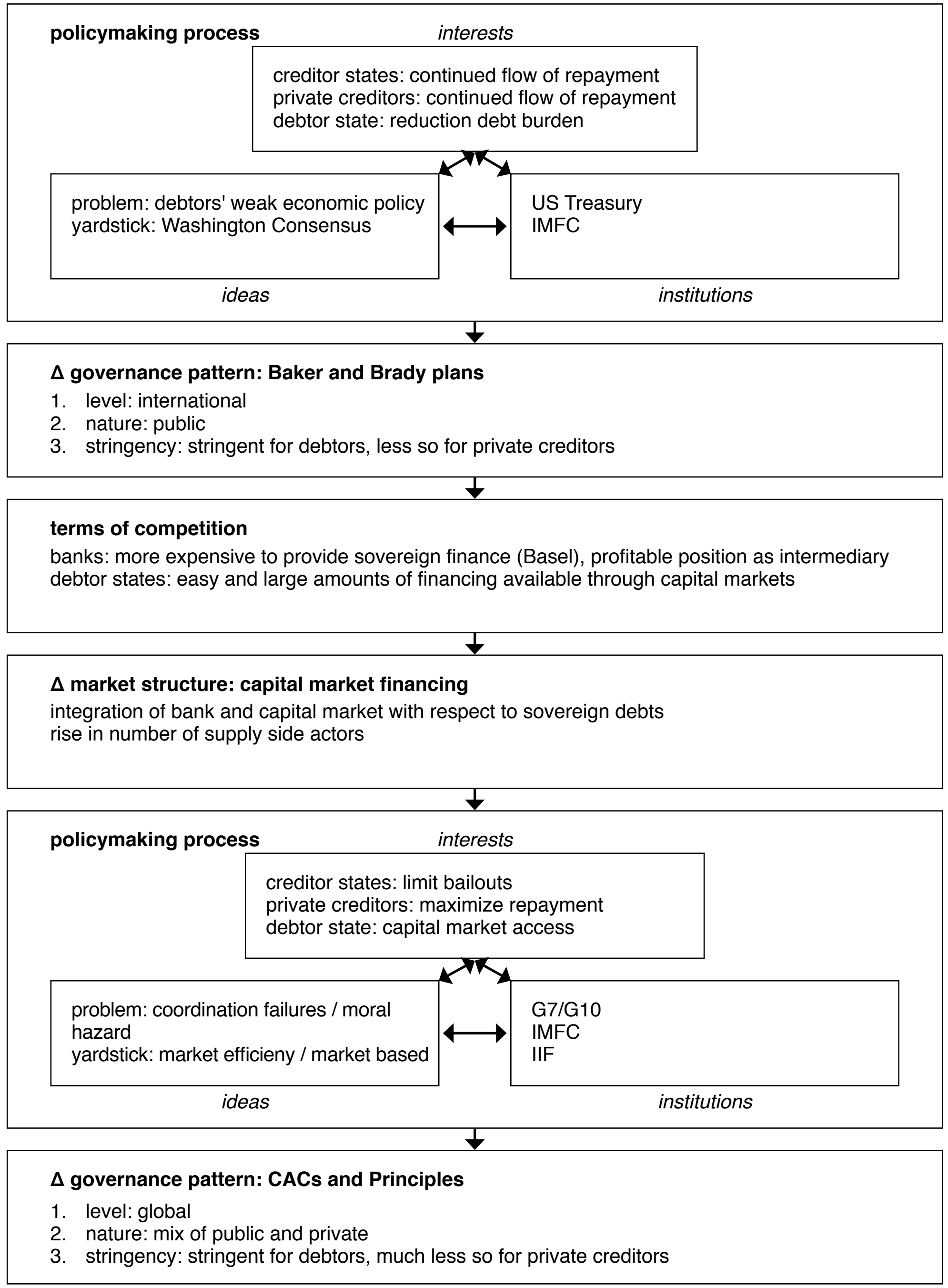


The feedback dynamic at work in the market for sovereign debt

As figure 5.1 above shows, in the policy domain of sovereign debt crisis resolution there has been a limited shift upward on the jurisdictional dimension, a more pronounced shift towards governance of a more private nature, and a clear shift towards patterns of governance that are only stringent in the sense of setting rules for the negotiating process between public debtors and private creditors (thereby empowering market actors and being market-based). The shifts can be explained by applying the analytical framework as developed in the theory chapter.

The following analysis is focused on the time period of this chapter and thus 'steps into' the feedback loop at the point where the Baker and Brady plans were being negotiated. In the concluding chapter the analysis from this chapter will be extended with that of chapter three, including the developments of the 1970s. Figure 5.2 on the next page shows the feedback loop that was introduced in the first chapter (figure 1.1) is represented in a linear fashion, making one and a half 'rounds'. Starting from the policymaking process in response to the Latin American debt crisis (leading to the Baker and Brady plans) we move to the shifts in governance entailed by the Baker and Brady plans and on to the changes in terms of competition and market structure (first full round). Subsequently the (partial) 'second round' starts with the negotiations on the SDRM, CACs and Principles and ends up with the shifts in governance the CACs plus Principles pattern of governance entailed. In the following, this feedback loop will be elaborated.

Figure 5.2 Linear representation of the feedback loop between market structure and governance pattern in the case of the resolution of sovereign debt crises



The response to the Latin American debt crisis was focused on maintaining the soundness of the global financial system. In other words, creditor states and private creditors had a (strong) preference for a continued flow of repayments to private creditors while debtor states had a preference for a reduction of the debt burden. The close alignment of official US preferences and the preferences of their internationally active banks led to plans that put the burden of adjustment primarily on debtor countries, accompanied by official refinancing (and limited private refinancing). This governance pattern could emerge because of the strong weight of the US in the primary international policymaking institution (the IMFC) – inasmuch the US did not unilaterally design the governance pattern. Furthermore, both public and private actors in the immediate period after the Mexican default coalesced along the view that the crisis was the result of weak economic policies in the debtor countries, and that the solution should consequently focus on improving their policies. This was reflected in the conditionality attached to the IMF programmes under the Baker and Brady plans (which were later baptised the Washington Consensus).

The Brady plan was designed to provide incentives for the creation of a secondary market for sovereign debts, and by creating these also provided the foundation for a primary market in emerging market debt. Viewed from the side of public authorities, these incentives rested on the underwriting of Brady bonds. As regards the banks, they had the additional incentive of the profitability of acting as intermediaries placing sovereign bonds in the market. Many banks thus made the strategic decision to leave the sovereign debt market as lenders, and bonds emerged as the substitute for sovereign bank lending. The Brady pattern of governance consequently led to a change in market structure towards capital market funding of debtor countries and increased integration of the banking and capital market. As it turned out, capital market funding for emerging markets was readily available (which seemed beneficial for the demand side of the market).

Another lasting result of the resolution of the Latin American debt crisis under the Baker and Brady plans was the institutionalisation of a banking lobby at the international level in the form of the IIF. As described in chapter three, this private sector association was instigated and supported by public authorities like the IMF. It evolved out of the bank steering committees addressing the debt crisis into a policy advocacy group that was to become the prime interlocutor of global level official policymakers (IMF, G7 authorities). This strengthened the voice of the private sector in subsequent policymaking processes (as will be elaborated below).

Over the course of the early 1990s, the changes in market structure began to consolidate, and international bonds as a share of outstanding sovereign debts increased. At the same time, banks reduced their direct exposure through bank lending. This new capital market financing could also increase coordination problems in case of sovereign debt problems, however. With bonds thinly spread among thousands of more or less anonymous creditors in many jurisdictions (instead of several hundred banks in a few jurisdictions for the largest syndicated loans), it would become more difficult to negotiate and enforce debt restructurings. Furthermore, the sheer amount of money involved had increased, which could potentially mean ever higher official financing for crisis-ridden countries (money which would effectively bail out private creditors).

The 1994 Mexican crisis underscored the new nature of sovereign debt crises and led to a revision of the preferences of creditor countries' authorities and the IMF. Perhaps the realisation that the IMF's resources were no longer adequate to fulfil its mandate in this new capital market-financed world aided the revision of these preferences. The new market actors (bondholders) somehow had to be involved in the resolution of sovereign debt crises.

However, the dominant policymaking institutions in the domain of sovereign debt restructuring (especially G7/G10) had an exclusive membership with a high level of access for private actors (mainly the IIF and its members). This had led to a skewed argument pool focusing on 'market-based' governance patterns. Possible measures taken had to improve market efficiency (e.g. through transparency in the debate on crisis prevention). The policy discussions on sovereign debt restructuring were therefore delegated by the G7 to the creditor forum of the G10, while preliminary discussions in the IMF Board on a statutory mechanism were smothered.

The 1997-1998 East Asian crisis and the associated large-scale official lending packages for many countries drove the point home to creditor countries' authorities. Policy discussions on a new pattern of governance for sovereign debt crises started in earnest. Also, the sheer size of this crisis seemed to open a window of opportunity for different voices to be heard in the policy discussions. Global financial governance was suddenly at the centre of attention and a whirlwind of governance proposals ensued.

Yet, the main policymaking institutions (the IMFC and G7/G10) did not adjust their market-oriented ideology. The exclusionary nature of these policymaking institutions led to scant debate of 'radical' reform proposals that would, for example, lead to more public and stringent governance patterns (e.g. capital controls) and instead focused in first instance on CACs. When the G10 revealed their model CACs this amounted to a global level standard of a public nature that would set regulations for the process of negotiations between debtors and creditors and in that sense restrained their behaviour. This reflected only a limited shift at the jurisdictional level, which is understandable as contagion ensures that big crises become global in scope. The Baker and Brady plans were consequently already close to being global level plans, and there was no reason for further shifts along this dimension. However, the standard was vague on the outcome of these negotiations and in that way was much less stringent for private actors than the Baker and Brady plans.

Implementation of CACs was initially limited (not to say non-existent), and sovereign debt crises continued (most notably Argentina which defaulted in 2001). This led the IMF to launch the SDRM, seemingly egged on by the US Secretary of the Treasury. This global level governance pattern of a public nature would function as a bankruptcy court and in a sense was more stringent than the Baker and Brady plans.

Interestingly, private sector involvement in the negotiations was initially limited. The new market structure had not yet led to a significant revision of preferences, and the proposals so far were market-friendly. The involvement of the IIF in the policymaking institutions had ensured market-based governance patterns that could even be ignored in their implementation (the CACs). As the momentum for the SDRM built, however, it quickly became clear how the policymaking institutions allowed international private sector actors to satisfy their preferences for lax governance patterns: opposition from the private sector and emerging markets led to the burying of the proposal. The private sector's opposition was strengthened by the fact that emerging markets themselves feared for their terms of competition in the market, meaning they would either loose access to capital markets or be required to pay higher spreads vis-à-vis other possible investments.

However, private sector interests are not entrenched enough to pre-empt all creditor authorities' preferences. At any rate, the problems which would have been addressed by an SDRM were unlikely to disappear. This serves to explain the acceptance (and implementation) of the CACs and the design of the private sector-led Principles. This goes to show that state actors are still influential in the age of global capital markets, even if the skewed argument pool means they share the same broad outlook on things as the private sector. The outcome of the process reflects a compromise between public sector authorities' preferences for 'economically sound' and intellectually rigorous proposals and the preferences of private sector actors to maximise leeway in order to ensure a comfortable competitive position and profits.

In summary, we see increasing internationalisation of the market being accompanied by pressures for global level, market-based governance patterns in order to deal with sovereign debt crises. Support from public actors for more stringent forms of governance is defeated in policymaking institutions with a strong position of private sector interests and a general market-oriented ideology (in other words: the yardstick for solutions is addressing 'market failures' in a way that does not interfere with market processes). The emergence of global level policymaking institutions is therefore an important explanatory factor in the emergence of 'governance light'. In practice, the governance pattern means most of the costs of sovereign debt crises are still born by the general public in poor and emerging market countries, while creditors have considerable leverage to get repaid.

It remains to be seen, however, whether this 'governance light' can deal with possible sovereign debt restructurings in the Eurozone as a result of the current crisis. The problems of emerging market countries have suddenly come close to home in some erstwhile creditor countries. The effects of the crisis on the governance pattern for sovereign debt restructuring will be further discussed in the concluding chapter.

Chapter 6

Global financial governance in the wake of the crisis

This thesis started off with an anecdote about the near collapse of IKB Deutsche Industriebank in the ongoing financial crisis that began in 2007. Unfortunately, these kinds of anecdotes can be situated almost anywhere in the world: from Iceland where the entire banking sector collapsed, to the Netherlands where several banks needed state support, to Dubai where the first in what later became a longer series of sovereign debt crises occurred. Hubris went before the fall, as many iconic industry names suddenly came knocking on the state's door to obtain rescue funds.

But where the socio-economic consequences of this crisis have been severe and enduring for many people who lost homes, livelihoods or opportunities in life, at the time of writing the salary bonus bonanza has once again started at the top banks. We can safely say the benefits of global financial integration have been distributed unevenly. Yet, it is not clear whether the current crisis (the biggest economic malaise since the Great Depression) will lead to a significant reorientation of the workings of the global financial system. The relationship between the latest round of changes in the market structure and patterns of governance remains unclear. Why does it not seem possible to find a pattern of governance that mitigates the risks and effects of financial crises?

It is this concern about the instability of financial systems and their distributional impact (in good times and bad) that provided the foundation for the overarching question of this thesis: What explains the relation between market structures and patterns of governance, so as to understand the dynamics of the global financial system? This overarching question was broken down into three research questions:

1. How has the pattern of governance shifted in the two policy domains of bank capital adequacy standards and sovereign debt crisis resolution over the period 1980 - 2005? How have the relevant market structures changed over the same period?
2. What are the characteristics of the policymaking process leading to these shifts in the pattern of governance of the two policy domains in global financial governance?
3. What is the role of the policymaking process in both shifts in governance and changes in market structure? In short, how do shifting patterns of governance relate to changes in market structures?