

# *Les Jeux Sont Faits*: Structural Origins of the International Debt Problem

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*Les Jeux Sont Faits* literally means "The Games Are Played (Are Over)." It is also a gambling term especially common in roulette: "The Bets Are Placed." Jean-Paul Sartre appropriated the phrase as the title for a play about the ways in which we lock our lives into irreversible structures. The Sartre play suggests a third translation: "The Die Is Cast."

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Never have so many countries owed so much money to so many banks, with so little prospect of repayment. For more than two years the international financial system has staggered under the burden of a so-called "debt crisis," in which a group of non-oil developing countries<sup>1</sup> (NODC's) and their lenders have struggled to prevent default on a level of external debt that is by almost any measure excessive. The most dramatic debt figures are those for the major Latin American borrowers. By the beginning of 1985, Brazil's estimated external debt was almost \$100 billion, Mexico's in excess of \$96 billion, and Argentina's at least \$45 billion.<sup>2</sup> The nine largest U.S. banks have over 110% of their capital exposed in loans to these three debtor states, and over 200% exposed to

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1. I have employed the term "NODC" to include those countries in which (1) oil exports do not constitute two-thirds of total exports, or (2) oil exports are less than 100 million barrels per year. (This is the convention adopted by the IMF and other analysts of international financial matters.) Even though the oil exports of Mexico and Venezuela have constituted more than two-thirds of their respective total exports in the 1980's, those countries will also be included as NODC's, since that was their status through most of the 1970's.

2. Like most of the other numbers used in this Article, these are approximations based upon estimates or figures compiled by financial concerns, the media, and international organizations (especially the International Monetary Fund and the World Bank). For slightly different estimates of Latin American indebtedness, see Riding, *Latin Debt: Postponing the Burden*, N.Y. Times, Sept. 23, 1984, § 3, at 1, cols. 2-4; Witcher, *Bankers, Preparing for 1985 Debt Talks with Third World, Are Warned Not to Let 1984's Successes Go to Their Heads*, Wall St. J., Dec. 28, 1984, at 16, cols. 1-2. See also the figures in Rowe, *New Debt Repayment Terms Expected*, Wash. Post, Aug. 29, 1984, at D8, cols. 3-4:

NODC's as a whole.<sup>3</sup> Many of the outstanding bank loans have required some form of renegotiation in 1983 and 1984. Although prospects for the debtor states to continue to pay their debts have brightened considerably due to the worldwide economic recovery, sober analysts nonetheless warn that the crisis has deeper implications and may remain a concern for several years.<sup>4</sup>

With so much at stake, there has been an avalanche of popular and scholarly literature on the causes of the debt crisis, especially for Latin American countries (which will be the main focus of this Article). What is most striking about much, if not most, of this commentary is its emphasis on "external shocks" as the main explanation for the crisis. This external economic shocks explanation posits that the debt crisis was, as the International Bank for Reconstruction and Development (the World Bank) put it in 1984, "the result of an unexpected mixture of circumstances—[OPEC-induced oil price increases in 1973 and 1979], prolonged recession in industrial countries, the strong dollar, and high rates of interest."<sup>5</sup> The international financial system and its sovereign borrowers were simply unlucky: the upward surge in oil prices in 1973 and

Latin American Indebtedness  
(billions of dollars)

<u>Country</u>	<u>Total Debt</u>	<u>Public Sector</u>	<u>Private Sector</u>
Brazil	100.0	62.0	38.0
Mexico	94.0	76.0	18.0
Argentina	43.5	29.6	13.9
Venezuela	34.0	28.0	6.0
Chile	21.0	7.0	14.0
Peru	12.4	10.5	1.9
Colombia	10.5	6.7	3.7
Bolivia	5.3	3.8	1.5
Ecuador	6.8	5.2	1.6
Uruguay	4.6	3.3	1.3

3. See International Financial Markets and Related Problems: Hearings Before the House Comm. on Banking, Finance and Urban Affairs, 98th Cong., 1st Sess. 73, 76 (1983) (statement of Paul Volcker, Chairman, Bd. of Governors, Fed. Reserve Sys.) [hereinafter cited as International Financial Markets Hearings]. As of June 1982, claims on NODC's by the nine largest U.S. banks constituted 10.6% of total assets, 222% of total capital; claims on Argentina, Brazil, and Mexico constituted 112.5% of total capital.

4. See, e.g., Quale, *The International Debt Crisis—Phase II: Time for a New Approach*, in *A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* ch. 7 (W. Eskridge ed. 1985) (forthcoming).

5. World Bank, *World Development Report 31* (1984); cf. Hughes, *Debt and Development: The Role of Foreign Capital in Economic Growth*, 7 *World Dev.* 95, 109 (1979) (minimizing dangers of a general debt crisis in 1979, though recognizing possibility of default by individual developing countries that follow imprudent policies).

1979 led to increased NODC debt, which borrowing countries were unable to service (*i.e.*, to make yearly principal-and-interest payments) when the worldwide recession cut into their export earnings and rising interest rates increased the yearly servicing expenses. The external shocks theory is a reassuring one for Western financial and political systems because if it is correct, the global economic recovery and the decline of OPEC in 1984-1985 ought to rescue the system from the crisis. Once the external shocks disappear or are ameliorated, the theory posits, the crisis will dissipate. And so it may.

Although many people continue to pay lip service to the external shocks explanation because of its optimistic overtones, most knowledgeable analysts also realize that this explanation is oversimplified. Many NODC's subject to similar if not greater external shocks have been able to accumulate a large external debt without significant problems (*e.g.*, South Korea); some countries even seemed originally to have benefited from the external shocks yet now have problems servicing their large external indebtedness (*e.g.*, Mexico and Venezuela).

As a result of these and other anomalies, more sophisticated explanations for the crisis are emerging. One approach, explored in Part I of this Article, is to view the external shocks as the trigger of a problem which did not become a crisis until the NODC borrowers and the international financial institutions made mistakes in dealing with that problem between 1973 and 1982. This "shocks-and-mistakes" explanation is realistic and analytically sophisticated, without sacrificing much of the optimism of the original external shocks explanation. If the external shocks dissipate and the actors learn from their mistakes, then the crisis will resolve itself.

One problem with the shocks-and-mistakes theory is that it is ahistorical and unsystematic. It presumes that the roots of the debt problem extend back about ten years (from the OPEC price increases in 1973 to 1982), and it tends to ignore longer range trends and structures that generated the mistakes made in the 1970's. Indeed, it attributes mistakes to bankers and borrowers that might, in truth, have been eminently reasonable conduct given the circumstances and the assumptions of the period.

Drawing from models and sources of international finance, Latin American socio-political dynamics, and bank regulation, Part II of this Article argues that the debt problem was a natural result of socio-political, institutional, and economic structures which con-

tributed to the rapid accumulation of too much international sovereign debt. The predominant ideology of growth impelled certain NODC's, especially those in Latin America, to seek foreign capital to sustain their development plans. Because of weak political structures, however, the debtor countries continued to borrow from foreign banks, even when it should have been clear that borrowing was just postponing hard political sacrifices that would ultimately have to be made.

Moreover, just when the debtor states sought massive inflows of foreign capital to sustain their growth after the early external shocks, the banks were poised to lend unprecedented sums of money. In addition to the availability of large OPEC deposits, the bankers' systematic underappreciation of sovereign risk and their confidence that political pressures would protect them against NODC default contributed to a mania of sovereign lending. Also important was the decline of the Bretton Woods system, for its demise left international lending virtually unregulated and exposed to crashes and panics of the kind to which it had historically been subject. Western bank regulations were not structured to deal with risks and transactions of this sort, and if anything the role of the Western governments was to encourage and subsidize international lending. By the time the banks and the regulators better realized the risks of the NODC indebtedness, the banks, the borrowers, and the national and international regulators had become hostages to the large volume of outstanding loans.

This structural explanation posits neither fools nor villains. The mistakes were either hard to avoid or all but compelled by historical trends beyond the control or comprehension of any but the most cassandric observer. Such an explanation is a more satisfactory exposition of the crisis because it represents a better view of the historical context and contours of the problem. For these same reasons, however, this second explanation might generate less optimism than the short-term shocks-and-mistakes theory. It might take the banks a long time to work themselves out of the involuntary lending cycle, especially if the debtor countries refuse to sacrifice their economic development and the Western governments postpone meaningful financial reform. New external shocks (another round of oil price increases or a faltering of the global economic recovery) or policy mistakes (large government deficits or persisting problems of currency overvaluation) could make the crisis worse and press some countries closer to default.

While more expositionally complete, this structural approach

might itself be too confining a perspective on the international debt problem. A third way to look at the problem is to see it as part of, or a symptom of, a larger crisis of development. This idea is explored in Part III of this Article, which analyzes the origins of the debt problem under three paradigms of development.

Traditional development theory, based upon a Western modernization paradigm, views development as an endogenous process of industrialization and economic growth, and emphasizes the role of capital accumulation in achieving growth. The debt problem has exposed the traditional theory to criticism insofar as infusions of capital have not necessarily led to sustained economic growth and have, instead, tightened ties of dependency of borrowing countries on lending countries, ties which threaten the former's economic viability.

A second theory of development, the dependency paradigm, may explain the debt problem better: the industrialized core states of the world create international economic structures which ensure the dependency of the peripheral states, so that they can be exploited by those of the core. The debt problem, in that view, may be a symptom of the continuing hegemony of the core states in the world system. While this theoretical explanation may be a cogent normative framework for the debt problem, it is an incomplete historical description because it fails to recognize the ways in which the problem exposes core states' vulnerability. Moreover, the debt problem has not impacted equally on all non-core states, some of which may have profited considerably from infusions of Western capital. States are not doomed to eternal dependency or blessed with everlasting hegemony.

A third paradigm, based on interdependent global development, may be a more useful way to view the debt crisis historically. The world systems model developed by historian-sociologist Immanuel Wallerstein is a starting point: although the core capitalist countries continue to lead and dominate the world system, countries on the periphery can seize opportunities to advance, or at least to become part of the semi-periphery of partially industrialized states and regional socio-political powers. The world economic situation has been in flux since 1966-1968, when U.S. political and economic hegemony began to falter. The decline of this hegemony has been both a test and an opportunity for the newly industrializing countries. It is an opportunity for these countries to ascend, primarily by reliance on their state-centered approach to capitalism. It is also a test to determine whether individual countries have the eco-

conomic discipline and internal political strength to weather the crisis.

The international debt problem is a "crisis" only within the context of the modernization paradigm. Indeed, it exposes that view of development to question. Under the dependency and world systems paradigms, on the other hand, the debt problem is only a symptom of broader problems. Late developing countries face severe obstacles in their economic plans and are highly vulnerable to economic and political decisions of industrial countries. The debt dilemma demonstrates the difficulty of Latin American "development" within the capitalist world system. Indeed, it raises anew the fairness questions of unequal opportunity and distribution of risks and rewards under the existing system.

#### I. EXTERNAL SHOCKS, AND MISTAKES MADE BY DEBTOR COUNTRIES, BANKS, AND REGULATORS IN RESPONDING TO THE SHOCKS

Working from data gathered by such organizations as the International Monetary Fund (IMF) and the World Bank, sophisticated analyses published by authors working under the auspices of the Brookings Institution, the Institute for International Economics, the Organisation for Economic Co-operation and Development (OECD), and the Federal Reserve Board have recently stressed the role of both exogenous and endogenous factors leading to the debt crisis in 1982. Without the exogenous factors (external shocks), they argue, the crisis would not have occurred. The important advance made by this literature, however, is its recognition that business and policy mistakes of the leading participants in these loan transactions have been just as important contributions to debtor vulnerability as the exogenous factors. Specifically, the NODC's, especially those in Latin America, responded to the 1973 and 1979 oil price shocks by borrowing far too much money; the banks were eager to lend far more money than they should have; and the regulators raised no objections to the excessive lending, even after it became apparent that the loans represented a clear threat to the banks' solvency. Finally, the other shocks of 1979-1982—recession, declining prices for NODC products, rising interest rates, and a strong dollar—made the servicing burdens intolerable for the debtor countries, which in turn failed to adjust to the drastically changed conditions. When the banks finally realized that problems existed, the whole house of cards collapsed.

A. *Excessive Sovereign Borrowing in Response to the Oil Price Shocks, 1973-1982*

The sharp rise in the price of oil in 1973-1974 and again in 1979-1980 was an important exogenous cause of the debt crisis. William Cline of the Institute for International Economics calculates that, between 1973 and 1982, NODC's paid \$260 billion (real dollars, adjusted for inflation) extra because of the price shocks.<sup>6</sup> This precipitous and largely adverse shift in the terms of trade left the NODC's with potentially enormous current account deficits.

At least three responses were possible to actual or projected increases in current account deficits. The NODC's could have (1) sought to reduce the trade imbalance by encouraging import substitution and/or increased exports to make up for the increased sums needed to pay for the imported oil; (2) attracted the capital needed to finance the payments deficits, either by an enhanced domestic savings effort or by more direct foreign investment; or (3) borrowed the money from foreign official and/or private lenders.<sup>7</sup> Typically, countries employed a combination of these mechanisms. For example, many of the Asian developing countries, such as Singapore and South Korea, combined export expansion and an enhanced public savings effort, and (in the case of South Korea) direct foreign investment, to cover their increased oil payments. Very few countries were able to perform this economic feat, however, and those that were able to do so tended to be "upper-income developing countries." A second group of countries, including Kenya and other African states, adjusted through import substitution and enhanced public savings, but at the price of slower export growth than in the 1960's. Unlike the first group, these countries also had to resort to a substantial amount of external borrowing to cover the remainder of the oil import deficit. Most of these countries were "lower-income or middle-income developing countries."<sup>8</sup> Finally, many countries relied on external financing to cover the defi-

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6. W. Cline, *International Debt: Systemic Risk and Policy Response* 10 (1984).

The value of oil imports increased from 6% of the NODC total merchandise imports in 1973 to about 20% in 1980. *Id.* at 8-9.

7. These responses and the following discussion in text are based upon World Bank, *supra* note 5, at 25 (Box 2.3).

8. The distinction among "upper-income," "lower-income," and "middle-income" developing countries is based on distinctions drawn in Organisation for Economic Co-operation and Development, *External Debt of Developing Countries: 1983 Survey* 10-11, 49 (1984) [hereinafter cited as 1983 OECD Survey].



cits. These countries tended to be fast-developing, upper-income developing countries in Latin America. It is this third group of countries upon which the remaining analysis will concentrate.

In sum, for NODC's as a whole (and especially for the third group of countries), increased domestic savings, export growth, and import substitution did not cover the higher oil prices. The consequences are represented graphically in Chart 1: the NODC's as a whole ran substantial current account deficits after 1973. And the deficits increased in size—from an overall NODC deficit of \$11 billion in 1973 to \$108 billion in 1981—until 1982, when the trend reversed itself and the deficit fell back to \$87 billion.<sup>9</sup> Direct foreign investment increased only by modest amounts. Rather than using foreign exchange reserves to cover those deficits (indeed, they generally added to those reserves in the 1970's), most NODC's paid for the deficits by borrowing money. (Because the NODC economies were centered around the state, or around state enterprises, the overwhelming bulk of the indebtedness was owed by the public sector.<sup>10</sup>) As a result, the external debt of NODC's nearly quintupled between 1973 and 1982, increasing at an average annual rate of 19%. Even after discounting for inflation, the debt more than doubled.<sup>11</sup> The ratio of NODC debt to NODC exports rose from 115% in 1973 to 144% in 1982.<sup>12</sup> Particularly troublesome were the trends for the main Latin American borrowers. Brazil's and Argentina's external debt increased sixfold between 1973 and 1982, while Mexico's increased ninefold—all well above the general fivefold increase for NODC's as a whole.<sup>13</sup> Similarly, the ratio of debt to exports rose sharply for these three largest borrowers in the period 1973-1982: from 106.2% to 365.3% for Brazil, from 154.6% to 248.6% for Mexico, and from 140.8% to 353.5% for Argentina.<sup>14</sup>

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9. See Appendix, Table 1. The economic tables cited in the footnotes may be found in the Appendix at the end of this Article.

10. In 1981, the World Bank estimated that about 80% of the long-term external debt of NODC's was either owed by the state or guaranteed by its subdivisions, departments, or agencies and instrumentalities. World Bank, *World Debt Tables* viii (1983). By another estimate in late 1984, approximately 70% of the Latin American external indebtedness was owed by the public sector. See Rowe, *supra* note 2, at D8.

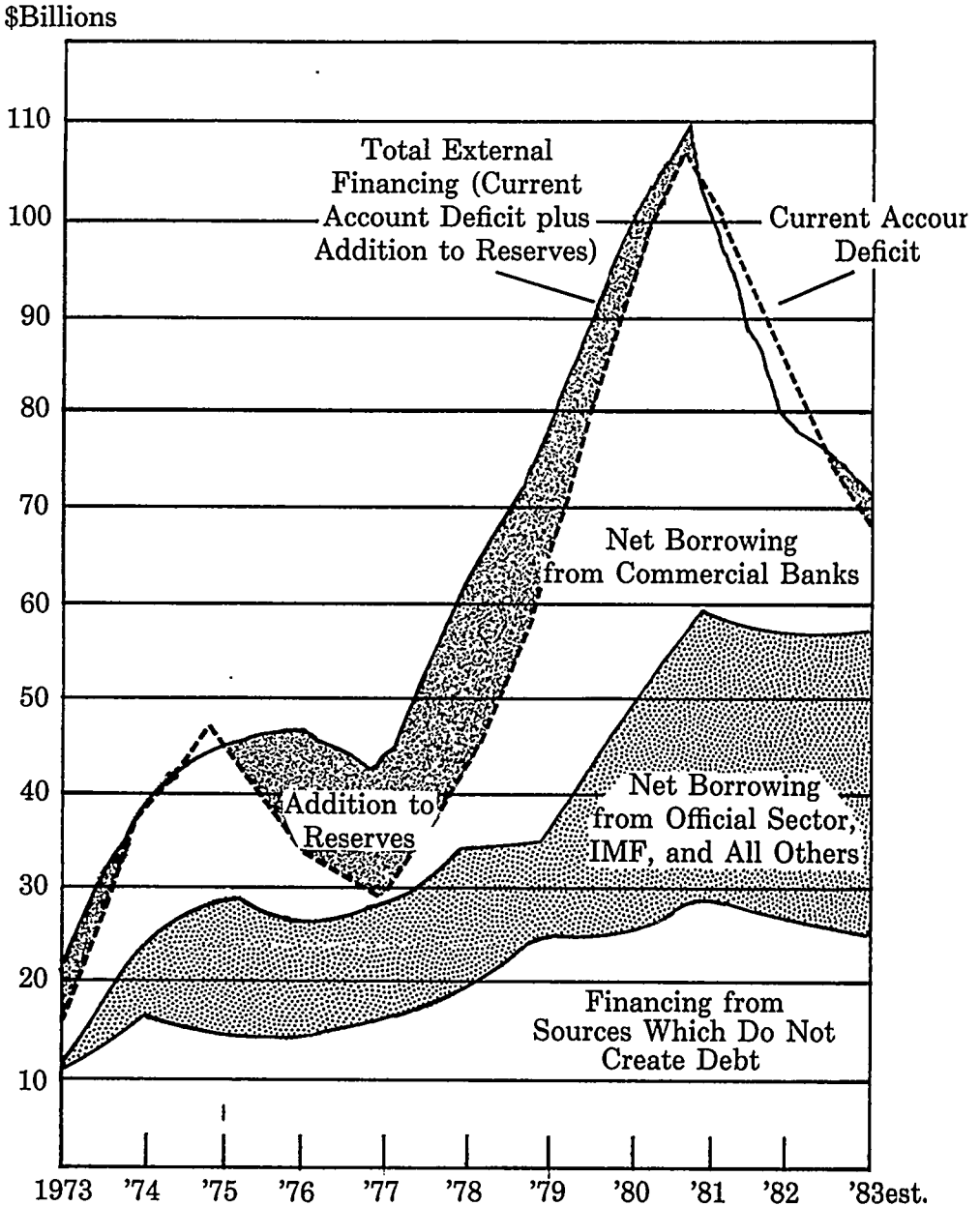
11. See Appendix, Table 2; W. Cline, *supra* note 6, at 2-3 (Table 1.1).

12. See Appendix, Table 2.

13. See Appendix, Table 3.

14. *Id.*

Chart 1  
Non-Oil Developing Country Sources  
of External Finance



Source: Citibank; Int'l Monetary Fund, World Economic Outlook.

This level of debt was, for many countries, imprudently large under the circumstances and reflected mistaken judgments both by the borrowing countries and the lending banks. Latin American NODC's, for their part, believed that their payment balances were temporary and that difficult policy adjustments restricting growth and domestic consumption could be avoided or postponed by foreign borrowing.<sup>15</sup> Foreign borrowing was an appealing substitute for currency devaluation and import restrictions, and in light of the brisk inflation of the 1970's, the real rates of interest (nominal interest rate minus rate of inflation) paid by these countries were minimal and in some years actually negative.<sup>16</sup> For these reasons, NODC's borrowed heavily in the 1970's, and their short-term growth continued, though typically at somewhat reduced rates.

For much the same reasons, the long-term prospects worsened: state enterprises grew accustomed to borrowing abroad, the elites continued their high level of import consumption, state enterprises and projects had insufficient incentives to economize, and the current account deficit increased each year. According to a recent Brookings Institution study by Thomas Enders and Richard Mattione, foreign financing in the 1970's enabled the Latin American countries to live beyond their means for ten years by covering the costs of balance-of-trade deficits, overappreciated currencies, and public sector deficits. Current account deficits rose from 2.2% of the GDP in 1971-1973 to 5.0% in 1980. In the same period (1970-1980), the average real exchange rate of Latin American currencies increased by 31%, and public sector deficits increased to between 5% and 8% of the GDP for the largest countries.<sup>17</sup> These payment imbalances were not temporary, and Latin American countries could not borrow indefinitely to cover them. The excessive borrow-

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15. See Crowe, *International Public Lending and American Policy*, in *Debt and the Less Developed Countries* 27-29 (J. Aronson ed. 1979); T. Enders & R. Mattione, *Latin America: The Crisis of Debt and Growth* 6-13 (1984); [Sec'y of Treasury] Regan, *The United States and the World Debt Problem*, *Wall St. J.*, Feb. 8, 1983, at 32, cols. 3-6.

16. Real interest rates in the United States from 1976 to 1980 were as follows:

<u>Year</u>	<u>Long-Term Debt</u>	<u>Short-Term Debt</u>
1976	2.3%	-0.2%
1977	1.5%	-0.5%
1978	0.9%	-0.2%
1979	0.7%	1.3%
1980	2.1%	2.1%

Int'l Monetary Fund, *World Economic Outlook* 120-21 (1984) (Tables 2.6 & 2.7).

17. T. Enders & R. Mattione, *supra* note 15, at 8, 65 (Table 1 & Appendix, Table B-6).

ing, it turned out, had been a miscalculation.

The borrowing countries could not have obtained these huge loans from their traditional sources—the IMF, the World Bank, and Western governments—because those sources had limited funds and imposed stringent guidelines and restrictions.<sup>18</sup> The sovereign borrowers, therefore, obtained most of their loans from private banks. The banks, in turn, were just as eager to make the large volume of loans as the countries were to take the money. Bankers viewed international lending as a profitable activity in the 1970's, and a number of financial cheerleaders, notably Walter Wriston of Citicorp, vociferously espoused the view that international lending was the wave of the future.<sup>19</sup>

One reason, no doubt, for the desire of banks to make these sovereign loans was the large pool of "petrodollars" (OPEC profits deposited in Western banks) they had available and the paucity of other profitable loan opportunities which could absorb those petrodollars. That is, the current account deficits of the NODC's had been matched or exceeded by huge surpluses for most of the OPEC states, which had deposited most of their revenues in U.S. and European banks. Conventional borrowers, such as individual mortgagors and businesses, could not absorb the enormous new supply of loanable funds, especially during the recession of 1974-1975. In order to maintain earnings on their large reserves of petrodollars, banks were happy to lend money to developing countries.<sup>20</sup>

It may be that these supply-side pressures were even more important than the demand-side pressures in explaining why so many lent so much to Latin American and other countries. One recent account of the crisis describes the leading international bankers as "travelling salesmen" or "hucksters" who persuaded countries to borrow enormous sums of money, to be provided by far-flung syndicates of banks, each contributing millions of dollars based on little more than telexes describing the deals.<sup>21</sup>

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18. See generally I. Friedman, *The World Debt Dilemma: Managing Country Risk* 27-50, 63-74 (1983).

19. See, e.g., Stabler, *Mideast Oil Money Proves Burdensome to Eurodollar Banks*, *Wall St. J.*, June 6, 1974, at 1, 29 (contrasting the caution of Chase Manhattan's David Rockefeller with the optimism of Walter Wriston).

20. See generally D. Delamaide, *Debt Shock: The Full Story of the World Credit Crisis* 34-37 (1984); Solomon, *Developing Nations and Commercial Banks: The New Dependency*, 12 *J. Int'l L. & Econ.* 325, 326-34 (1978).

21. D. Delamaide, *supra* note 20, at 43-45. Because huge syndicated loan deals had to be put together quickly, and because the banks generally relied on the lead bank's judgment,

Whatever the general validity of such an indictment, the bankers (and the bank regulators) made two very big mistakes. First, they underestimated the possibility that countries would overborrow and then default on their loans, or at least not be able to pay current principal and interest. Bankers told one another repeatedly that "countries don't go broke,"<sup>22</sup> but to the extent that failure to pay interest and principal payments is the same thing as being "broke," this view was oversimplified.

The second mistake was excessive concentration by the largest banks in loans to similarly situated sovereigns, an elementary failure to diversify their portfolio of risks. In 1979, the nine leading U.S. banks had on loan to the three main Latin American debtor countries (Brazil, Mexico, Argentina) more than 100% of their paid-in capital, and by the end of 1983 the figure for several of the banks exceeded 150%.<sup>23</sup> Had any one of those countries defaulted, the banks' shareholders would have lost much of their investment, and several banks might have become insolvent themselves. Yet the bank regulators—chiefly the Comptroller of the Currency and the Federal Reserve Board in the United States—did almost nothing about the bankers' chief mistakes until 1979, when they instituted a largely ineffectual system of hortatory country lending guidelines.<sup>24</sup> Not until 1983, under the threat of stringent congress-

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there developed a practice one executive called "receptionist banking"—"When you went out to lunch you could have told the receptionist to watch the telex and take \$5 million of any deal offered." *Id.* at 44-45.

22. See generally Schirano, *A Banker's Point of View, in A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* ch. 2 (W. Eskridge ed. 1985) (forthcoming) (personal account by an international banker).

23. See International Financial Markets Hearings, *supra* note 3, at 386 (statement of Richard Dale, Brookings Inst.). Exposure of eight leading U.S. banks as of December 31, 1983, was as follows:

Millions of Dollars in Loans

<u>Bank</u>	<u>Argentina</u>	<u>Brazil</u>	<u>Mexico</u>	<u>Venezuela</u>	<u>Loans as % of Capital</u>
Citicorp	1090	4700	2900	1500	154.3
Bank America	300	2484	2741	1614	116.7
Mfg'rs Hanover	1321	2130	1915	1084	200.3
Chase Manhattan	775	2560	1553	1226	136.5
J.P. Morgan	741	1785	1174	464	102.9
Chemical	370	1276	1414	776	136.0
Bankers Trust	230	743	1286	436	119.4
Continental Ill.	401	476	699	436	83.9

The Latin American Times, Apr. 16, 1984 (No. 58), at 8.

24. In 1979, the federal regulators created the Interagency Country Review Committee (ICERC), which was charged with administering a new system for evaluating country risk.

sional legislation, did the regulators propose mandatory rules to prevent banks from making too many ill-advised international loans.<sup>25</sup>

### *B. Debtor Country Vulnerability to Higher Interest Rates and Worldwide Recession, 1979-1982*

The level of debt for NODC's as a whole, and particularly for the leading debtor countries in Latin America, posed problems both for the debtor countries and for the international financial system because it represented a postponement of hard economic choices. Still, between 1976 and 1979, the debt situation appeared to be under control. Export growth of the leading debtor countries was sufficient to service their growing external indebtedness.<sup>26</sup> The

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The system had four elements: (1) assessing and reporting the country exposures of each bank to enable regulators to monitor such exposures; (2) evaluating the banks' internal systems for reviewing country risk with the aim of encouraging more systematic internal review of foreign lending; (3) classifying the credit risk of countries whose external payments had been (or were likely to be) interrupted; and (4) commenting on the risks associated with each bank's large exposures in particular countries, with the aim of encouraging portfolio diversification. International Financial Markets Hearings, *supra* note 3, at 53-54, 84-89 (statement of Paul Volcker). The object of this system was "to call significant exposures to the attention of senior management and boards of directors of the banks, to raise questions, and to force careful consideration." *Id.* at 54. However, the ICERC had virtually no effect (it appears) on the escalating foreign sovereign debt, in part because its guidelines were only hortatory, too timid, and too late in the cycle of lending.

25. In response to congressional dissatisfaction with previous efforts, the Federal Reserve Board, Comptroller General, and Federal Deposit Insurance Corporation submitted a "Joint Memorandum" on a "Program for Improved Supervision and Regulation of International Lending," reprinted in Proposed Solutions to International Debt Problems: Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs, 98th Cong., 1st Sess. 24-52 (1983). The Joint Memorandum proposed a five-point plan: (1) strengthening the existing program of country risk evaluation; (2) increasing disclosure of banks' country exposures; (3) establishing a system of special reserves for questionable foreign loans; (4) promulgating new rules for fee accounting; and (5) improving international financial cooperation. *Id.* at 25. Congress embodied most of the regulators' proposals in the International Lending Supervision Act of 1983, Pub. L. No. 98-181, 97 Stat. 1278, codified at 12 U.S.C. §§ 3901-3912. An excellent analysis of the Act and its regulations may be found in Lichtenstein, *The U.S. Response to the International Debt Crisis: The International Lending Supervision Act of 1983*, 25 Va. J. Int'l L. 401 (1985), reprinted in *A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* ch. 8 (W. Eskridge ed. 1985) (forthcoming).

26. Former Brazilian Planning Minister Mario Simonsen has suggested that so long as export earnings are growing at a higher rate than the interest rate, debt-servicing problems should not develop. M. Simonsen, *The Developing Country Debt Problem* 6 (1984); see W. Cline, *supra* note 6, at 7 (citing M. Simonsen, *The Financial Crisis in Latin America* (1983)). Cline notes that in the period 1973-1980, the interest rate averaged 10.2% while the growth rate of NODC exports averaged 21.1%. W. Cline, *supra* note 6, at 8; see Appendix, Table 5.

world of international debt changed dramatically after 1978, however. The second OPEC oil price shock placed new pressure on NODC current account balances and, more importantly, triggered severe deflationary policies, higher interest rates, and diminished trade in the Western industrial countries (chiefly the United States). Although, astonishingly, bankers were still scrambling to make NODC sovereign loans, the combination of higher oil prices, lower demand for the exports of developing countries, and higher interest rates after 1979 severely impaired the ability of many of the sovereign debtors to service their debts.

The NODC borrowers were particularly vulnerable in the post-1979 crisis because of the terms of their private bank loans. Sovereign loans from official sources (IMF, World Bank, Western governments) in the 1950's and 1960's came with constraining conditions, but also included concessionary terms such as below-market fixed-interest rates and easy repayment schedules over a long term. In the 1970's, NODC's found private banks to be more reliable sources of funds (without the conditions often attached to official loans), but the non-concessionary nature of their loan terms presented very substantial future risks for the heavily indebted countries.

First, and primarily, the private loans tended to carry floating-interest rates: the rates were periodically adjusted at one to two points above the London Interbank Offer Rate (LIBOR). Roger Kubarych of the New York Federal Reserve Bank estimates that international sovereign debt contracted at floating-interest rates constituted 70% of the total sovereign debt in 1983.<sup>27</sup> And the floating-rate debt was concentrated in a handful of countries: according to OECD calculations, Brazil, Mexico, Argentina, South Korea, and Chile owed 87% of the total floating-interest debt in 1983.<sup>28</sup> As a result, fluctuations in interest rates would be felt

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Thus, under Simonsen's standard, the debt-servicing burden of NODC's did not become a cause of concern until 1981-1982, when the world recession contributed to a sharp reduction in the rate of NODC export growth and high interest rates. This approach is not completely satisfactory, however, because it assumes that no new borrowing occurs in the given year. When the country is committed to borrowing more money each year, and the existing debt must be serviced at the current interest rate, an export growth rate exceeding the interest rate does not suggest that the country has no problems.

27. Kubarych, *The Financial Vulnerability of the LDC's: Six Factors, in A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* ch. 1 (W. Eskridge ed. 1985) (forthcoming).

28. 1983 OECD Survey, *supra* note 8, at 37-38.

quickly by the most heavily indebted countries. Second, most of the external debt was contracted in U.S. dollars, rather than in a diversified range of hard currencies, thus exposing the debtor countries to the risk that the dollar would prove unusually strong.<sup>29</sup> Third, much of the external debt was short-term. From 1972 to 1974, the typical maturity of NODC sovereign debt had gone up to ten to twelve years, but after 1974 the average maturities fell back to five to seven years, and fewer ten-year loans were obtainable after 1977.<sup>30</sup> The major borrowing countries had twice as much short-term debt as the average NODC.<sup>31</sup> One disadvantage of this increase in short-term debt was that when new loans were negotiated (or old loans renegotiated), the borrowing country would have to pay not only the going interest rate, but also the various fees attending such loans (commitment fees, participation fees, and, where a banking syndicate was involved, management fees).<sup>32</sup> As a result of the risk premium assessed by banks and of these various fees and commissions, the effective interest rate on these loans was sometimes as much as 4% above LIBOR.<sup>33</sup>

These risks materialized in the period 1979-1982, when the Western countries, led by the United States, responded to the second round of OPEC price increases by a monetary policy which made it substantially more difficult for the main NODC borrowers to service their external debts and to repay or renegotiate loans

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29. See *id.* at 39 (56% of LDC debt and 58% of debt-service payments were in dollars for 1981-1983); Mohl & Sobol, *Currency Diversification and LDC Debt*, Fed. Res. Bd. N.Y.Q. Rev., Autumn 1983, at 19, 19 & n.1 (although 10.6% of the overall international syndicated financing in 1980 was accomplished in currencies other than the dollar, only 1.4% of the syndicated loans to the five main NODC borrowers [Mexico, Brazil, Argentina, South Korea, and The Philippines] was made in such currencies).

30. Lichtensztein & Quijano, *The External Indebtedness of the Developing Countries to International Private Banks*, in *Debt and Development* 185, 208-09 (J.C. Sánchez Arnau ed. 1982). The debt obtained on the Eurocurrency market showed a remarkable shortening of maturities: while 62.5% of the loans to developing countries had maturities greater than seven years in 1974, only 8.6% had such maturities in 1977 (only 5.0% and 4.7% had such maturities in 1975 and 1976, respectively). *Id.* at 209 (Table 11).

31. See Appendix, Table 4.

32. See Lichtensztein & Quijano, *supra* note 30, at 214 (Table 13) (typical extra fees charged borrowers by commercial banks: commitment fee payable on that part of the loan which has not been made during the drawdown period, 0.5% of the loan amount per annum; participation fee to banks in the syndicate, 0.625%; management fee to the managing bank or agent, 0.375% plus \$10,000 per annum).

33. Lichtensztein & Quijano, *supra* note 30, at 212 n.2 (citing *Inter-American Development Bank, Latin America's External Indebtedness: Current Situation & Prospects* 25 (1977)).



when their terms expired.<sup>34</sup> The chief result of the new policies was that both nominal and real interest rates soared. Average market rates for new or rolled-over loans jumped to 13.0% in 1979, 15.4% in 1980, and 17.5% in 1981.<sup>35</sup> More important, as the rate of inflation fell after 1980, the real rate of interest soared, reaching 7.5% in 1981 and 11.0% in 1982.<sup>36</sup> Based only upon the interest rates that might have been expected from the period 1961-1980, William Cline estimates that real interest rates were 5.8% higher than expected in 1981 and 9.3% higher in 1982.<sup>37</sup>

A second consequence of these policies was appreciation in the value of the dollar—on the whole an unfavorable development for debtor countries that had to repay loans in dollars. The dollar appreciated by 11% in 1981 and 17% through November 1982. Though it lost some strength in 1983 it remained at levels well above those of the 1970's, and overall it appreciated against other "hard" currencies.<sup>38</sup> It is estimated that the dollar in February 1985, was over 50% stronger in comparison with other major foreign currencies than it was in mid-1980.<sup>39</sup>

A third, less direct result of the severe monetary policies of the Federal Reserve Board was a worldwide recession in 1980-1982. Real growth in the industrialized countries fell off in 1980-1982, which had a predictable effect on NODC exports.<sup>40</sup> Consequently, NODC export growth, which had averaged 8% in the 1970's, was only 1.8% in 1982.<sup>41</sup> Also, because commodity export prices were

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34. For background on the complicated decision to tighten U.S. monetary policy to combat inflation in 1979 and afterward, see Blustein, *Monetary Zeal: How Federal Reserve Under Volcker Finally Slowed Down Inflation*, Wall St. J., Dec. 7, 1984, at 1, col. 6.

35. See Appendix, Table 5. These market rates represent LIBOR plus one percent.

The average nominal rates of interest paid on all outstanding long-term external debt of NODC's increased from an aggregate of 4.5% in 1973-1977 to 8.5% in 1982. Int'l Monetary Fund, *World Economic Outlook* 173 (1982).

36. Overall, the real rate of interest on NODC indebtedness increased from an aggregate of -6% for 1973-1977 to an aggregate of +3% for 1981-1982, and went even higher in 1983-1984. W. Cline, *supra* note 6, at 11-12.

37. *Id.* "For the 1960's and 1970's real interest rates . . . averaged 1.66%. In 1981 this real rate was 7.46%, and in 1982 it reached 10.95%. Thus the excess of interest rates above the real level that might have been expected based on the past two decades was 5.8 percentage points in 1981 and 9.29 percentage points in 1982." *Id.* at 12.

38. Int'l Monetary Fund, *Annual Report* 1983, at 26-27 (1984) (Chart 10).

39. Pine, *Calls for Action: Rapidly Rising Dollar, Big Trade Deficit Stir More Pleas for Help*, Wall St. J., Feb-12, 1985, at 1, col. 6 (dollar has appreciated about 140% against the franc, 110% against the pound, 15% against the yen).

40. Int'l Monetary Fund, *World Economic Outlook* 170 (1983) (Table 1).

41. W. Cline, *supra* note 6, at 13.

more sensitive to this downward swing in the business cycle, NODC aggregate export prices fell in 1982 to 90% of their 1980 value, while import prices remained about the same (after fluctuating upward in 1981).<sup>42</sup>

In short, at the very time that debtor countries desperately needed strong export sales to pay the suddenly mounting costs of servicing their high-interest debt in overvalued dollars, their earnings were falling. The result of this dilemma, represented graphically in Chart 2, is that total debt and debt-servicing payments surpassed export growth after 1978. Between 1973 and 1977, the ratio of debt service-payments to exports of goods and services hovered around 15% for NODC's as a group; the figure shot up to 19% in 1978-1979 and reached 23% by 1982.<sup>43</sup> Again, the leading Latin American borrowers were significantly worse off: the ratio of debt service to exports in 1982 was 87% for Brazil, 59% for Mexico, and 103% for Argentina.<sup>44</sup> For these countries, export earnings were barely able to keep up with existing payment schedules in 1982.

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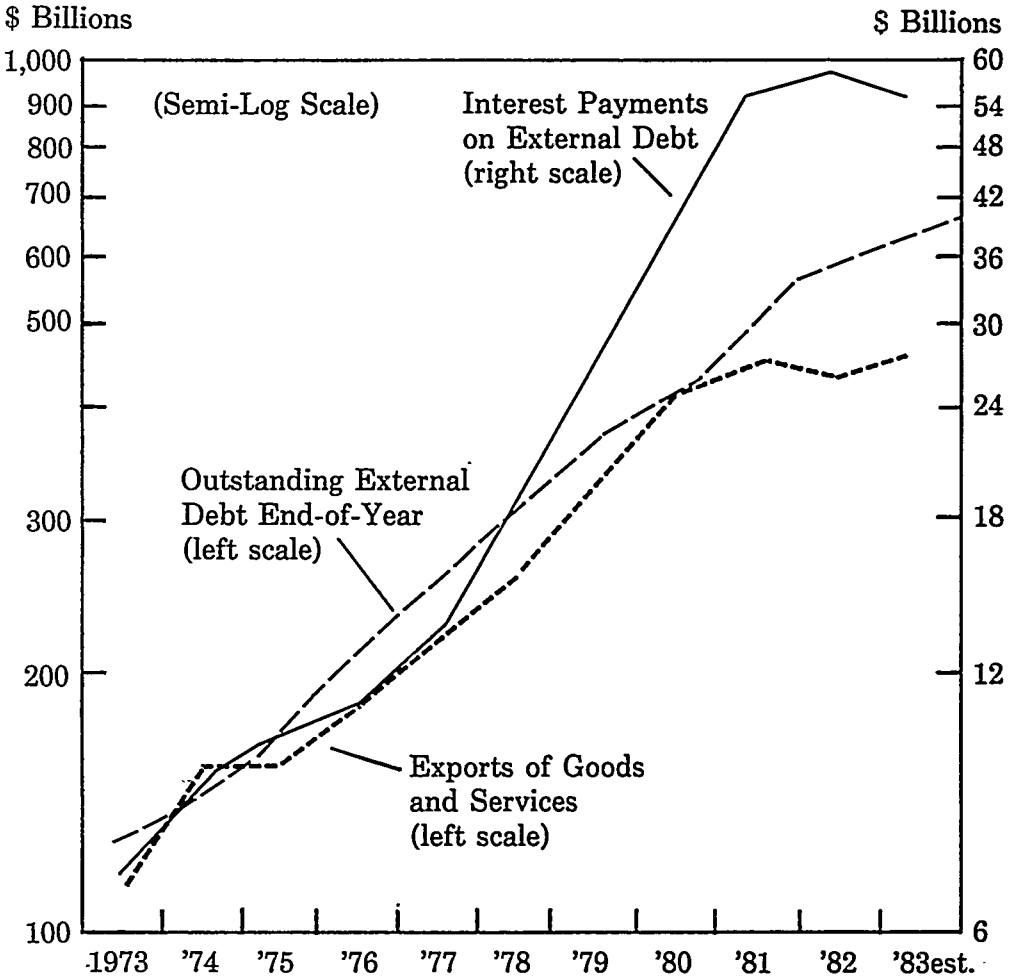
42. *Id.* at 12 (citing Int'l Monetary Fund, *International Financial Statistics* 56-57 (May 1983)).

43. See Appendix, Table 2.

44. See Appendix, Table 3.

Chart 2

Non-Oil Developing Country External Debt, Exports, and Interest Payments



Source: Citibank; Int'l Monetary Fund, World Economic Outlook.

Risky planning by both borrowers and lenders left the NODC's highly vulnerable to the problems of the early 1980's, though it is fair to say that few analysts predicted such a confluence of events in 1977. William Cline estimates that the NODC's as a group "lost approximately \$141 billion in higher interest payments, lower export receipts, and higher import costs as the consequence of adverse macroeconomic developments" after 1978.<sup>45</sup> Other analysts estimate that these countries lost another \$30 billion through their failure to diversify their currency repayments.<sup>46</sup>

Not surprisingly, the impact of the external shocks differed from country to country. In their study of the debt crisis in Latin America, Thomas Enders and Richard Mattione conclude that the cumulative negative shocks of 1979-1982 were enormous for Brazil (\$48.5 billion) and substantial for Argentina (\$13.4 billion), Colombia (\$6.8 billion), and Chile (\$4.8 billion). Because Peru, Mexico, and Venezuela were on balance oil-exporting nations in 1979-1982, however, Enders and Mattione conclude that they incurred "positive shocks" (they were better off, considering the higher oil prices, higher interest rates, and recessionary world market).<sup>47</sup> Although Bela Balassa and Desmond McCarthy found small negative shocks for Mexico and Peru in a similar study,<sup>48</sup> the point is that while Mexico, for example, was much less severely impacted by the various external shocks than Brazil, to take the worst case, it was

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45. W. Cline, *supra* note 6, at 13. The specific line items, according to Cline's calculations, are:

<u>Effect</u>	<u>Amount</u>
Real interest rate (1981-1982) in excess of 1961-1980 average	\$ 41 billion
Terms-of-trade loss, 1981-1982	\$ 79 billion
Export volume lost because of recession	<u>\$ 21 billion</u>
Total:	\$141 billion

Id. (Table 4).

46. Mohl & Sobol, *supra* note 29, at 20.

47. T. Enders & R. Mattione, *supra* note 15, at 16-19 (Tables 3 & 4).

48. B. Balassa & D. McCarthy, *Adjustment Policies in Developing Countries 1979-82* (1983), conclude that "[t]he benefits Mexico derived from improvements in its terms of trade, resulting from higher petroleum prices, were offset by the adverse effects of the slowdown of world demand for its exports." Enders and Mattione, however, conclude that Mexico suffered no adverse effects in its non-oil exports. (Both studies found substantial adverse effects as a result of higher interest rates.) The different conclusions with regard to Peru are minor: Balassa and McCarthy found no adverse shocks in 1979-1980 and a 2% shock in 1981, while Enders and Mattione concluded that Peru came out slightly ahead in the period 1979-1982.

nonetheless Mexico, and not Brazil, which found itself unable to service its debt in August 1982. The explanation for the debt crisis rests, it would appear, not only with the large-scale lending of the 1970's and the unanticipated cumulative shocks of 1979-1982. One must also look at the policy responses of the debtor countries to the last series of oil price, interest rate, and trade shocks.

*C. Debtor Country Policy Errors Exacerbating the Debt-Servicing Problem, 1979-1982*

Although the banks remained willing, even anxious, to lend them ever more money (until 1982), NODC's facing substantial adverse external shocks after 1979, according to classic adjustment theory, should have adopted policies to attract hard currency that could be used to service the external debt. Even those countries that had benefited from the oil price increases needed to avoid policies that could have turned a favorable situation into a disaster.<sup>49</sup>

First, countries should generally avoid overvalued exchange rates, namely official rates that do not reflect the value the currency brings on the free market. Overvalued exchange rates discourage exports by making them relatively more expensive and encourage imports by making them relatively less expensive. The result harms both trade and current account balances. Overvalued exchange rates also encourage capital flight: if the NODC's currency is not really worth the official rate, the holders of that currency will want to convert their money into a hard, more stable currency.

Second, a classic adjustment policy would require that borrowing countries reduce or eliminate special subsidies, state enterprise deficits, and trade restrictions, because they impede the operation of free markets and efficient allocation of productive efforts. To the extent that Latin American industries were "protected" by means of subsidies, and to the extent government enterprises were unprofitable and suffered losses, NODC governments were probably not working in the most effective way to promote exports or reduce dependence on imports.

Third, vulnerable debtor countries should apply monetary and

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49. For a discussion of the policy alternatives open to NODC's confronted by adverse external shocks, see B. Balassa & D. McCarthy, *supra* note 48, at 6-8; Int'l Monetary Fund, *supra* note 38, at 42-43; de Vries, *Restructuring Debtor Economies: Long-Term Finance*, 38 J. Int'l Aff. 31, 34-36 (1984).

fiscal policies to control inflation. Specifically, public sector deficits must be reduced and expansion of the money supply restrained. Inflation, like overvalued currency, tends to harm the terms of trade by rendering exports more costly abroad and foreign imports less expensive to domestic consumers. Moreover, where domestic interest rates on savings are lower than the rate of inflation—a common consequence of insufficiently restrictive monetary and fiscal policies—savings are reduced and capital will be exported to safer and more profitable currencies. Again, investment, highly dependent on the availability of domestic capital, would be impeded.

Adjustment efforts differed from country to country. Countries such as Mexico, Venezuela, and Argentina followed very poor policies (according to traditional adjustment theory), which induced or facilitated more than \$40 billion in capital flight between 1979 and 1982.<sup>50</sup> Brazil and Peru made the greatest adjustment efforts, but were nevertheless unsuccessful in controlling runaway inflation.<sup>51</sup> When the banks curtailed their lending to the region in 1982,<sup>52</sup> the international debt “crisis” was triggered.

That Mexico, which suffered less than most other Latin American countries from the external shocks of 1979-1982, was the first to confess inability to service its debts is explained by the policies its government followed. Because Mexico had become a net oil exporter by the end of the 1970's and foresaw (incorrectly) continued increases in the price of oil, the Mexican government followed a highly expansionist policy. The peso was deliberately overvalued until 1982, and public sector deficits were almost a quarter of the

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50. According to T. Enders & R. Mattione, *supra* note 15, at 20 (Table 5), Argentina suffered a negative shock of \$13.4 billion between 1979 and 1982. That is, higher oil payments, higher interest rates, and the trade recession cost the country \$13.4 billion in that period. This negative shock was compounded by capital flight of \$14.3 billion. Mexico felt a positive shock of \$11.7 billion, which was erased by capital flight amounting to \$18.7 billion. Venezuela's positive shock (\$19.1 billion) was not completely offset by capital flight of \$13.0 billion.

Roger Kubarych estimates that 40% of all bank lending from 1979 to the end of 1981 (\$40-\$50 billion) may have ended up as capital outflows from the debtor countries. Kubarych, *supra* note 27.

51. T. Enders & R. Mattione, *supra* note 15, at 22, argue that “internal causes of the [international debt] crisis were more significant than were external causes.” Although this thesis is far from accepted wisdom, the internal factors were critical, for they contributed to bank skepticism about Latin American lending.

52. Commercial bank lending to developing countries fell by \$23 billion in 1982, with the main Latin American borrowers (Mexico, Brazil, Argentina, Chile) being hit hardest. See World Bank, *Debt and the Developing World: Current Trends and Prospects x* (1984) (abridged version of World Debt Tables, 1983-84 edition).

GDP.<sup>53</sup> Although the economy grew rapidly in this period, these expansionist policies yielded predictably harmful side effects. Inflation ran out of control, and real interest rates were negative, leading to a massive capital flight from pesos into more stable currencies. More than \$17 billion left the country in 1981-1982, contributing nearly one-fifth of the total external debt. As a result of the domestic inflation and the overvalued peso, non-oil exports were crippled and imports soared. The enormous government deficit, based upon the prospect of continuing oil price increases, had mortgaged the country.<sup>54</sup>

Deteriorating oil market conditions in 1981-1982 alerted the Mexican government to the fact that it had overextended itself. In February 1982, the government devalued the peso and made an effort to reduce the federal deficit. Price controls were tightened. Flexible interest and exchange rate policies were instituted to prevent new overvaluation of the peso. Notwithstanding these efforts, inflation continued at an alarming rate and the flow of international loans dried up. Mexico was unable to meet its scheduled payments in August 1982, because of its payments deficits, capital flight, and a new-found reluctance of foreign banks to continue making loans based upon the prospect of future oil price increases. The United States and the Bank for International Settlements (BIS) extended Mexico emergency credits in August, and in December the IMF agreed to a loan of SDR 3.61 billion (\$3.86 billion).<sup>55</sup> In return, Mexico agreed to reductions in the public sector deficit and the current account deficit and to a greater effort against inflation. The commercial banks formally agreed to \$5 billion in new loans in March 1983, and much of the Mexican public

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53. See Appendix, Table 6.

54. The consequences of Mexico's development policies from 1979-1982 are explored in more detail in Buirra, *The Exchange Crisis and the Adjustment Program in Mexico*, in *Prospects for Adjustment in Argentina, Brazil, and Mexico: Responding to the Debt Crisis* 51 (J. Williamson ed. 1983). See also T. Enders & R. Mattione, *supra* note 15, at 28.

55. T. Enders & R. Mattione, *supra* note 15, at 28. "Special Drawing Rights" (SDR's) are the "currency" of the IMF. They consist of a weighted average of several key currencies and are, essentially, bookkeeping entries. Each member country in the IMF contributes a "quota" of its own currency, thereby creating a pool of assets that the IMF can lend to countries experiencing balance-of-payments difficulties. On demand, a member of the Fund may swap its own currency (up to its quota) for SDR's or hard currencies. If the member is willing to agree to an IMF readjustment program, it can obtain funds up to several times its quota. See generally I. Friedman, *supra* note 18, at 41, 63; World Bank, *Annual Report* 185-86 (1983).

debt was rescheduled in the summer of 1983.<sup>56</sup> A second major rescheduling of a substantial part of the Mexican external debt occurred in the summer of 1984, when Mexico was rewarded for progress against inflation with longer maturities for its outstanding loans and with interest rate concessions.<sup>57</sup>

Argentina did not fare as "well." Highly sensitive to external markets and terms of trade, Argentina nevertheless followed, almost in textbook fashion, policies which aggravated the negative shocks caused by oil price increases, higher interest rates, and diminished trade.<sup>58</sup> By 1982, a severely overvalued peso, public sector deficits exceeding 14% of the GDP, triple-digit inflation, and severe negative real interest rates left Argentina with a \$30 billion foreign debt (most of it due in 12 months), massive capital flight and current account deficits, declining government revenues, and bankruptcy and illiquidity in the foundering private sector.<sup>59</sup>

Some efforts were made after March 1981 to ameliorate the problem—including devaluations of the peso and reductions in the current account deficit and the level of wage increases—but they proved unavailing in light of political instability and the war with Great Britain.<sup>60</sup> The Falklands-Malvinas War not only contributed to the government deficits and inflation, but undermined the confidence of Western bankers in Argentina and its ability to manage its own affairs. When foreign bank funds dried up, Argentina was forced to ask for relief. Argentina obtained from the IMF a loan of SDR 2.02 billion (\$2.16 billion) in January 1983, conditioned upon an IMF adjustment program to reduce government deficits and in-

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56. Details of the 1982-1983 restructuring of Mexico's external debt may be found in J. Kraft, *The Mexican Rescue* (1984). See also Mudge, *Sovereign Debt Restructure: A Perspective of Counsel to Agent Banks, Bank Advisory Groups and Servicing Banks*, in *A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* ch. 4 (W. Eskridge ed. 1985) (forthcoming).

57. See generally Sesit & Frazier, *Mexico, Foreign Banks Agree to Work Out Plan to Reschedule Several Years of Debt*, *Wall St. J.*, June 6, 1984, at 37, col. 2; Tapia, *Mexico's Debt Restructuring: The Evolving Solution*, 23 *Colum. J. Transnat'l L.* 1 (1984); Witcher, *Banks Give Ground on Mexico Debt Terms in Exchange for Close Watch on Economy*, *Wall St. J.*, Aug. 30, 1984, at 23, col. 1.

58. Argentina's problems are explored in more detail in Pastore, *Progress and Prospects for the Adjustment Program in Argentina*, in *Prospects for Adjustment in Argentina, Brazil, and Mexico: Responding to the Debt Crisis* 7 (J. Williamson ed. 1983). See also W. Cline, *supra* note 6, at 268-73.

59. See Appendix, Table 6.

60. See T. Enders & R. Mattione, *supra* note 15, at 21-22, 26; Pastore, *supra* note 58, at 11.



flation. Commercial banks extended a \$1.1 billion loan, which they supplemented with more new money later in 1983.<sup>61</sup> Argentina had problems in meeting the IMF program goals in 1983, and in 1984 fell into arrears on its servicing payments. After months of difficult renegotiations, Argentina reached tentative new loan agreements with the IMF and with its bank advisory group in late 1984.<sup>62</sup>

Most Latin American countries adjusted to the external shocks better than Mexico and Argentina did, but after the Falklands-Malvinas War and the Mexican crisis of August 1982, the banks further reduced their lending in the entire region. Outstanding U.S. bank loans in the region increased only \$1.2 billion in the last six months of 1982, compared with \$7.3 billion in the latter half of 1981.<sup>63</sup> This psychological chain reaction, tied to the notorious herd instinct of banks, precipitated a series of Latin American reschedulings in 1983, the chief one being that for Brazil.

Brazil was a NODC that made an effort to adjust to the substantial external shocks it suffered, though its efforts, and its success, were only partial. While a proposed stabilization program was never implemented, and the government followed an inflationary, high-growth policy through most of 1979, in late 1979 and in 1980, Brazil devalued the cruzeiro, abolished subsidies to domestic industries, and followed restrictive monetary and fiscal policies. By 1981 these policies had brought growth to a halt, but they did discourage the corrosive capital flight that had afflicted Mexico.<sup>64</sup> On the other hand, the high public sector deficits contributed to an annual inflation rate exceeding 100% and to negative real interest rates, which discouraged domestic savings and investment.<sup>65</sup> In short, Brazil was able to reduce the effects of the severe external shocks, but was not able to eliminate them.

In part because of the Mexican crisis, Brazil after September 1982, was unable to obtain enough new loans to cover its current

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61. See T. Enders & R. Mattione, *supra* note 15, at 26-27.

62. See Pine, *Argentina Gets Loan From IMF of \$1.66 Billion*, *Wall St. J.*, Dec 31, 1984, at 12, col. 1; Rowe, *Bankers Said Skeptical of Argentine Plan*, *Wash. Post*, Dec. 4, 1984, at E1, col. 2.

63. See W. Cline, *supra* note 6, at 18.

64. See T. Enders & R. Mattione, *supra* note 15, at 23-24; B. Balassa & D. McCarthy, *supra* note 48, n.p. (table entitled "Brazil: Indicators of External Shocks and Structural Adjustment 1978-82"). See generally Diaz-Alejandro, *Some Aspects of the 1982-83 Brazilian Payments Crisis*, 1983 *Brookings Papers on Economic Activity* 515 (excellent analysis of economic background).

65. See Appendix, Table 6.

account deficit and to service its existing debt. Thus in early 1983, Brazil also requested a rescue package from its official and private lenders. The IMF extended SDR 4.955 billion (\$5.3 billion) in return for the government's commitment to encourage export growth, reduce current account deficits, and slow inflation. The private banks agreed to new loan commitments of \$4.4 billion and to a rescheduling of \$4.7 billion due in 1983, contingent upon Brazil's following the IMF program.<sup>66</sup> In fact, it soon became apparent that Brazil would not be able to meet those IMF conditions, and a milder program (plus \$6.5 billion in new loans from commercial banks) was agreed to in late 1983.<sup>67</sup> A new longer term rescheduling of Brazil's external debt was negotiated by early 1985, but the package is still tentative because of Brazil's failure to meet IMF goals.<sup>68</sup>

By mid-1983, the external debts of Peru, Venezuela, and Chile were also being rescheduled as part of this financial chain reaction; previous renegotiations continued in Bolivia, Costa Rica, Ecuador, and Nicaragua.<sup>69</sup> In the cases of Venezuela (which enjoyed net benefits from the external shocks of 1979-1982 but failed to manage them to create permanent growth opportunities), and Peru (which had few if any net adverse shocks until 1982 and was trying to

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66. See Bacha, *The IMF and the Prospects for Adjustment in Brazil*, in *Prospects for Adjustment in Argentina, Brazil, and Mexico: Responding to the Debt Crisis* 31, 32-33 (J. Williamson ed. 1983); *Fund Approves Package of Assistance for Brazil Totaling SDR 5 Billion*, IMF Survey 65 (Mar. 7, 1983).

67. See Gilpin, *Brazil Gets \$6.5 Billion in New Loans*, N.Y. Times, Jan. 28, 1984, at 39, cols. 3-5.

68. Kristoff, *Banks and Brazil Resolve Big Issues*, N.Y. Times, Feb. 2, 1985, at 34, col. 4.

69. For these countries, the pattern was similar to that in Argentina, Brazil, and Mexico: external shocks; failure to cope; resultant inflation and (sometimes) capital flight; drying up of new bank credit; confession of inability to service debts; a rescue package by the IMF, the banks, and (sometimes) the U.S. government. Chile was a severe disadjuster, following a highly expansionistic growth policy until 1981, fueled mainly by foreign debt (since domestic saving was very low). Highly overvalued exchange rates led to capital flight and undermined the country's export position. As a result, credit dried up in 1982 (and this would probably have occurred even without the Mexican and Argentine problems), and agreements for new loans and rescheduled debt were made with the IMF and the banks in 1983. See T. Enders & R. Mattione, *supra* note 15, at 25-26.

Although Peru had small positive results from the external shocks, they were overwhelmed by other adverse developments in 1982, including excessive public sector deficits and the resulting inflation, shortfalls in the expected levels of exports caused in part by natural disaster (El Nino), and limited availability of new credit. In the summer of 1983, Peru obtained \$830 million in commercial bank financing (new money plus rescheduled debts), together with \$1 billion through a Paris Club rescheduling of official indebtedness. See *id.* at 29.

adjust at least in part), the early restructurings were precipitated by the abrupt cut-off of new funds to the region rather than by any urgent need in 1982 to reevaluate their particular external debt levels.<sup>70</sup> Just as decisively as they had earlier encouraged almost limitless sovereign borrowing, the banks in 1982-1983 grew nervous and began a long cycle of renegotiations and adjustment programs as prerequisites for new money in most parts of the suddenly less creditworthy Latin American region.

Under the emerging economic policy analysis recounted above, there was no single "cause" for the debt problem. Among the contributing causes were the external shocks (oil price increases, high real interest rates, deterioration in terms of trade and trade levels); short-sighted planning and risk assessment by the borrowing countries, the banks, and the people who were supposed to have been regulating the banks; poor policy responses by some of the debtor countries to the external shocks after 1979; and a herd-like crisis mentality that gripped bankers after the first few countries faltered in their debt servicing.

## II. POLITICAL, INSTITUTIONAL, AND ECONOMIC STRUCTURES CONTRIBUTING TO THE DEBT PROBLEM

The shocks-and-mistakes explanation for the debt crisis set forth above is in many ways a satisfactory one. If the external shocks had not been so severe and cumulative, or if borrowers, lenders, and regulators had behaved differently, then the emergency might have been averted. Such an explanation has a number of shortcomings, however. One is that it is ahistorical. If one's historical frame is broader than the last ten years, it is easy to see that the current problem is not unique.<sup>71</sup> Latin American countries, for example, were regular borrowers on the European bond

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70. "To be sure, there was . . . underlying deterioration in the debt-servicing capacity of many of the Latin American countries in 1982, largely because of the depressed level of their exports (which fell from \$97 billion in 1981 to \$87 billion in 1982 for the region as a whole). Nonetheless, the sharp psychological shift aggravated debt problems and at least in some cases (especially Peru) probably precipitated debt-servicing disruptions that otherwise could have been avoided." W. Cline, *supra* note 6, at 18 (citations omitted). See also T. Enders & R. Mattione, *supra* note 15, at 27, 29.

71. Charles Kindleberger, for example, notes that manias of foreign lending occurred in 1808-1810, 1823-1825, 1856-1861, 1885-1890, 1910-1913, and 1924-1928, and that all of these manias were stimulated by an external economic crisis that led to a euphoric period of lending, which in turn snapped back in a series of revulsions. C. Kindleberger, *Manias, Panics and Crashes* (1978).

market after 1820. Though they defaulted with regularity during trade recessions, they continued to receive loans on a large scale until the 1930's.<sup>72</sup>

There is nothing new about international debt crises. Indeed, the debt crises of the last thirty years have in at least one respect been less alarming, because they have generally not resulted in sovereign defaults. It appears that structural incentives regularly lead certain countries to overborrow and banks to overlend. The present problem, however, is in many respects unique. To understand its uniqueness and its origins, one must examine not only the shocks and mistakes of the last ten years, but also the massive reordering of the world's politics, economics, and finance after World War II.

Another shortcoming of the short-term analysis of the crisis is that it begs a number of questions by implicitly attributing the crisis to fortuity (external shocks) and error (policy mistakes). As history, this sort of approach requires elaboration. Why do large groups of sophisticated and intelligent people make such enormous "mistakes"? The modern historian is reluctant to believe them idiots or blunderers and, therefore, seeks an explanation for systematic errors in the structures and institutions of society. Professor Carlos Diaz-Alejandro has recently argued that the shocks-and-mistakes explanation is an unfair, post hoc attribution of error to banks and countries, for no reasonable observer in 1980-1981 would have predicted the "crisis" of 1982-1984.<sup>73</sup> This argument may go too far (there were actually a number of Cassandras warning of the danger before 1981), but it is historically acute in suggesting that structural reasons, rather than isolated mistakes, gave rise to the amplitude of the problem. To what extent were the external shocks truly fortuitous? Why have Latin American countries fallen into illiquidity while other NODC's have not? While individ-

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72. Thus, £21 million was on loan to the newly independent Latin American states by 1825, and the foreign indebtedness continued to grow during the nineteenth century (generally in the form of bonds, not bank loans). Despite regular defaults on the debt (especially a massive one in the 1870's), British investment in Latin America stood at £179.5 million in 1880 (£123 million invested in state bonds) and £995.3 million in 1913 (£314.3 million in state bonds). Overall, Latin America has been the largest consumer of industrial country capital in both the nineteenth and twentieth centuries. See Corm, *The Indebtedness of the Developing Countries: Origins and Mechanisms*, in *Debt and Development* 14, 29-35, 45 (J.C. Sánchez Arnau ed. 1982) (Table V). For a detailed discussion of the history of lending to Latin America, see generally R. Conde, *The First Stages of Modernization in Latin America* (1974); J. F. Rippy, *British Investment in Latin America, 1822-1949* (1959).

73. Diaz-Alejandro, *Latin American Debt: I Don't Think We Care in Kansas Anymore*, 1984 *Brookings Papers on Econ. Activity* 335, 336-49.

ual events may have an adventitious quality (*e.g.*, the OPEC price increases), the modern historian finds patterns where the traditional historian or the ahistorical analyst would see accidents. Even without the accumulation of external shocks, one might doubt that some reckoning would not have occurred.

Specifically, the argument of Part II is that structural weaknesses of Latin American politics (mainly, uncritical dedication to growth, but without the ability to make hard decisions in support of long-term growth), together with historical changes in international financing, led to a great mania of sovereign lending after the late 1960's, followed quite inevitably by a revulsion when external events revealed vulnerability. Because of the unique nature of international sovereign lending and of the cooperative mechanisms to deal with the problem collectively, however, the revulsion did not lead to a great panic or crash, but it has posed a continuing problem which private and public institutions are now struggling to resolve. Some kind of crisis, in short, was inevitable. Although its timing and some of its dimensions have been affected by the external shocks, the debt problem is the result of colliding structural changes in Latin American development strategies, the business of international lending, and its regulation or lack thereof.

#### *A. The Politics of Latin American Development and The Ideology of Growth*

Through most of the nineteenth century, the newly independent Latin American states were socially and politically dominated by oligarchies derived from the agrarian, landowning class of the colonial period. Socially, most of the countries were authoritarian, elitist, hierarchical, and corporatist.<sup>74</sup> The Church, the military, and the landowners were sharply differentiated from the bulk of the population and ensconced in power. Although most of the Latin American states were nominally democracies in the nineteenth century, political power rested with bureaucracies and executives

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74. Major sources for my discussion of Latin American socio-political evolution are D. Palmer, *Peru: The Authoritarian Tradition* 26-33 (1980); Wiarda & Kline, *The Latin American Tradition and Process of Development*, in *Latin American Politics and Development* 1 (H. Wiarda & H. Kline eds. 1979).

The basic point of Wiarda and Kline's study is that Latin American society has evolved in fundamentally different ways from North American society since the seventeenth century. The following dichotomies, apparent since the seventeenth century, characterize the contrast:

that protected the interest of the elites. Economically, the countries imported manufactured and luxury goods, and exported primary commodities. Foreign debt was incurred mainly to support consumption by the elites, major government projects, and military ventures.

Many of the Latin American states defaulted on their foreign debts in the 1870's, marking in some ways a convenient starting point for the present analysis. In the hundred years after 1870, the main Latin American countries seriously devoted themselves to growth. Three periods of change are identified and characterized in Chart 3.<sup>75</sup>

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	<u>Latin America</u>	<u>North America</u>
[Political]	Authoritarian, absolutist, centralized, corporatist	More liberal, early steps to representative rule
[Religious]	Catholic and orthodox	Protestant and pluralist
[Economic]	Feudal, mercantilist, patrimonialist	Capitalist and entrepreneurial
[Social]	Hierarchical, two-class, stratified, rigid	More mobile and multiclass
[Educational & Intellectual]	Scholastic, rote memory, deductive	Empirical, scientific, inductive

Id. at 23 (Table 2.1).

75. Chart 3 is based in large part on the synthetic socio-political analysis found in T. Skidmore & P. Smith, *Modern Latin America* 46-70 (1984) (especially Table 2.1), and G. Wynia, *The Politics of Latin American Development* (2d ed. 1984).

## Chart 3

## Periods of Growth and Development in Latin America

	<u>Growth Philosophy</u>	<u>Social Forces</u>	<u>Political Patterns</u>
Period I 1870's-1930	Primary commodity export	Modernization of some elites; rise of entrepreneurial middle sector; creation of a working group in cities	Either oligarchic democracy or rule by <i>caudillos</i>
Period II 1930-1960's	Horizontal import substitution, especially in larger states	Establishment of entrepreneurial and technocratic elites; unions; embourgeoisement of the military and the Church	Cycle of democracy and military rule
Period III 1960's-1980's	Variety of strategies: socialism, vertical and horizontal import substitution, and export expansion	Sharpening of class conflict and population pressures; increasing dilemmas of growth and justice issues	Bureaucratic authoritarian, with trend to democracy 1979-1985

1. *The First Period: 1870's-1930*

Change came slowly in the first period. A modest middle class, consisting of merchants, bureaucrats, and craftsmen, existed in the Latin American countries in the nineteenth century, but on the whole it was conservative, dependent on the state, and nondynamic because it was tied to the agrarian commodity export economy of the *latifundia* (large estates). In Argentina, Brazil, and Chile, the old landed wealth and the newer commercial wealth

joined forces to produce stable oligarchic rule from 1870 to 1930. Other countries, most notably Mexico and Venezuela, saw *caudillos* (military dictators) seize power for long stretches. Both types of leaders, however, introduced an improved infrastructure and some industry.<sup>76</sup> The purpose was to modernize society, to make it more like the powerful and wealthy societies to the North. Modernization was for the most part imported from the United States and Europe and was both cause and incentive for an expansion of the countries' basic commodity exports: coffee (Brazil, Colombia), bananas (Central America), meat and wool (Argentina), and even guano (Peru). Modernization, in turn, generated new social forces—including entrepreneurs in both agriculture and industry and a working class.

The gradual social diversification of the Latin American countries had some effect on both the politics and economic programs of those countries. Politically, the middle class upset the oligarchical, corporatist rule of the nineteenth century but did not necessarily displace it. That is, the agrarian oligarchs who had long ruled these countries were not eager to relinquish power to middle-class coalitions and typically had staunch allies within their respective military structures. On the other hand, the needs and demands of a larger middle-class and working-class population could not be lightly ignored. The typical political strategy was co-option of the middle sectors by the existing government: if the middle groups would support the oligarchy, government would be in some measure responsive to their needs.

## 2. *The Second Period: 1930-1960's*

The worldwide Depression in the years after 1929 was a major turning point because it exposed the weaknesses of the oligarchic policies: as the prices of primary commodities plummeted in the 1930's, opportunities for growth dissipated, and existing oligarchic regimes were supplanted. Understanding the political, social, and economic forces waxing during this second period of development (1930-1960's) is critical to an understanding of the origins of the debt problem of the 1980's.

Politically, this second period in Latin America was one of crisis

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76. On Latin American modernization before 1930, see generally R. Conde, *supra* note 72; D. Palmer, *supra* note 74, at 18-67 (emphasis on Peru, but general analysis of Spanish America as well).

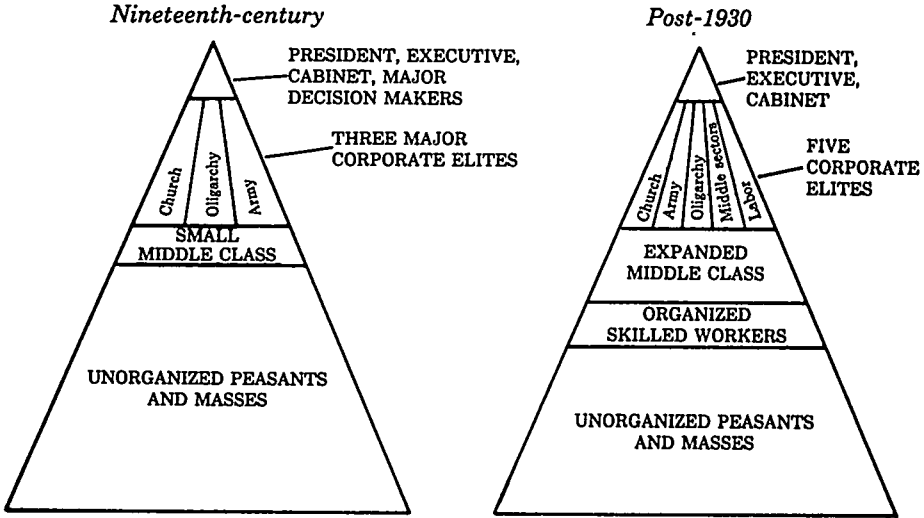


and transition away from the relative stability of oligarchical rule, which had been discredited.<sup>77</sup> There was a political lacuna, filled at first in some countries (Chile, Mexico, Uruguay, Venezuela) by entrepreneurial middle class democracy, and in other countries (Brazil, Argentina, Cuba, Dominican Republic, Honduras, Nicaragua, Paraguay, Guatemala) by dictators whose state-building efforts were influenced by modernization aspirations. These modernization policies, discussed below, ensured the permanent political significance of the entrepreneurial middle class and workers. As Chart 4 illustrates, five corporate elites—the large landowners, the military, the Church, the entrepreneurial middle class, and the unions—were the socially and politically relevant ones in the period after 1930. (The post-1930 socio-political structure is only an expansion of the nineteenth century hierarchy.) These groups vied for control of power and policy, but no one group or cluster of groups was able to preserve lasting domination. As a result, the relative political stability of oligarchic rule (1870-1930) gave way to instability after 1930.

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77. The discussion in text is based upon tables (developed by Dr. Riordan Roett, Ms. Stephanie Humbert, Ms. Abby Tabb, and me) which summarize the main political events in selected Latin American countries. The tables, developed in connection with Roett, *The Foreign Debt Crisis and the Process of Redemocratization in Latin America*, in *A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* ch. 9 (W. Eskridge, Jr. ed. 1985) (forthcoming), appear as Appendix C to that book [hereinafter cited as *Latin American Political Tables*]. For comparative socio-political analyses of individual countries and the countries as a group, see, e.g., G. Wynia, *supra* note 75; Wiarda & Kline, *supra* note 74.

Chart 4  
*Latin American Social Stratification*



Source: Wiarda & Kline, *The Latin American Traditional Process of Development*, in *Latin American Politics and Development* 32 (H. Wiarda & H. Kline eds. 1979).

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For most of the Latin American countries, politics during this second period was cyclical, alternating between populist democracy and authoritarian (usually military) rule.<sup>78</sup> With an established landowning class, a strong military, and a vigorous entrepreneurial middle class, Brazil was a classic example of this cycle.<sup>79</sup> Brazil's oligarchic First Republic lost its legitimacy when its commodity-export policy was crushed by the worldwide Depression, and it was overthrown in a military coup led by General Getúlio Vargas, who ruled as a dictator supported by the new entrepreneurial middle-class and working-class groups. Vargas himself was overthrown by a military coup in 1945 but returned to office in the 1950 presidential elections. Civilian middle-class-oriented presidents governed from 1955 to 1964, but when the economy faltered in 1961-1964 the military again intervened. The unstable cycle of democracy and dictatorship also characterized the political systems of Argentina, Peru, Colombia, Venezuela, Ecuador, Uruguay, Bolivia, Honduras, Guatemala, El Salvador, and Panama in the period 1930 to 1960, although each country followed its own unique pattern of coping with the tensions among the five or more power groups in society.<sup>80</sup>

Two groups of Latin American countries did not adhere to the

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78. In countries following this model, the society is dominated by elites which accept democratic institutions unless they threaten the elites' vital interests. Elections may be held, but democratic governments are punctuated by military coups when the government challenges a vested interest or appears incapable of managing the country. After several years of authoritarian government, there may be another coup, or new elections may be held. The alternation of democracy and despotism is the political system. See Huntington, *Will More Countries Become Democratic?*, 99 *Pol. Sci. Q.* 193, 210 (1984) (developing cyclical model and arguing that it can pose real obstacles to long-term democratic institutions); Roett, *supra* note 77 (applying cyclical model to Latin America).

79. See *Latin American Political Tables*, *supra* note 77, Table for Brazil. On Brazil's political history after 1930, see, e.g., P. Flynn, *Brazil: A Political Analysis* (1978); R. Schneider, *The Political System of Brazil: Emergence of a "Modernizing" Authoritarian Regime, 1964-1970* (1971); T. Skidmore, *Politics in Brazil, 1930-1964: An Experiment in Democracy* (1967).

80. For a chronology of transitions in the politics of these countries, see *Latin American Political Tables*, *supra* note 77. For historical and political analyses of individual countries, see, e.g., J. Alexander, *Bolivia: Past, Present, and Future of Its Politics* (1982); R. Dix, *Colombia: The Political Dimensions of Change* (1967); M. Goldwert, *Democracy, Militarism and Nationalism in Argentina* (1972); D. Levine, *Conflict and Political Change in Venezuela* (1973); L. Lott, *Venezuela and Paraguay: Political Modernity and Tradition in Conflict* (1972); J. Martz, *Ecuador: Conflicting Political Culture and the Quest for Progress* (1972); D. Palmer, *supra* note 74 (Peru); P. Smith, *Argentina and the Failure of Democracy: Conflict Among Political Elites* (1974); P. Snow, *Political Forces in Argentina* (1979); M. Weinstein, *Uruguay: The Politics of Failure* (1975).

cyclical model. Mexico and Chile, for example, consolidated and stabilized their democracies before 1930 and enjoyed free elections in the second period.<sup>81</sup> Mexico was particularly successful, in large part because its governing party explicitly organized itself around the major interest groups (agrarian, middle class, union, and military). Nicaragua and Paraguay illustrate a different pattern of response to the crisis of the 1930's: reactionary dictators remained in power for decades and stifled political conflict and development.<sup>82</sup>

Notwithstanding these exceptional cases, the cyclical model has generally characterized Latin American politics since 1930 and contributed to two structural weaknesses in Latin American political systems. One weakness has been a lack of permanence in the governments, which impairs their ability to formulate and execute long-term policy. Democratically elected leaders are typically not in power long enough to carry out systematic policy, and the authoritarian governments, even when they cling to power, sooner or later lose their legitimacy, and hence their ability to make broad plans for the country. At its extreme, the cyclical model all but conditions the population to expect a change of government when things start going wrong.<sup>83</sup> Even when a government may implement a policy, the policy might be changed or abandoned when the government itself is overthrown.

A second weakness is that "hard decisions"—those requiring sacrifice by major groups in the country (such as redistribution or diminution of property or income)—do not get made. Since all groups are politically relevant, and no one group is able to hold power alone for very long, the power groups tend to agree (tacitly) not to harm the interests of one another.<sup>84</sup> This system of mutual

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81. On Mexico, see J. Hellman, *Mexico in Crisis* (2d ed. 1983); R. Newell & L. Rubio, *Mexico's Dilemma: The Political Origins of Economic Crisis* (1984); L.V. Padgett, *The Mexican Political System* (1976). On Chile, see B. Loveman, *Chile: The Legacy of Hispanic Capitalism* (1979); B. Loveman, *Struggle in the Countryside: Politics and Rural Labor in Chile, 1919-1973* (1976); M. Mamalakis, *The Growth and Structure of the Chilean Economy: From Independence to Allende* (1976); J. Petras, *Politics and Social Forces in Chilean Development* (1969); B. Stallings, *Class Conflict and Economic Development in Chile, 1958-1973* (1978).

82. On Nicaragua, see R. Millett, *Guardians of the Dynasty: A History of the U.S. Created Guardia Nacional de Nicaragua and the Somoza Family* (1977); T. Walker, *Nicaragua: The Land of Sandino* (1981). On Paraguay see L. Lott, *supra* note 80; G. Pendle, *Paraguay: A Riverside Nation* (1956); Wiarda & Kline, *supra* note 74, at 134-37.

83. See Huntington, *supra* note 78, at 210.

84. This has been called the "living museum" effect: Before a new group can participate in the political process, it must show the established elites that it is powerful and is willing

accommodation among the corporatist powers yields either no policy (in theory harming no group) or contradictory policies (a group harmed by one policy will get a trade-off policy that is in its interest).<sup>85</sup> Such a system may operate satisfactorily during favorable times, but not during adversity. The fragility of the government even under the best of circumstances makes it hazardous to risk alienating its power base, or intensifying its opposition, by demanding unpopular sacrifices. Thus, if the democratic government makes a hard decision, it stands to lose the next election or to be overthrown by the military on the edge of the political situation. If the authoritarian government makes a hard decision, it may lose its always evanescent legitimacy and fall under renewed pressure to hold free elections. Even the more stable democracies have had this second problem. Stability in Mexico under the Revolutionary Constitution of 1917 has depended upon the ability of the governing party to accommodate all its constituent interest groups, which has often resulted in wildly contradictory policies.<sup>86</sup> Even a long-lived democracy such as that of Chile proved vulnerable to military overthrow in 1973 when President Allende proposed policies that stimulated intense opposition among the military and landowning elites.<sup>87</sup>

Economically, Latin American politics in this second period generally embraced the middle-class, entrepreneurial philosophy of growth. Even when they did not actually hold political power, the middle class was disproportionately influential in matters of policy, in part because it offered greater competence and efficiency to the government and in part because the Depression discredited the *latifundiaría's* (large landowners') development philosophy (export primary commodities, import manufactured goods). Moreover, the

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to respect the rights of already established groups. Thus the power structures will either co-opt the rising group or repress it. (The third alternative is a genuine social revolution such as that of Cuba in 1958.) See C. Anderson, *Politics and Economic Change in Latin America: The Governing of Restless Nations* 104 (1967); Wiarda & Kline, *supra* note 74, at 42.

85. Wiarda & Kline, *supra* note 74, at 81-82. See generally Schmitter, *Military Intervention, Political Competitiveness, and Public Policy in Latin America: 1950-1967*, in *Armies and Politics in Latin America* 113 (A. Lowenthal ed. 1976).

86. See R. Newell & L. Rubio, *supra* note 81, at 121-26; R. Vernon, *The Dilemma of Mexico's Development* 188-93 (1963).

87. Some useful sources on the political and socio-economic forces that contributed to Allende's overthrow include J. Carriere, *Landowners and Politics in Chile: A Study of the "Sociedad Nacional de Agricultura" 1932-1970* (1981); Allende's Chile (K. Medhurst ed. 1972); Chile 1970-73: *Economic Development and Its International Setting* (S. Sideri ed. 1979); G. Wynia, *supra* note 75, at 179-90.

middle class penetrated both the increasingly "professionalized" military and the Church, and thus infected these important power groups with their values of economic growth and long-range planning.<sup>88</sup> The "ideology of productive growth" heralded by the entrepreneurial middle class posited that (1) the purpose of development is to become more like the wealthy economies of the industrialized countries; (2) Latin American countries will not develop by relying on primary commodities as their chief economic activity and therefore must diversify into manufacturing activities; and (3) in order to catch up with the industrialized countries and ultimately become competitive with them, the Latin American governments should stimulate a rapid and decisive growth in their countries' GDP's.<sup>89</sup> Some of these ideas were not utterly alien to the old-fashioned oligarchies, which naturally favored any growth that enriched them and which also wanted to emulate the wealthy industrial countries. What was most different about the new approach to development pressed by the entrepreneurial middle class was the idea that growth requires active government encouragement plus massive inflows of capital for industrial production, rather than consumption, purposes.

Although the foundations for later growth were laid in the 1930's and 1940's, the Depression and World War II were dampers on dramatic Latin American growth. The post-War period was more auspicious because of the boom in world trade, the creation of international financial organs to encourage Third World development, and the improvement in the terms of trade for Latin American primary commodities.<sup>90</sup> Specifically, the leading Latin

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88. See *infra* notes 103-107 and accompanying text for a case study of this phenomenon.

89. G. Wynia, *supra* note 75, argues that the 1929 Depression yielded three new development strategies in Latin America: (1) "progressive modernization" or industrialization combined with some effort at more equitable income distribution; (2) "conservative modernization" or industrialization centered on investment, without any effort at income redistribution; and (3) "revolutionary socialism." *Id.* at 111, 128-29 (Table 5.2); see also T. Skidmore & P. Smith, *supra* note 75, at 51-64. The first two strategies, or some hybrid of them, were the only ones actually attempted in the second period (1930-1960's). The third one, of course, has had some application in the third period (in Cuba, primarily, and the 1970-1973 Allende period in Chile) and is of great theoretical importance. For the purposes of this Article, however, discussion will focus on the two "modernization" strategies. For other sources on the Latin American embrace of the ideology of productive growth, see, e.g., W. Glade, *The Latin American Economies* (1969); United Nations, *The Economic Development of Latin America in the Post-War Period* (1964); United Nations, *The Process of Industrial Development in Latin America* (1966).

90. The typical pattern during this second period was the following:

American countries underwent substantial economic growth between 1950 and 1970. Annual real GDP growth of 7% or more was registered in most years between 1950 and 1970 by the two largest countries, Mexico<sup>91</sup> and Brazil.<sup>92</sup> Venezuela and Peru saw steady growth rates of between 5% and 6% per year.<sup>93</sup> Growth was substantial, but less even, in Argentina and Chile.<sup>94</sup> The average growth rate in Latin America during this second period was more than 5% per year.<sup>95</sup>

Generally, the middle-class ideology of productive growth was triumphant after 1950: most of the power groups (whatever their rhetoric or background) came to accept it, and it worked to yield

1. The middle class became increasingly important in the early twentieth century, and the Depression gave them intellectual force by discrediting the oligarchy's policies.

2. The Depression was an economic blow to the country, but it also provided incentives for local industry to develop, potentially a source for new economic growth opportunities.

3. Between 1945 and 1955, rapid growth based on import substitution began. At some point in the 1950's, the government moved from encouragement to active financial involvement in industrial development. Substantial growth then followed.

For specific country patterns, see L. Allen, *Venezuelan Economic Development* 103-13 (1977) (very high growth rate 1950-1957; recession 1958-1962; uneven growth 1962-1975; mounting inflation of government expenditures); M. Mamalakis, *supra* note 81, at 89-99 (Chile struggled in the period 1930-1955, but after 1955 major growth gains were registered); L. B. Pereira, *Development and Crisis in Brazil, 1930-83*, at 15-32 (1984); D. Syvrud, *Foundations of Brazilian Economic Growth* 12-41 (1974) (ideology of growth dominated government policy after 1940's).

91. Gollas, *External Debt and Economic Growth: Mexico*, in *Foreign Debt and Latin American Economic Development* 139, 141 (A. Jorge, J. Salazar-Carillo & R. Higonnet eds. 1983) (Table 1) (Mexico's GDP grew at an average annual rate of 9.2% in 1954-1955; 6.7% in 1956-1970; 5.3% in 1971-1972). See R. Newell & L. Rubio, *supra* note 81, at 158 (Graph VI-1) (Mexico's GDP grew in constant prices at an average annual rate of 6.8% between 1958 and 1970).

92. Baer, *The Brazilian Growth and Development Experience: 1964-1975*, in *Brazil in the Seventies* 41, 47 (R. Roett ed. 1976) (Table 1) (GDP grew 9.3% in 1968, 9.0% in 1969, 9.5% in 1970, 11.3% in 1971, 10.4% in 1972, and 11.4% in 1973).

93. See G. Wynia, *supra* note 75, at 200 (Venezuela's GDP grew by an average 5.7% per year from 1960 to 1975); Schydrowsky & Wicht, *The Anatomy of an Economic Failure, in The Peruvian Experiment Reconsidered* 94, 95 (C. McClintock & A. Lowenthal eds. 1983) (Peru's GDP grew by an average 5.4% per year from 1945 to 1966).

94. Chile's average annual growth was 3.7% from 1950 to 1955, 3.9% from 1955 to 1960, and 5.4% from 1960 to 1965. However, from 1965 on, Chile's growth oscillated, varying from a high of 6.9% in 1966 to a low of -11.2% in 1975 (a decline in GDP). See M. Mamalakis, *supra* note 81, at 92; Sutton, *Structuralism: The Latin American Record and the New Critique*, in *The IMF and Stabilisation: Developing Country Experiences* 19, 27 (Table 2.1) (T. Killick ed. 1984).

95. See Schydrowsky & Wicht, *supra* note 93, at 95.

high rates of growth. In contrast to a reliance on commodity exports before 1930, the dynamo that generated the impressive growth rates was industry. In Brazil, for example, industrial sector growth rates were about double the growth rates of the agricultural sector, except during Brazil's recession of 1962-1967.<sup>96</sup> A similar trend can be observed in Mexico.<sup>97</sup> Obviously, the effect of such disproportionate rates of growth was that the industrial sector became increasingly important (in the process, of course, making the entrepreneurial middle class more prominent). Between 1950 and 1970 in both Brazil and Mexico, agriculture's share of GDP declined from one-quarter to one-tenth, while the share of GDP attributable to industrial production increased.<sup>98</sup>

The primary developmental policy to foster productive growth in the 1930's to 1950's was "horizontal import substitution," that is, the replacement of imported manufactured consumer goods with domestically manufactured consumer goods.<sup>99</sup> This was thought to

96. Baer, *supra* note 92, at 47 (Table 1) (industrial growth rates were 10.3% per annum for 1956-1962, 3.9% for 1962-1967, 12.85% for 1968-1973; agricultural growth rates in the same periods were 5.7%, 4.0%, and 5.5%, respectively).

97. Gollas, *supra* note 91, at 141 (Table 2).

98. Graham, *Mexican and Brazilian Economic Development: Legacies, Patterns, and Performance*, in *Brazil and Mexico: Patterns in Late Development* 13, 21 (S. Hewlett & R. Weinert eds. 1984) (Table 3):

Percentage Distribution of GDP

Sector	1950		1960		1970	
	Brazil	Mexico	Brazil	Mexico	Brazil	Mexico
Agriculture	24.9	22.5	19.2	15.9	10.2	11.6
Industry	26.0	30.4	32.6	29.2	36.3	34.3
Services	49.1	47.1	48.2	54.9	53.5	54.1

99. Luiz Bresser Pereira has shown that import substitution was the basic development strategy for Brazil between 1930 and 1961, and has generated a model of development based upon this strategy:

1. The needs of the domestic market, limitations on import capacity (war, tariffs), and governmental stimuli create possibilities for import substitution.
2. The government builds an infrastructure of transportation, communication, and education.
3. Entrepreneurs take advantage of the import substitution possibilities and whatever infrastructure the country has and enter into businesses that can displace existing imports.
4. The indigenous import substitution businesses are very successful (high profits). Investment is channeled into sectors offering the highest and most rapid return on investment—in which a relatively small investment yields large increases in production.
5. Industrial growth attracts more people to the urban areas and produces higher wages and increased consumption.



be an easy way to grow rapidly, because internal markets were virtually untapped. Due to low transportation and labor costs, consumer goods could be manufactured more cheaply within the country in many instances, and resources could be targeted to sectors where great returns might be expected. The policy of import substitution was earliest and most firmly embraced by the big countries in the region—Argentina, Brazil, and Mexico—for they had large internal markets (*i.e.*, large populations of consumers) that could sustain substantial domestic industrial production.<sup>100</sup> Smaller countries followed this policy somewhat later and less purposively. For example, while their governments did encourage some import substitution, Peru, Venezuela, and Chile still relied on commodity exports for much of their growth into the 1960's.<sup>101</sup> Because of their very small internal markets, Central American countries did not seriously initiate import substitution efforts until the 1960's (after formation of a Central American Common Market).<sup>102</sup>

### 3. *The Third Period: 1960's-1980's*

Import substitution was hardly a panacea, though. Once the most profitable markets were tapped by domestic industry, marginal returns began to fall. The result was slower and/or more erratic growth and, all too often, political crises, with new avenues of growth explored by the authoritarian governments that took control. Problems with horizontal import substitution as a mechanism for industrialization helped usher in a third period of growth in the 1960's. Several examples reveal the diversity of economic policy responses in this new period.

Brazil's robust growth rate decelerated from 1962 to 1967, and

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See L. B. Pereira, *supra* note 90, at 32-44, 45 (Figure 2.1).

100. See T. Skidmore & P. Smith, *supra* note 75, at 58 (Brazil, Mexico, Argentina); Graham, *supra* note 98, at 22-25 (Brazil followed the most rapid and diverse import substitution policy in the region in the 1950's; Mexico almost caught up with Brazil in the 1960's).

101. See T. Skidmore & P. Smith, *supra* note 75, at 117, 118 (Chile: copper in 1956 and after), 200-02 (commodity exports led growth in Peru); L. Allen, *supra* note 90, at 13, 177-78 (Venezuela: oil); Cotler, *Democracy and National Integration in Peru*, in *The Peruvian Experiment Reconsidered* 3, 11-15 (C. McClintock & A. Lowenthal eds. 1983) (import substitution policy in Peru, 1950-1968).

102. The Central American Common Market (CACM) was formed in 1960 "to stimulate industrial development [by] . . . promoting free trade among member countries and creating common tariffs to protect infant industries." T. Skidmore & P. Smith, *supra* note 75, at 297-98.

the economy's poor performance triggered a military coup in 1964.<sup>103</sup> The military held power from 1964 until March 1985 (the scheduled transition back to civilian rule),<sup>104</sup> and its central goal was the maintenance of strong economic growth. To do this, the military government, in alliance with the technocrats and entrepreneurs, shifted Brazil's development approach from horizontal import substitution to vertical import substitution (domestic production of capital goods to displace imports) and export expansion.<sup>105</sup> As a result, the growth industries from 1967-1973 were not those oriented toward the domestic consumption market (clothing, shoes, foodstuffs), but rather capital goods and export items in which Brazil had a labor-cost or resource advantage (minerals, metal products, machinery, electrical equipment, transport equipment, rubber products, and chemicals).<sup>106</sup> The new export-led model of development envisioned by the Brazilian government contemplated the solidification of a modern productive sector of the economy which would be fully integrated with international capitalism and would receive most of the benefits of development; the marginalized sector would be gradually integrated into the modern one, though in a subordinate position.<sup>107</sup>

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103. S. Robock, *Brazil: A Study in Development Progress* 160 (1973). After 1964, "Brazil became a technocratic government under military guardianship." *Id.* at 163. This incident was representative of a larger phenomenon: the *embourgeoisement* of the military. After World War II, an increasing number of military officers came from middle-class backgrounds (or adopted middle-class points of view). Hence, many of the military coups of the 1960's were inspired by essentially middle-class growth aspirations. See Nun, *The Middle Class Military Coup*, in *The Politics of Conformity in Latin America* 66 (C. Veliz ed. 1967).

104. *Wash. Post*, Jan. 16, 1985, at A1, col. 5. With the military government's acquiescence, opposition leader Tancredo de Alameda Neves was elected president by a special electoral college on January 15, 1985. Neves is expected to be inaugurated on March 15, 1985, as Brazil's first civilian president in over two decades.

105. L. B. Pereira, *supra* note 90, at 152-58. See also S. Robock, *supra* note 103, at 111-15.

106. See Baer, *supra* note 92, at 48 (Table 2); Cline, *Brazil's Emerging International Economic Role, in Brazil in the Seventies* 63, 64-65 (R. Roett ed. 1976) (placing the shift to export expansion in 1967-1968).

107. Luiz Bresser Pereira has generated a model of development based upon Brazil's post-1967 strategy:

1. The limits of horizontal import substitution are reached with resulting lower growth rates. An alliance of the entrepreneurial middle class, government technocrats, and/or the military takes over the government and shifts the direction of economic development policy.
2. The economy is increasingly integrated with that of international capitalism. There is more emphasis on producing manufactured goods for export to industrial and other countries. Greater production of capital goods may reduce some imports as well.
3. The government works to modernize the country's infrastructure further. In-

The establishment of an authoritarian government was not unique to Brazil in this third period. Authoritarian military governments replaced democratic ones in Argentina in 1966 and 1976, in Peru and Panama in 1968, in Ecuador and Honduras in 1972, and in Chile and Uruguay in 1973, in most instances justifying military control as a means of redirecting the country's economic policy to improve economic growth.<sup>108</sup>

After substantial, albeit irregular, growth in the 1960's, Chile under the Allende government (1970-1973) experimented with a socialist approach to development, including redistribution of land and nationalization of major industries. In the short term, these policies produced economic chaos and problems, thereby triggering the military coup of 1973. With mixed success, the military government sought to achieve high growth rates in the 1970's by opening the economy to foreign investment, which was intended to stimulate export industries.<sup>109</sup> Peru, like Chile and Brazil, had sluggish growth in the early 1960's, and the lack of suitable economic direction was one justification for the military coup by General Velasco in 1968.<sup>110</sup> The Velasco government, while authoritarian, followed policies of redistribution and nationalization akin to those of Allende rather than those of General Pinochet, Allende's successor.

Although the third period of Latin American development has been a time of political and economic experimentation, the fundamental structures in Latin America have not changed much from the seminal second period. Politics still tends to be cyclical. Although the authoritarian governments have been able to hold power longer, most were replaced with democratic governments between 1979 and February 1985.<sup>111</sup> Additionally, hard decisions are still finessed, and regimes are still devoted to economic growth as a

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vestment by multinational enterprises is welcomed, especially so that the country can have access to modern technology needed to make its goods competitive.

4. The government favors the upper classes, in part because of the need for more investment funds. The theory is that some of the growth will ultimately "trickle down" to the lower classes.

See L. B. Pereira, *supra* note 90, at 152-58.

108. See Roett, *supra* note 77; Latin American Political Tables, *supra* note 77.

109. See Foxley, *Towards a Free Market Economy: Chile 1974-1979*, in *The Political Economy of Development and Underdevelopment* 397 (C. Wilber ed. 1984).

110. See P.-P. Kuczynski, *Peruvian Democracy under Economic Stress: An Account of the Belaúnde Administration, 1963-1968* (1977). See also *Manifesto of the Revolutionary Government of Peru—1968*, in *The Politics of Antipolitics: The Military in Latin America* 208 (B. Loveman & T. Davies, Jr. eds. 1978).

111. See Latin American Political Tables, *supra* note 77:

means of satisfying all the relevant interest groups as well as maintaining order and authority.

An integral part of the middle-class ideology of productive growth that has dominated policy since 1930 is the idea that capital is critical to rapid development and that the annual rate of private domestic capital formation is insufficient to achieve the level of growth desired. Hence, the capital for development must come from somewhere else.

Latin American governments themselves have been one major source of investment capital, through subsidization to favored industries, capitalization of state-owned trading and manufacturing enterprises, and creation of an infrastructure (roads, communications, and education) capable of sustaining modernizing growth. The Brazilian and Mexican governments own about half of the capitalized value of their respective countries' fifty largest firms.<sup>112</sup> Brazil's state sector has been particularly active, dominating some of the main export industries and doubling its share of the GDP between 1947 and 1973.<sup>113</sup> Argentina, Peru, Venezuela, and Colombia also have stressed the role of government expenditures and state-sponsored enterprises in their development.<sup>114</sup> Only Chile

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<u>Country</u>	<u>Transition to Democratic Government</u>
Brazil	March, 1985 (expected)
Argentina	1983
Peru	1980
Bolivia	1982
Ecuador	1979
El Salvador	1982-1984
Guatemala	1985 (expected)
Honduras	1984
Panama	1984
Uruguay	1985

112. See Graham, *supra* note 98, at 31-33 (Table 7):

<u>Firm Category &amp; Country</u>	<u>Foreign</u>	<u>Private</u>	<u>State</u>
Percentage Distribution			
Largest 50 Firms			
Mexico	20	38	42
Brazil	28	16	56
Largest 200 Firms			
Mexico	34	45	21
Brazil	35	33	32

113. See Baer, *supra* note 92, at 51.

114. See Sheahan, *The Economics of the Peruvian Experiment in Comparative Perspective*, in *The Peruvian Experiment Reconsidered* 389 (C. McClintock & A. Lowenthal eds.

under military rule has moved away from state financial involvement in the economy.

Latin American planners have generally assumed that government capital was insufficient to stimulate the growth they desired—external sources of capital were needed. Foreign direct investment was the main source of external capital in the second period (through the 1960's). For example, 49% of the sales volume of Brazil's top 1000 nonfinancial firms in 1974 could be attributed to firms owned or controlled by foreign multinational corporations; Peru in 1969 saw foreign-controlled subsidiaries account for 69% of sales; comparable figures for Mexico and Argentina for 1972 were 27% and 31%, respectively.<sup>115</sup> Foreign control was even more pronounced in industries geared mainly for exports, such as the rubber, machinery, and chemicals industries. In Jamaica, for example, direct foreign investment accounted for one-third of the total investment in the period 1953-1972 but was overwhelmingly important for the development of the bauxite industry in that same period.<sup>116</sup> Overall for Spanish Latin America, U.S. investment in 1970 was 1.18 times the total domestic governmental revenues of these countries.<sup>117</sup> Between 1950 and 1966, foreign direct investment was the main external source of development capital in Latin America.<sup>118</sup>

A third source of capital for Latin American development was external indebtedness. It was widely assumed that development would entail current account deficits, as capital goods were imported and expensive infrastructural investments were undertaken. Those deficits were financed by foreign indebtedness.<sup>119</sup> A great

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1983).

115. See J. L. Reiffers, *Transnational Corporations and Endogenous Development: Effects on Culture, Communication, Education, and Science and Technology* 23-24 (1982).

116. See Bernal, *Economic Growth and External Debt of Jamaica*, in *Foreign Debt and Latin American Economic Development* 89, 91 (A. Jorge, J. Salazar-Carillo & R. Higonnet eds. 1983) (Table 1).

117. See Appendix, Table 7.

118. Fishlow, *Latin America's Debt: Problem or Solution*, *Colum. J. World Bus.*, Spring 1982, at 35, 36.

119. Susan Strange has repeatedly asserted: "A political economy has two ways to grow: by direction and by debt." The former would require the preemption of immediate consumption in favor of long-term capital investments leading to a centrally planned economy. *Strange, Debt and Default in the International Political Economy*, in *Debt and the Less Developed Countries* 7, 8 (J. Aronson ed. 1979). For earlier standard authorities preaching the same gospel, see, e.g., C. Kindleberger, *Economic Development* 198-200, 233-40 (2d ed. 1965); P. Samuelson, *Economics* 636-40 (7th ed. 1967).

deal of Brazil's "economic miracle" after 1967 was fueled by external debt, which quadrupled between 1968 and 1973; in 1970, the overall ratio of external debt to total exports was a virtually unprecedented 150%.<sup>120</sup> In Spanish Latin America, the overall ratio of external debt to total exports increased from 41% in 1950 to 115% in 1970.<sup>121</sup> By the early 1970's, external indebtedness had surpassed direct foreign investment as the main source of capital in most of these countries.<sup>122</sup>

Thus, even before 1973, Latin American debt was increasing significantly. Given the social, political, and economic policy structures described above, it is easy to see why Latin American political leaders after 1973 quite naturally responded to external shocks by increasing indebtedness rather than by adopting other policies. Horizontal import substitution could produce only limited reductions in the payment deficits, because the most likely domestic markets were already localized. (Recall that this is the reason such policies were partially abandoned in the 1960's.) Export growth required further capital investment in imported technology, components, and materials, and thus further debt. Increasing public sector deficits would have been intolerable because of the inflationary pressures of such a move. The only viable alternative to contracting more debt, therefore, was to cut back on the growth rate. And that the governments were generally not willing to do: twenty to thirty years of growth exercised an enormous gravitational force on decisionmaking. Growth was the government's *raison d'être*, and its cessation might prove to be its *coup de grace*. Fragile governments could please most of the power groups so long as the pie was expanding (unions and the middle class could gain without penalizing the landowners), but once the pie started to stagnate or shrink, political sacrifices by important groups were all but inevitable. In other words, given the socio-political dynamics, governments could safely make *distributional* decisions (which groups will receive added income), but not *redistributional* decisions

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120. L. B. Pereira, *supra* note 90, at 170-72. Note, though, that debt as a fraction of GDP actually declined in 1971-1973 (due to the large growth rate, which offset the increase in debt). *Id.* at 173 (Table 8.5). See also Wellons, *Brazil: Financing the Miracle*, in P. Wellons, *World Money and Credit: The Crisis and Its Causes* 3, 15 (1983) (Brazil was better off due to external borrowings).

121. See Appendix, Table 9.

122. See Graham, *supra* note 98, at 28 (Table 6) (foreign debt was 1.04 times direct foreign investment in 1967 for Mexico, 2.51 in 1975; for Brazil, 0.95 in 1967, 1.50 in 1975).

(which groups will be penalized so that the debt can be brought under control).

Different countries responded in different ways, but generally they followed this pattern of debt expansion. The authoritarian regimes in Brazil and Peru, for example, pursued middle-class, technocratic goals (particularly growth) and saw themselves as engines of more effective development. Rather than curtail that growth—and antagonize unions and entrepreneurs—they increased their external indebtedness more than sixfold. The authoritarian regimes in Chile, Argentina, and Uruguay, less “liberal” than those of Brazil and Peru, expanded their external debt sixfold to placate their contending interest groups, the most important perhaps being the military (which in the case of Argentina fought a war). From 1970 to 1982, the democratically elected governments of Mexico explicitly followed a policy of continuing growth as well as improving the lot of the poor, which entailed large increases in government deficits, as well as a ninefold increase in external debt. Venezuela, which (like Mexico) became a leading oil exporter, followed a similar policy, grounded upon the hope that oil wealth would keep the pie expanding. Whatever the actual form of government, most Latin American countries consciously followed the path of least political resistance: rather than force important groups to make present sacrifices, the governments borrowed a lot of money. It is hard to imagine their following any other policy in response to the post-1973 external shocks.

### *B. The Decline of the Bretton Woods System: The Reemergence of Uncontrolled Private International Lending*

Of course, no matter how much Latin American (and other) countries might have wanted to finance enormous current account deficits through external borrowing in the 1970's, they could not have done so if potential lenders had been unprepared to lend unprecedented sums of money. The currently fashionable explanation for the large-scale lending of the 1970's is that private commercial banks had enormous amounts of money on deposit from the OPEC countries, creating hydraulic pressures on them to lend that money—and NODC's were the only available borrowers for loans of that magnitude. What is often overlooked is that the banks eagerly solicited the OPEC deposits, apparently believing that loans to NODC's were not only acceptable but indeed very profitable lending opportunities. The banks knew what they were doing, yet

they apparently overextended themselves in their haste to attract OPEC petrodollars and then to lend those funds to NODC's, especially in Latin America. Two additional structural phenomena explain the eagerness of banks to overextend themselves.

The first structural factor is the Minsky-Kindleberger theory of manias and panics, which historically has been applicable to international sovereign lending.<sup>123</sup> After an external political or economic shock (a "displacement"), there will be an increase in speculative activity in which certain investments are thought by some to be superprofitable in the period of uncertainty.<sup>124</sup> Others join in this activity, creating a "mania" of speculation, fueled by a collective "euphoria," or unjustified herd-like optimism about the investment opportunity (increased speculation does, indeed, make the activity profitable in the short term).<sup>125</sup> When the speculation bottoms out, there is a period of uncertainty ("distress"), followed sooner or later by a "revulsion" against the speculative activity and then often by a "panic" or "crash."<sup>126</sup>

The mania-and-panic cycle characterized international sovereign lending, especially to Latin American countries, in the nineteenth century through the 1920's, and was repeated after the 1960's. The displacement was inflation caused by U.S. deficits and the OPEC price increases; the mania was euphoric private bank lending to NODC's (especially in Latin America); distress and revulsion finally came in 1982, when everyone realized that the loans could not be repaid. This section, which will explore the structural components of the mania-and-panic cycle in more detail, will also explain why the cycle revived in the 1960's after a 35-year hiatus. A critical reason for the hiatus was the Bretton Woods system of controlled international finance and, under it, the relatively minor role of private lenders in international sovereign borrowing after World War II.

The decline of the Bretton Woods system and the reemergence

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123. C. Kindleberger, *supra* note 71, at 15-24; see also C. Kindleberger, *Debt Situation of the Developing Countries in Historical Perspective*, in *Financing and Risk in Developing Countries* 3 (S. Goodman ed. 1978); Aronson, *The Politics of Private Bank Lending and Debt Renegotiations*, in *Debt and the Less Developed Countries* 283, 283-84 (J. Aronson ed. 1979).

124. C. Kindleberger, *supra* note 71, at 41-45.

125. *Id.* at 45-49. In this period, money will be created to fuel the flames of speculation, *id.* at 52-54, and swindles are likely to occur, as the speculating frenzy increases business greed and insecurity. *Id.* at 78-96.

126. *Id.* at 107-15.



of private institutions in international sovereign finance is the second structural factor leading to the large volume of sovereign loans after the 1960's. The 1930's, when many developing countries had defaulted on their international loan obligations and industrial countries adopted protectionist measures which all but killed world trade, taught the world financial community a lesson. The end of World War II provided an opportunity to do something about that lesson, and the result was the Bretton Woods system, whose purpose was to provide a stable international monetary and trade climate, with the United States as the guarantor of international economic stability.<sup>127</sup> Thus the Bretton Woods system posited that the dollar (fully redeemable in gold) would replace gold as the ultimate standard of value, and that other currencies would have fixed exchange rates pegged to the dollar. The IMF was established to regulate currency exchange rates (and approve changes in the rates if a country was chronically in balance-of-payments deficit) and to provide access to credit to allow countries to adjust to short-term economic difficulties. The World Bank was established to make loans to countries, enabling them to make infrastructural improvements. A corollary to Bretton Woods was that the United States would provide foreign aid and loans, first to Europe under the Marshall Plan and then to underdeveloped countries, to help the world economy recover from World War II.<sup>128</sup>

In most respects, the Bretton Woods system provided a workable world financial environment for economic development. International trade flourished, creating a supply of capital goods to developing countries and a market for their exports. Foreign direct investment also flourished, providing technology, know-how, and capital for industrial development. And, not least important, developing countries seeking to borrow money could obtain funds from the IMF to smooth over trade imbalances, from the World Bank to fund development and infrastructural projects, and from Western governments (especially the United States) to finance im-

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127. A useful summary of the creation, rise, and fall of the Bretton Woods system can be found in M. Moffitt, *The World's Money: International Banking from Bretton Woods to the Brink of Insolvency* 13-40 (1983). See also J. Aronson, *Money and Power: Banks and the World Monetary System* (1977).

128. For a history and critical evaluation of the Marshall Plan, see generally H. Price, *The Marshall Plan and Its Meaning* (1955).

ports and some development projects.<sup>129</sup>

Official international lenders, moreover, made the loans for long terms and at concessionary interest rates. The disadvantages of official loans were that the lenders often attached conditions (the IMF insisted on measures to redress poor trade balances, for example) and did not have unlimited monies to lend. But these "disadvantages" had some positive effect as well: a structural bias in favor of underlending may have been useful, because the ideology of productive growth, so fervently embraced by developing countries, and the weaknesses of their political systems (especially in Latin America) made them all too prone to overborrow if they were not so constrained. Indeed, from 1956 to 1979, notwithstanding the bias of underlending, developing countries regularly confessed inability to service their debts, and their official creditors (typically under the auspices of the Paris Club)<sup>130</sup> would restructure the debt so that it could be serviced.<sup>131</sup>

The Bretton Woods arrangement in large part unravelled in the 1960's, and its demise set the stage for a new mania of lending to NODC's. First, the United States partially withdrew as the guarantor of world trade.<sup>132</sup> Its own balance-of-payments deficits, which helped to fuel the 25-year post-War boom, led to a flow of dollars abroad and exposed U.S. gold reserves to instant depletion. Thus President Nixon, on August 15, 1971, renounced gold convertibility, thereby allowing the dollar's value to be determined by market forces. Although currencies of many developing countries continued to be pegged to the dollar, other currencies floated; in neither case was the IMF able to enforce exchange rate discipline as it had done in the past. As a result, countries had greater freedom to maintain overvalued currencies (the exchange rate against other currencies is higher than its purchasing power indicates), which ar-

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129. The roles of the IMF and the World Bank are described in R. Ayres, *Banking of the Poor: The World Bank and World Poverty* (1983); J. Williamson, *The Lending Policies of the International Monetary Fund* (1982).

130. The Paris Club was the most prominent among several deliberately noninstitutional groups of industrialized country representatives. These government representatives began in the 1950's to negotiate some relief of "official" debt. D. Delamaide, *supra* note 20, at 133-34; see also Rieffel, *The Paris Club, 1978-1983*, 23 *Colum. J. Transnat'l L.* 83 (1984).

131. See I. Friedman, *supra* note 18, at 110 (Table 7.1) (listing 59 multilateral debt renegotiations of developing countries with official creditors).

132. See generally D. Delamaide, *supra* note 20, at 38-40; M. Moffitt, *supra* note 127, at 29-40 (tracing process by which the burdens on the United States imposed by the Bretton Woods system became too great in the period 1960-1971).

tificially stimulated imports for individual countries and hurt their export positions (exports being relatively expensive). So, too, they felt less constrained about maintaining a reasonable balance of payments.<sup>133</sup> The post-Bretton Woods era has been characterized by

a lack of any form of cooperation or coordination in exchange rate or monetary policies on a global scale. The floating system itself could not have been expected to offer an automatic mechanism to correct imbalances and instabilities resulting from independent, uncoordinated policies motivated solely by national self-interests.<sup>134</sup>

Without external constraints on their balance-of-payments deficits and exchange rates, NODC's were more free to continue payments deficits and to overvalue currencies—policies that ultimately impelled them to seek huge foreign loans.

Second, by the end of the 1960's, the official lenders were being supplanted by private commercial banks as the main source of development loans. Reasons for this include the failure of official lending's supply of funds to keep pace with the inflation of the 1960's and the growth of private international banking institutions. After a 20-year hibernation, private international banking showed signs of revival in the 1950's, as U.S. banks opened overseas branches so that they could serve the global financial needs of their multinational corporate clients.<sup>135</sup> Moreover, in 1963, the U.S. government created an incentive for greater use of foreign branches when it created the Interest Equalization Tax on foreign borrowing from U.S. banks.<sup>136</sup> The tax did not apply to bonds issued abroad by branch offices of U.S. banks. This, together with the 1965 Voluntary Foreign Credit Restraint Program (creating voluntary ceilings on bank loans to foreign entities) and the Office for Foreign Direct Investment Guidelines (preventing multinational corporations from sending too much money to their foreign

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133. See M. Moffitt, *supra* note 127, at 101-04.

134. Preface, *Floating Exchange Rates and the State of World Trade Payments* xv (D. Bigman & T. Taya eds. 1984); see also Agmon, Hawkins & Levich, Introduction, in *The Future of the International Monetary System* 1, 2-3 (T. Agmon, R. Hawkins & R. Levich eds. 1983).

135. M. Moffitt, *supra* note 127, at 43-44.

136. Interest Equalization Tax of 1964, Pub. L. No. 88-563, 78 Stat. 809 (codified as amended in scattered sections of 26 U.S.C.).

subsidiaries), generated an explosion of overseas branches.<sup>137</sup> The number of foreign branches of U.S. banks almost quadrupled between 1965 and 1974.<sup>138</sup> Foreign loans as a portion of total U.S. bank loans increased from 3% in 1960 to 15% in 1972.<sup>139</sup>

The "Euromarket" was the result of this flow of U.S. bank assets abroad: "Eurodollars" (or U.S. currency abroad) were freely and continuously exchanged, placed on loan, and invested through the London and other exchanges. Branches of U.S. and Japanese banks joined European banks in putting together enormous syndicated loan packages to sovereign and commercial borrowers around the world. A typical \$10 million loan could be for a medium term (seven to twelve years), with risks to be limited by participation of several banks in the loan and by periodic rollovers of the loan every six months (at prevailing interest rates).<sup>140</sup> Most of the NODC sovereign loans were made on the Euromarket after 1970, and (due in part to infusions of OPEC country deposits after 1973) the Euromarket's growth enabled it to meet developing countries' demands for credit.<sup>141</sup> Well before the OPEC price increases of 1973, there was what Michael Moffitt terms a "global money market,"<sup>142</sup> whose goals dovetailed almost perfectly with those of de-

137. See M. Moffitt, *supra* note 127, at 47.

138. In 1965, thirteen U.S. banks with gross assets of \$8.9 billion had foreign branches in 211 locations. By 1974, 125 banks with gross assets of \$140.5 billion had 732 branches. See Appendix, Table 8.

139. M. Moffitt, *supra* note 127, at 50.

140. See D. Delamaide, *supra* note 20, at 40-43.

141. The Eurodollar market grew at a compound annual rate of 37% between 1965 and 1971, in large part because of the tax incentives for keeping dollars abroad. See *supra* notes 136-137 and accompanying text. According to Wellons, *International Banks and Balance of Payments Finance in the Mid-1970's*, in P. Wellons, *supra* note 120, at 23, 59 (Table A), the Eurodollar market reached the following levels after 1971:

<u>Year</u>	<u>Eurodollar Market (billions of dollars)</u>
1971	145
1972	200
1973	305
1974	375
1975	460
1976	565
1977	695
1978	895
Dec. 1979	1155
Mar. 1980	1200
June 1980	1270

142. M. Moffitt, *supra* note 127, at 41.

veloping countries: the latter wanted to borrow a lot of money, and the former very much wanted to lend it.

While it is true that there would have been pressure on the large international banks to recycle petrodollars through loans to NODC's, that does not explain the banks' eagerness to attract petrodollar deposits and then place them on loan to NODC's. Nor does it explain the banks' continued enthusiasm for sovereign lending after 1979. Indeed, this enthusiasm for what are now seen as risky loans seems to be at odds with the widely held view that bankers are risk averse.<sup>143</sup> The "mania" (using the Minsky-Kindleberger term) of NODC, and especially Latin American, loans was in retrospect mildly irrational. The hypothesis suggested here is that bankers as a group shared a "mentality of expansion" that justified large-scale lending, which appears unreasonable only in light of subsequently understood facts. That mentality can be explained by reference to three structural themes.

### 1. *The Allure of Short-Term Profits, and the Lemming Phenomenon*

Institutions do not make loan decisions. Their officers, influenced by their own career goals and objectives, make those decisions. Once U.S. banks had established so many foreign branches (originally to service their clients, and subsequently to avoid taxes), the officers in charge of them were under some pressure to justify the investment by generating loans. If a banker heading up a foreign branch office did not make loans, that banker's career went nowhere, and in the early 1970's the old multinational corporate customers were not generating as many loans as they did previously. The successful Eurobanker was the one who—like Walter Wriston—made loans one day and worried about the consequences the next.<sup>144</sup> If private (corporate) demand slackened but foreign

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143. See Schirano, *supra* note 22; White, *Efficiency Justifications for Personal Property Security*, 37 Vand. L. Rev. 473, 495-97 (1984). But see Schwartz, *The Continuing Puzzle of Secured Debt*, 37 Vand. L. Rev. 1051, 1062-65 (1984), who argues that because the risk preferences of lending officers will be neutralized by the banks' managers, banks are risk neutral. This mechanism was not operative during the mania period, however, because of the allure of short-term profits and the indistinct nature of the long-term risks.

144. Wriston, who built Citibank into the world's most aggressive bank, epitomized the new breed of international bankers. See M. Moffitt, *supra* note 127, at 56. For these international bankers:

[T]he name of the game was growth. Once banks had expansive foreign branches, the officers who ran them had to generate enough business to justify

sovereign demand was strong, the sovereign loans were made.

In the short term, these loans were quite profitable. Banks typically charged several up-front fees: a "commitment fee" for committing funds to the borrower; various "servicing" or "management" fees; and, if the bank put together a loan package for a group of banks, a "syndication" fee. Moreover, the interest rates on these loans were usually one or two points above LIBOR. Nothing advances a banker's career like short-term profits, and the more foreign sovereign loans made, the greater the profits. In 1970, the profits of Chase Manhattan Bank included \$108 million from domestic loans, \$31 million from foreign loans; in 1976 the figures were \$23 million and \$108 million, respectively. Other banks showed similarly impressive earnings figures.<sup>145</sup> Because large-scale banking is both fiercely competitive and closely knit (everyone knows everyone else), good profits from international lending for one bank created a "lemming" phenomenon: If Citibank and Chase Manhattan were making a lot of money on loans to Latin America, other banks would be left behind if they did not make loans there as well. Walter Wriston was the lemmings' guru. Much of the expansion was thus defensive in nature.<sup>146</sup>

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the costs of going global. . . . For Eurobankers, the emphasis on growth complemented their career objectives nicely. A rapid increase in lending and borrowing was the way to advance careers and reach the pinnacle of top management.

*Id.* at 55. See also D. Delamaide, *supra* note 20, at 34-37.

145. M. Moffitt, *supra* note 127, at 52 (Table 1) (specific profit figures for top ten multinational banks, broken down into domestic and international segments). International earnings as a percentage of total earnings for the top ten U.S. multinational banks were as follows:

	<u>Domestic</u>		<u>International</u>		<u>Compound annual rate of change, 1970-76</u>	
	(millions of dollars)				<u>Domestic</u>	<u>Int'l</u>
	1970	1976	1970	1976		
Citicorp	87.1	112.0	58.0	293.0	4.3%	31.0%
Bank of America	141.5	201.5	25.0	134.4	6.1	32.4
J.P. Morgan	77.1	95.3	25.5	107.4	3.6	27.1
Chase Manhattan	108.6	23.0	30.7	82.0	-22.8	17.8
Manufacturers Hanover	76.0	63.1	11.4	80.2	-3.1	38.4
Chemical	70.2	51.7	7.7	41.0	-5.0	32.1
Bankers Trust	46.3	20.7	7.8	36.9	-12.6	29.6
Continental Illinois	64.4	101.0	-0.1	30.0	7.8	n.a.
First Chicago	61.0	77.1	1.2	15.8	4.0	53.7
Security Pacific	57.4	71.0	0.2	5.3	3.6	72.7
Total	789.6	817.3	167.4	826.0	-1.4%	33.4%

*Id.* at 53 (Table 2).

146. See *id.* at 93-98 (reasons for expansionist philosophy: (a) defensive expansion to retain clients; (b) contribution to current earnings; (c) servicing multinational client needs; (d)

## 2. *Failure to Appreciate Country Risk*

The initially favorable profits were not completely accurate indications of the true value of these loans. Once banks started making international sovereign loans again, they could naturally obtain higher-than-market interest rates and up-front fees which improved immediate and short-term earnings, but there were serious long-term risks involved. These risks included not only the ordinary risks inherent in domestic lending, but also "country risk."

Country risk is "the possibility that sovereign borrowers of a particular country may be unable or unwilling, and other borrowers unable, to fulfill their foreign obligations for reasons beyond the usual risks which arise in relation to all lending."<sup>147</sup> Obviously, because of the increased riskiness of these sovereign loans, banks have substantial incentives to monitor sovereign loans and to ensure that they not become overcommitted to particular sovereign borrowers. It is therefore surprising to learn that few banks did country risk analyses of loans to developing countries and their enterprises. It is all the more surprising that the loans were not monitored more carefully, for banks were lending large sums of money to borrowers who (1) were putting up no collateral, (2) were subject to no bank control of the specific use of the funds, and (3) were (apparently) free to borrow as much money as they wished from other sources as well.<sup>148</sup> In the domestic lending markets, it is unusual to find such failure to appreciate a substantial risk. Three reasons contributed to this underestimation of risk in international sovereign lending during the mania period. Two of the reasons represent banker misperceptions; the third has some validity but represents a tendency of Western private banking systems to impose costs on the public.

One reason for underestimating country risk is that the decision-making and information-gathering structures of banks in the 1970's were biased. One bias was partial blindness to the historical problems with international sovereign lending. The bank managers of the 1970's were not around in the 1930's, when the Latin American countries had last defaulted on their external debts, and even

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opportunities of the Euromarket); Schirano, *supra* note 22 (herd-like instincts of bankers caused them to make sovereign loans).

147. Group of Thirty, *Risks in International Bank Lending* 6 n.3 (1982).

148. See *International Financial Markets Hearings*, *supra* note 3, at 381, 392 ff. (statement of Richard Dale, Brookings Inst.) (explaining risk in loans to foreign sovereigns).

the largest banks had very little experience in this area until the 1960's. The facts that confronted bankers in the 1970's suggested less risk: the leading Latin American borrowers had been growing vigorously for ten to twenty years, and there seemed to be every prospect that they would continue to do so. Decisions, including review and monitoring of loan decisions, may reflect an "availability heuristic": people are more sensitive to vivid current news than to historical patterns because the former makes more of an impression (and hence is more likely to dominate a present consideration).<sup>149</sup> The vivid, readily available current information may then be overgeneralized, as decisionmakers often assume that current information is representative of the relevant data (the "representativeness heuristic").<sup>150</sup> The future will probably resemble the present. For these reasons, a bank manager defending a decision to lend a lot of money to Brazil and Mexico in 1974 or even 1980 was far more persuasive than one arguing that in the 1930's those countries had defaulted, because the recent "hard" data (summarized in charts and graphs) supported the first banker.

A second type of bias relates to the way in which the banks gathered and processed information. There was very little readily available information in the 1970's about Latin American patterns of debt, due to haphazard accounting by the debtor countries and a lack of cooperation among the lenders. Even when the data was available, its importance was not fully appreciated. Once large volumes of loans were made to these countries, "cognitive dissonance" among the decisionmakers biased their analyses of later loan requests by overemphasizing good news about foreign sovereign lending and by underappreciating the doubts and risks.<sup>151</sup> In

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149. See R. Nisbett & L. Ross, *Human Inferences: Strategies and Shortcomings of Social Judgment* 45-60 (1980); Tversky & Kahneman, *Judgment under uncertainty: Heuristics & biases*, 185 *Science* 1124 (1974), reprinted in *Judgment under Uncertainty: Heuristics and Biases* 3 (D. Kahneman, P. Slovic & A. Tversky eds. 1982); see also J. March & H. Simon, *Organizations* (1958) (institutions and companies are subject to many of the same decision-making biases as individuals are).

150. See R. Nisbett & L. Ross, *supra* note 149, at 17-28, 37-42; Tversky & Kahneman, *supra* note 149, at 4-11. Experimental results show that decisionmakers do generally believe in the (erroneous) "law of small numbers"—that a small sample will yield representative results. This mistaken belief causes decisionmakers to have unrealistic expectations about the stability of observed patterns and the replicability of prior beneficial experiences. Tversky & Kahneman, *Belief in the Law of Small Numbers*, 2 *Psych. Bull.* 105 (1971), reprinted in *Judgment under Uncertainty: Heuristics and Biases* 23 (D. Kahneman, P. Slovic & A. Tversky eds. 1982).

151. According to the theory of cognitive dissonance, once a decisionmaker becomes even



short, to deny later loan requests might suggest questions about earlier decisions, and bankers were generally unwilling to face those questions. These psychological mechanisms explain why the euphoria of this mania period was, for a time, almost self-regenerating.

A second reason for the failure of banks to appreciate country risk was that they believed that diversification of loans among different countries would spread the risk of default, based upon the conventional view that economic performance of borrowers in different countries is subject to divergent risks.<sup>152</sup> Yet this view ignored the experience of the 1930's, when a worldwide depression affected sovereign loan repayments in a wide range of countries. While some external global events would affect some countries and not others, a great many events—such as higher oil prices, recession, and interest rate increases—would affect most countries similarly. The amount of systematic, or nondiversifiable, risk in international lending was apparently underestimated by bankers. Moreover, to the extent that country risk can be managed by geographical diversification, the banks failed to follow a legitimate diversification policy, for they concentrated most of their loans in similarly situated Latin American states.<sup>153</sup>

A third reason banks did not worry much about country risk was that they assumed that there were political checks on default: the developing country would not default because that would exclude it from future loans essential to its development, and even if there were a default, the U.S. government would step in and rescue the banks.<sup>154</sup> Such an assumption may also be subject to some question, for Latin American countries had frequently defaulted on

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tentatively committed to a decision, he will tend to view subsequent evidence as more supportive of the decision than it really is and will tend to avoid or denigrate nonsupportive evidence. See L. Festinger, *Conflict, Decision and Dissonance* (1964); I. Janis & L. Mann, *Decision Making: A Psychological Analysis of Conflict, Choice and Commitment* 171-72, 213-14 (1977) (amending the original Festinger analysis).

152. See Folkerts-Landau, *The Regulatory Origins of the International Debt Crisis*, *The Banker's Magazine*, Sept.-Oct. 1984, at 44; R. Dale & R. Mattione, *Managing Global Debt* 23-24 (Brookings Inst. Staff Paper 1984); Goodman, *Bank Lending to LDC's: Are Risks Diversifiable?*, *Fed Res. Bank N.Y.Q. Rev.*, Summer 1981, at 10; Walter, *Country Risk, Portfolio Decisions and Regulation in International Bank Lending*, *J. Banking & Fin.*, Mar. 1981, at 77.

153. Minority Staff, *House Comm. on Banking, Finance and Urban Affairs, Global Debt and International Financial Stability*, in *International Financial Markets Hearings*, supra note 3, at 137, 144-46 [hereinafter cited as *Minority Staff Report on Global Debt*].

154. Folkerts-Landau, supra note 152, at 44.

loans in the nineteenth century and then returned to the international funds market within a short time. (Indeed, historically, countries often do behave in ways contrary to their long-term self-interest.) Also, the banks may not have appreciated the political hostility in Congress to any kind of "bail-out" of the banks.<sup>155</sup> Finally, recent econometric studies suggest that it is in the borrowing country's self-interest to default when the debt-servicing burden becomes too high, even though default would exclude the country from international money markets.<sup>156</sup>

Nevertheless, because of the unique public importance of the large international banks, it was probably a valid assumption that political checks would tend to prevent a series of defaults whose costs would be borne entirely by banks. On the one hand, because of their commitment to development and their reliance on foreign capital to achieve it, Latin American countries would be loathe to force an outright schism with the banks, which were the main source of past and future external capital. On the other hand, national regulators would view the survival and prosperity of the large international banks as an important public policy and might step in with remedial measures, for any major bank failures could trigger a financial panic.<sup>157</sup> To a certain extent, then, the banks' cocky political optimism may have been perceptive, though hardly justified in a larger policy sense.

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155. For example, when Federal Reserve Chair Paul Volcker appeared before the House of Representatives in 1983 to urge regulatory cooperation in working out the problems with foreign sovereign loans, he was peppered with hostile questions and attacks against using any tax dollars to assist the banks in their restructures. One congressman noted: "One of the most difficult questions . . . [is] why the banks loaned the money. If the banks make a profit, they don't share it with the taxpayers. Why should the taxpayers share in their losses?" International Financial Markets Hearings, *supra* note 3, at 94 (remark of Rep. Wylie); see *id.* at 119-21 (remarks of Rep. Frank) (questioning whether the U.S. government should rescue banks from the consequences of uncollectable loans overseas); *id.* at 90-91 (remarks of Rep. St. Germain, Chair, House Banking Comm.) (questioning whether Congress should be more concerned about banks and their foreign borrowers than about U.S. farmers, small businessmen, and homebuyers); *id.* at 98-99 (remarks of Rep. McKinney, Ranking Republican, House Banking Comm.) (questioning whether banks can have both deregulation and government support in the event of investment/lending failure).

156. See Eaton & Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 *Rev. Econ. Stud.* 289 (1981); J. Sachs, *LDC Debt in the 1980's: Risk and Reforms* (Nat'l Bur. Econ. Res. Working Paper No. 861, Feb. 1982).

157. See Wellons, *Business-Government Relations in International Bank Lending: The Debt Crisis*, in *A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problems* ch. 6 (W. Eskridge ed. 1985) (forthcoming).

### 3. *Lack of Regulatory Constraints*

The decline of the Bretton Woods system and the phenomenal growth of private international money centers resulted in an international financial system that was, in Michael Moffitt's words, "a private system with only marginal official participation."<sup>158</sup> The Euromarket, where most of the loans were made, was unregulated—no central bank, no exchanges, no domestic laws to check the stampede of bankers to make sovereign loans. The banks' failure to require some kind of collateral for their loans and their failure to devise a more appropriate diversification strategy were not subject to any meaningful scrutiny.

Of course, the private participants themselves, private commercial banks, are subject to national regulation. In the United States the Comptroller General, the Federal Reserve Board, and the Federal Deposit Insurance Corporation are supposed to ensure that shareholders do not lose their investments, or depositors their accounts, due to poor lending policies on the part of banks.<sup>159</sup> These regulators, however, seem to have had no greater understanding of country risk in the 1970's than the banks did.<sup>160</sup> Moreover, as Professor Lichtenstein has cogently argued,<sup>161</sup> federal banking regulators in the United States have traditionally eschewed analysis of portfolio diversification; instead, regulators have focused (perhaps too mechanically) on monitoring the reserves appropriate for a bank's level of lending.<sup>162</sup> Any examination of sovereign loans has tended to be *ex post* rather than *ex ante*.

Even if the federal regulators had understood the problem and had had the clear authority to act, there were political reasons for them to do nothing except hope that the risks would not materialize. The big banks and some commentators already complain that the United States over-regulates bank lending, thereby putting

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158. M. Moffitt, *supra* note 127, at 71.

159. See Federal Reserve Act, 12 U.S.C. § 221 et seq. (1982); Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-1832 (1982).

160. Federal Reserve Chair Volcker testified that the traditional regulatory methods were not well-suited to evaluating country risk: "Individual bank examiners were not generally equipped to evaluate economic conditions and prospects of countries. . . . The traditional criteria for formally 'classifying' or 'criticizing' loans were developed for private borrowers or local governments, and were not readily adaptable to consideration of 'transfer risk' or evaluating sovereign entities." International Financial Markets Hearings, *supra* note 3, at 41, 52 (statement of Paul Volcker).

161. Lichtenstein, *supra* note 25, at 403.

162. *Id.* at 403-05.

U.S. banks at a competitive disadvantage with banks in other Western countries.<sup>163</sup> Consequently, there is something of a "competition in laxness" among different national bank regulators. Moreover, bank regulators have been reluctant to institute rules that would offend borrowing countries. As Federal Reserve Chairman Volcker candidly admitted in 1983, bank regulators were loathe, for foreign relations reasons, to establish classifications that might be offensive to particular countries.<sup>164</sup> Indeed, federal regulators encouraged private bank lending to developing countries because it removed pressure on the U.S. government and the international financial institutions to make such loans in a period when they did not have the resources to do so.<sup>165</sup>

Under the Bretton Woods system, NODC's generally did not become too heavily indebted and there were mechanisms to smooth over short-term payment problems without denying borrowing countries more credit. When they did take on debt, it was on concessionary (bargain) terms from Western countries (chiefly U.S. trade credits and foreign aid) or multilateral lending institutions. When this public order withered in the 1970's, massive, less constrained private lending took its place. The corollaries of the demise of Bretton Woods and the mania-to-panic syndrome were that (1) the rapidity and competitiveness with which international lending developed charged it with an ideology of expansion parallel to that found in developing countries; (2) the risks of this sort of lending were systematically underestimated; and (3) the ideology of growth and accumulation of risks were not checked by national regulators because the existing regulatory philosophy was not sensitive to the possibility of overlending to sovereign debtors.

When OPEC dramatically raised its oil prices in 1973, and developing countries increased their demand for bank loans, the international banking system was poised to accommodate. Between one-third and one-half of the OPEC investable cash surplus was channeled into the Eurodollar market and domestic U.S. bank de-

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163. See *id.* at 433; International Financial Markets Hearings, *supra* note 3, at 391-92 (statement of Richard Dale, Brookings Inst.).

164. International Financial Markets Hearings, *supra* note 3, at 52-53 (statement of Paul Volcker).

165. Lichtenstein, *supra* note 25, at 407-09 (federal financial regulators encouraged loans to Indonesia in 1970's and were criticized by Congress); see Minority Staff Report on Global Debt, *supra* note 153, at 141.

posits.<sup>166</sup> Given this new supply of funds, the necessity of turning it over quickly, the paucity of equally attractive alternative demand, and the bankers' expansionist mentality and underestimation of sovereign risks, it was natural for U.S. (and other Western) banks to make further loans to developing countries from 1973 to 1979. In other words, unchecked by regulation and encouraged by systematic group euphoria about the profits and risks of international lending, international bankers made an increasing volume of loans each year to countries whose true creditworthiness was, in many cases, sinking just as fast as new money came in.

The power of these structural causes of the debt problem can be seen after 1979. Although the new OPEC price increase generated a substantial new influx of funds into the Eurodollar market, the level of country debt and bank exposure was remarkably high and (finally) cause for concern. The federal regulators in 1979 instituted a system requiring bank consideration of country risk and encouraging diversification of lending practices.<sup>167</sup> Yet the momentum of developing country sovereign lending continued and, in fact, accelerated.

The 1979 federal guidelines were a substantial failure, in part because they were only hortatory and reflected considerable regulatory ambivalence over whether and how to regulate.<sup>168</sup> More money was lent by banks to developing countries, and the level of their exposure increased (the nine major U.S. banks had 137% of their equity on loan to Brazil, Mexico, and Argentina in mid-1982, compared with 114% when the 1979 federal regulation was initiated),<sup>169</sup> because of the lemming phenomenon and the continued underappreciation of the risks. The period of euphoria persisted far longer than any objective analysis would have justified. Even after mini-crises concerning the debts of Mexico, Peru, Zaire, and

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166. See T. Enders & R. Mattione, *supra* note 15, at 6-13.

167. See *supra* note 24.

168. Richard Dale, for example, argues that the only workable approach is to have absolute ceilings on bank lending to sovereign borrowers and that the various regulations essayed by federal regulators through the 1970's—disclosure, light pressure to diversify, stricter accounting rules—were doomed to failure. See *International Financial Markets Hearings*, *supra* note 3, at 381, 384-91 (statement of Richard Dale). Professor Lichtenstein, in some contrast, argues that individual country ceilings are inconsistent with traditional U.S. regulatory policy, which stresses regulation of reserve levels rather than particular lending decisions. See Lichtenstein, *supra* note 25, at 403.

169. See *supra* note 23.

Poland between 1976 and 1981,<sup>170</sup> banks continued to make large-scale loans to Latin American and other developing countries. Remarkably enough, many banks were, according to one top executive, caught entirely by surprise when Mexico confessed its inability to service or repay its debt in August 1982.<sup>171</sup> In retrospect, the largely private system of international finance was not a system that worked very well.

*C. The Debt Problem as a Prisoners' Dilemma and Its Solution as a Public Good*

So far, the argument has been that the causes underlying the debt problem involve political, economic, and financial structures evolving after World War II. The Latin American debtor countries adopted an uncritical philosophy of growth which, in combination with an excessively accommodative political system unable to require short-term economic sacrifices, impelled those countries to seek more foreign loans in the 1970's. This unprecedented demand was met by an unprecedented extension of loan supply by international bankers who were unconstrained by regulatory attention. The countries' philosophy of growth and the liberation of international lending from earlier regulatory constraints came together to create a mania after 1966-1973, when the Vietnam War and the OPEC price increases ended the post-war period of low inflation and low nominal interest rates, and ushered in a new and troubling era of greater economic uncertainty (displacement). The mania continued without distress for some years after 1973 because favorable economic conditions for the debtor countries meant that their export growth more or less offset any growth in external debt. After 1979, however, the mania created a problem of too much debt and too much lending, but the euphoria caused the players in the market (and those ostensibly regulating them) to ignore the problem still. Distress became apparent in 1982, when banks cut back on their international sovereign lending. August 1982—the Mexican confession of its inability to pay—produced a revulsion.

Two issues remain for consideration. One is posed by Professor

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170. By the end of 1981, the commercial banks had engaged in multilateral debt renegotiations with at least six NODC's (Peru, Zaire, Jamaica, Turkey, Nicaragua, and Sudan) and had initiated negotiations with at least two others (Bolivia and Costa Rica). I. Friedman, *supra* note 18, at 127-33.

171. Schirano, *supra* note 22.

Diaz-Alejandro. After June 1982, banks did not just curtail their lending and/or demand higher interest rates in light of the higher perceived risks; they all but stopped lending to Latin American countries and created capital outflows by 1983.<sup>172</sup> Why? Part of the reason is the chain-reaction nature of the Minsky-Kindleberger revulsion: once the overextension has been realized, everyone wants out—immediately. But why was there no crash? Instead of complete disaster (default by the borrowers, a run on the main lenders, credit cut-offs, and so forth), the formerly euphoric bankers took their bad NODC investments to the once-written-off public sector (the IMF and the Western governments) and negotiated a series of measures to avert a crash. All the main participants perceived that their interests were best protected by negotiations that preserved bank-NODC relationships.

A more elaborate structural answer to these two questions starts with the peculiarly non-legal range of remedies available to the banks and the countries. Had the borrowers been private and not sovereign entities, the banks most likely could have enforced their rights under the loan agreements by instituting lawsuits to enforce liens, by foreclosing on collateral, or by attaching other assets to satisfy the debt. Had the total creditor claims exceeded the net worth of private (and not sovereign) debtors, the debtors could on a voluntary or involuntary basis have entered bankruptcy proceedings to settle their debts and/or reorganize their operations, thus giving them a “fresh start” unencumbered by debt. These options are not formally available in cases of sovereign debt: lawsuits to collect the debt are impractical, and there is no formal fresh start (bankruptcy) for countries.

Some commentators have written or assumed that countries cannot be sued for repudiation of their public debt.<sup>173</sup> As a matter of law they are wrong, though practically such lawsuits are not necessarily effective remedies. Sovereign loans are typically not backed by collateral that the banks can attach in the event of default, but they may have acceleration and elaborate cross-default clauses.<sup>174</sup>

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172. Diaz-Alejandro, *supra* note 73, at 350 (Table 4).

173. See, e.g., R. Dale & R. Mattione, *supra* note 152, at 20-21 (assuming that legal redress is not available against a defaulting government if sovereign immunity is invoked).

174. See, e.g., Model Mexican Restructure Agreement art. IX (July 1983) (on file with the author) [hereinafter cited as Model Restructure Agreement] (model agreement containing acceleration and cross-default clauses). See also Mendez, *Recent Trends in Commercial Bank Lending to LDC's: Part of the Problem or Part of the Solution?*, 8 *Yale J. World Pub.*

If the Mexican government, for example, fails to make timely payments of principal and interest, its creditors can demand that the entire loan amount fall due (be accelerated) *and* that all other loans to the Mexican government, its political subdivisions, and its state trading companies also fall due. The right of acceleration, of course, does the banks little good if they cannot enforce it through legal process. A lawsuit in Mexico would not likely be successful, since Mexican courts would defer to any state decree renouncing, or unilaterally amending, the debt obligation.

As a formal matter, a lawsuit in the United States against Mexico would usually be possible. Federal subject-matter and personal jurisdiction in lawsuits against "foreign states" (including political departments or subdivisions and most state trading companies) is governed by the Foreign Sovereign Immunities Act of 1976.<sup>175</sup> Such jurisdiction exists "as to any claim for relief . . . with respect to which the foreign state is not entitled to [sovereign] immunity under either sections 1605-1607 of [the Act] or under any applicable international agreement."<sup>176</sup> For example, pursuant to section 1605(a)(1), if the foreign state debtor "has waived its immunity either explicitly or by implication" in the loan agreement, it is not immune from suit to enforce the terms of the loan agreement.<sup>177</sup> A clause submitting the foreign state to the jurisdiction of U.S. courts to enforce the terms of the loan agreement would be such a waiver.<sup>178</sup> The waiver exception to immunity would usually be available for U.S. lenders to enforce sovereign debt agreements.<sup>179</sup>

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Order 173, 193-94 (1982) (describing cross-default clauses and their effects).

175. Pub. L. No. 94-583, 90 Stat. 2891 (1976), codified at 28 U.S.C. §§ 1330, 1332(a), 1391(f), 1441(d), 1602-1611 (1982). See Eskridge, *The Iranian Nationalization Cases: Toward a General Theory of Jurisdiction over Foreign States*, 22 Harv. Int'l L.J. 525 (1981).

176. 28 U.S.C. § 1330(a) (1982). An oddity (if not an idiom) of the FSIA is that it combines sovereign immunity, subject-matter jurisdiction, and personal jurisdiction inquiries into a single statutory test: If the "foreign state" is not immune under sections 1605 through 1607, it not only loses the sovereign immunity defense, but subject-matter jurisdiction is established and (if proper service is made) personal jurisdiction exists as well. Smit, *The Foreign Sovereign Immunities Act of 1976: A Plea for Drastic Surgery*, 1980 Am. Soc'y Int'l L. Proc. 49, 50-69 (1981).

177. 28 U.S.C. § 1605(a)(1) (1982).

178. See von Mehren, *The Foreign Sovereign Immunities Act of 1976*, 17 Colum. J. Transnat'l L. 33, 55-56 (1978) (sample waiver clause).

179. See Model Restructure Agreement, *supra* note 174, § 13.08 (detailed waiver of immunity clause).

One complication is that some Latin American countries have constitutional or statutory provisions that might be interpreted as prohibiting such waivers. The effect of such provisions has produced some uncertainty. See Kahale, *State Loan Transactions: Foreign Law*



A second basis for jurisdiction under the FSIA is section 1605(a)(2), the commercial activity exception to foreign state immunity. Under that exception, a foreign state that defaults on a public loan entered into in the United States or to be repaid in the United States would not be immune if the public loan were a "commercial activity."<sup>180</sup> The traditional view was that a country's public debt is not a commercial activity, and thus actions arising out of its nonpayment were immune from suit, even under the modern restrictive theory of immunity.<sup>181</sup> Although far from clear, the rationale for such a rule was probably based upon the governmental purposes of the public debt (development, infrastructure). The 1973 State Department draft of the FSIA would have left foreign states immune "in any case relating to its public debt," unless there were an explicit waiver of immunity or the debt were that of a state agency, instrumentality, or political subdivision.<sup>182</sup> That provision was deleted in the FSIA as enacted in 1976. Congress rejected the exception, in part, because "both a sale of bonds to the public and a direct loan from a U.S. commercial bank to a foreign government are activities which are commercial in nature and should be treated like other similar commercial transactions."<sup>183</sup>

Thus in most cases foreign states can be sued if they breach their loan agreements with U.S. banks. The problem would be to collect on the judgment, for these states may not have sufficient

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Restrictions on Waiver of Immunity and Submissions to Jurisdiction, 37 *Bus. L.* 1549 (1982).

180. 28 U.S.C. § 1605(a)(2) (1982); see *id.* § 1602 (the purpose of the FSIA is to ensure that, pursuant to "international law, states are not immune from the jurisdiction of foreign courts insofar as their commercial activities are concerned"); *id.* § 1603(d) (defining "commercial activity," albeit in a circular manner).

181. See *Victory Transport, Inc. v. Comisaria General de Abastecimientos y Transportes*, 336 F.2d 354, 360 (2d Cir. 1964) ("public loans" are inherently governmental acts, for which states require immunity from suit), cert. denied, 381 U.S. 934 (1965); Lalive, *L'Immunité de Juridiction des Etats et des Organisations Internationales*, 3 *Recueil des Cours de l'Académie de Droit International* 206, 285 (1953) (similar).

182. Draft § 1606 is reprinted in *Immunities of Foreign States: Hearing Before the Subcomm. on Claims and Governmental Relations of the House Comm. on the Judiciary*, 93d Cong., 1st Sess. 5 (1973).

183. H.R. Rep. No. 94-1487, 94th Cong., 2d Sess. 10 (1976); see *Jackson v. People's Republic of China*, 550 F. Supp. 869 (N.D. Ala. 1982). The Act's inclusion of sovereign loans within its intended definition of commercial activity is supported by modern international practice in other restrictive theory states. See, e.g., U.K. State Immunity Act of 1978, § 3(3)(b), reprinted in 17 *I.L.M.* 1123, 1124 (1978) (a "commercial transaction," for which the state has no immunity, includes "any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation").

assets in the United States, and many of the assets found there would in most cases be immune from attachment to enforce the judgment. The modern restrictive theory of immunity gives foreign states greater protection against losing their assets through attachment than against being sued. Under the FSIA, only the "property in the United States . . . used for a commercial activity in the United States" can be attached if the judgment is against the country itself or its departments or subdivisions.<sup>184</sup> Moreover, unless there is a waiver of attachment immunity, the property attached would have to be that "used for the commercial activity upon which the claim is based," namely, the loan.<sup>185</sup> The funds held by the state's central bank for its own account are expressly immunized by the FSIA.<sup>186</sup> In short, very little of the country's property in the United States would be available to satisfy any judgment accelerating and demanding payment on the country's public debt. If there were cross-default clauses in the loan agreement, the debt of state trading companies might also be accelerated, and any judgment against trading companies might be executed against any of their properties or funds in the United States, with certain exceptions.<sup>187</sup> But the central government's debt judgment would still remain largely uncollected in most instances.

The peculiar dearth of formal legal sanctions against sovereign borrowers that fail to make payments contributed to the uncontrolled spree of NODC borrowing and Western bank lending, especially after 1979. Without easily enforceable legal remedies, banks did not believe they were in a position to place restrictions on their sovereign loans in the 1970's, such as limitations on the use of the borrowed money, disclosure requirements, or ceilings on the country's total debt.<sup>188</sup> As a result, the countries were allowed to borrow as much as they wanted—which was too much. More important, the banks had insufficient incentives to monitor aggregate sovereign borrowing carefully and to develop a "maximum level of sus-

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184. 28 U.S.C. § 1610(a) (1982).

185. *Id.* § 1610(a)(2).

186. *Id.* § 1611(b)(1).

187. *Id.* § 1610(b).

188. In the case of corporate borrowing, bond covenants restrict the corporation's payment of dividends, its total indebtedness, maintenance of assets to secure the debt, and periodic disclosure of information so that the creditor may monitor the debtor's financial status. Because these covenants are practically unenforceable against sovereigns, they are typically not included in sovereign loan agreements. See R. Dale & R. Mattione, *supra* note 152, at 21 & n.34.

tainable debt" for each individual country.

Ultimately, when the euphoric lending gave way to reality, the dearth of legal sanctions generated a "prisoners' dilemma," a situation in which each player has strong self-interested incentives not to cooperate with the other players, with the result that all players are left in a worse position than the one they would have enjoyed had they cooperated with one another.<sup>189</sup> The banks involved in the debt dilemma in 1982 had precisely these incentives. Each bank realized that Mexico, Argentina, and Brazil (the three largest borrowers) were not the good credit risks they were once believed to be. Also realizing that if those countries were to default or declare a moratorium on interest payment there would be no effective legal sanction available, each bank responded rationally by eliminating new loans to these countries and by refusing to roll over old loans. These were perfectly normal, rational decisions for individual banks. But when *all* the banks curtailed, or virtually eliminated, sovereign lending in the second half of 1982, Mexico, Argentina, and Brazil found themselves without even the most minimal sources of finance that a well-managed country might need during a period of trade recession and high interest rates. As a result, these and other countries simply had to confess their inability to pay, leaving all the banks worse off because of rational behavior by the banks individually. This has been called a "contagious collapse of confidence" by some commentators,<sup>190</sup> and is the Minsky-Kindleberger "revulsion," but in truth it is nothing more than the playing out of this prisoners' dilemma on a massive scale.

As a result, the banks and their borrowers faced something more than a dilemma in 1982-1983: If they did not work their way out of the crisis, they faced disaster (the Minsky-Kindleberger "crash"). A successful workout required cooperation on two levels: first, co-

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189. For an excellent explanation of the prisoners' dilemma and an application of game theory to international trade, see Conybeare, *Public Goods, Prisoners' Dilemmas and the International Political Economy*, 28 *Int'l Studies Q.* 5 (1984).

190. The contagious collapse works as follows: (1) Since it has no legal redress, a bank with loans to a sovereign state will react to the state's prospect of default by cutting off further loans. (2) If other banks follow this strategy, then the country is placed in an untenable position, for even healthy Third World economies need commercial or other loans for their sovereign and private sectors. (The banks' cut-off of funds may apply to the private sector as well as the public.) (3) Once a bank has lost confidence in the ability of Country X to service its debts over time, it will re-evaluate its lending policy to adjacent Country Y (which probably should have been done long ago) and may cut off credit to Country Y as well. Again, the other banks do the same, and Country Y might be forced into default, even though it is better able to service its debts than is Country X.

operation between the banks as a group and the individual debtors, and second, cooperation among the banks in supplying new money and other forms of relief.

There were, indeed, very substantial motivations for cooperation on the first level. The big lenders were willing to cooperate because much of their capital was on loan to individual countries. If the countries in question were to threaten default or moratorium, the most heavily exposed banks would practically be required to lend "new money" even after the crisis of confidence. This phenomenon is called "involuntary lending": to prevent a total loss of a sizeable chunk of its assets (which might threaten its own solvency or profitability), a bank will rationally commit a smaller chunk of assets to new loans that carry high risks of loss, further committing the bank to that country.<sup>191</sup>

So long as it continues to embrace the ideology of growth, the sovereign borrower is also a captive of the situation. If a private company's debts exceed its assets, it may voluntarily go into bankruptcy or reorganization proceedings to reorder and reduce its external debt. There is no bankruptcy proceeding for sovereign states. Their traditional relief has been to default on loans or to suspend payments for a period of time.<sup>192</sup> But so long as they adhere to a philosophy of productive growth that stresses the need for capital investment, and their own citizens do not save and invest at the necessary levels, they continue to have a long-term need to borrow from international or foreign sources. If a sovereign borrower exercises its power to default, the banks can retaliate by exclusion from international capital markets. For this reason, and notwithstanding the discussions of a debtors' cartel in 1984, the Latin American countries have not walked away from their loans, even though debt servicing in 1984 kept growth rates relatively low and consumed most or all of their hard-earned trade surplus. To

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191. "The basic dynamic of forced lending is that the lender with existing exposure will increase the exposure with new loans as long as the new funds are judged likely to enable a firming-up of the previous exposure rather than to be merely a throwing of good money after bad." W. Cline, *supra* note 6, at 72. Involuntary lending will occur when "(a) the reduction in the probability of country default thereby achieved, *multiplied by* previously outstanding loans, *exceeds* (b) the terminal probability of default (after the new loans) as *multiplied by* the amount of the new loans." *Id.* (emphasis in original). For this analysis, the probability of a moratorium (suspension of principal and interest payments) is counted as 20% to 40% of a default. *Id.* at 73.

192. See Dammers, *A Brief History of Sovereign Defaults and Rescheduling*, in *Default and Rescheduling: Corporate and Sovereign Borrowers* 77 (D. Suratgar ed. 1984).

prevent loss of access to foreign capital, these countries have rationally committed themselves to increase trade surpluses through austerity programs and other measures and, in turn, to pay most or all of that surplus to foreign banks and other lenders.

While cooperation existed at the first level, a major problem jeopardized cooperation at the second level: hundreds of banks had money on loan and their exposure was very uneven. This created a "public goods dilemma" as the banks tried to reach agreement on new lending and loan rescheduling packages for the debtor nations. A public goods dilemma is a situation in which some participants have incentives to create a common benefit from which it is difficult to exclude "free riders," that is, those who have not contributed to the benefit's creation.<sup>193</sup> As a result, insufficient quantities of the benefit will be created. For each borrowing country, there were some banks whose exposure was very great and for which involuntary lending was a natural response. The exposure of other banks was not great, and their individual lending calculus suggested to them that no new money should be placed on loan. They were willing to risk default rather than advance new money, especially if they perceived that default could be staved off by new lending from the highly exposed banks. These free riders were potentially quite numerous. Realizing that the big lenders would have to supply new money, and seeing others free ride, moderately exposed banks might also have followed the free riders. The fear was that once a trickle of banks opted out of a joint solution, a wave would soon follow.

This public goods dilemma did not wreck the workout process, however. A major reason is that political pressures were applied to encourage the less exposed banks to contribute to the public good and not to be free riders. The highly exposed lenders tended to be big banks, which used their influence to lobby the smaller regional banks.<sup>194</sup> More important, national bank regulators in the United States and other countries applied pressure. Because the solvency of the big international banks was perceived to be a matter of public concern, national regulators committed public funds as bridge loans for the borrowing countries and pressed the regional banks to

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193. For an excellent explanation of the public goods dilemma and its possible application to international trade, see Conybeare, *supra* note 189.

194. See Gibbs, *A Regional Bank's Perspective: An Analysis of the Differences and Similarities in the U.S. Banking Community's Approach to and Participation in the Mexican Restructuring*, 23 *Colum. J. Transnat'l L.* 11, 18-19 (1984); Wellons, *supra* note 157.

participate in the joint effort.<sup>195</sup> "Cooperation" was thus ensured.

Although the lack of traditional legal remedies has thus made international sovereign financing erratic and vulnerable to spontaneous collapses, constructive mechanisms have been created to cope with the problem. Because neither the banks nor the debtor countries have an easy legal remedy like the foreclosure or bankruptcy available to private partners, their practical recourse is to cooperate with one another, and with the United States and the IMF, to create equivalent solutions by negotiation. Hence the series of debt-restructuring negotiations, in which the borrowing country agrees to an IMF program to improve its current account deficit, in return for new funds (from the IMF and the banks) and an extended time in which to repay its foreign debt.

These negotiated agreements have served the same ordering functions in this international sovereign context typically served by formal, coercive legal rules in private party settings.<sup>196</sup> First, and most important, the process of debt restructuring has compelled the Latin American governments to make some of the hard decisions that paralyzed them earlier. Although the IMF austerity plans have not necessarily been the best approaches, they have at least forced countries to adopt more realistic policies. Second, the process has enforced collective discipline on the banks. Acting through advisory groups, the banks have accomplished what the national regulators have never required: a group determination of the country's level of sustainable debt and a workout of loans that will fit into that determination. Third, the process has fostered better informed decisions. Information is now available to banks not only through the IMF and other multilateral agencies, but also through the Institute of International Finance created by the banks in 1983.<sup>197</sup> More important perhaps, country risk evaluations are now taken seriously. At least for a while, the banks will remember the lesson.

The forced dialogue between lenders and debtor countries does

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195. See Diaz-Alejandro, *supra* note 73, at 355; Wellons, *supra* note 157.

196. On the ability of negotiation and other informal means to serve as the functional equivalent of a formal legal regime (if not a more satisfactory regime), see, e.g., W. Stoever, *Renegotiations in International Business Transactions* ch. 7 (1981); Eisenberg, *Private Ordering through Negotiation: Dispute-Settlement and Rulemaking*, 89 *Harv. L. Rev.* 637 (1976).

197. See Surrey & Nash, *Bankers Look Beyond the Debt Crisis: The Institute of International Finance*, 23 *Colum. J. Transnat'l L.* 111 (1984).

not, however, assure that structural problems will be eliminated entirely, or even that the current debt problem will be easily solved. Beneath the negotiations are deep chasms of disaster. On the one hand is the possibility that the IMF austerity measures will destabilize individual countries or entire regions. Sacrifices demanded of politically potent corporatist interests might trigger a crisis of legitimacy similar to that which occurred during the Depression of the 1930's. Additionally, the debt-induced austerity measures might generate mass unrest due to unfulfilled popular expectations after so many years of growth.<sup>198</sup> Or, as Dr. Riordan Roett has argued, the workout process might imperil the fragile trend toward redemocratization in Latin America.<sup>199</sup> On the other hand is the possibility of sovereign loan default, which could severely damage the international financial system or lead to the failure of leading U.S. banks.<sup>200</sup> If the terms of renegotiation themselves dry up capital needed for development, or if they impose what appear to be unfair costs on Latin American or other developing countries, the possibility of breakdown remains.

### III. PARADIGMS OF DEVELOPMENT AS EXPLANATIONS OF THE DEBT PROBLEM

The structural explanation set forth in Part II helps to place the current international debt problem in a broader historical perspective, and for that reason it is complementary to the shocks-and-mistakes explanation of Part I. The structural explanation, however, does not fully explore one final, critical dimension of the international debt problem. How does the problem relate to the ongoing theoretical and policy debate about economic development itself? Indeed, it can be "explained" by several competing development theories (or ideologies). Conversely, the debt problem sheds valuable light on the validity of the development theories themselves.

It is impossible here to essay any comprehensive analysis of the debt problem under every one of the many schools of development

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198. Cf. C. Brinton, *Anatomy of a Revolution* (1938) (one trigger for revolution: unfulfilled expectations).

199. See Roett, *supra* note 77 (concerns regarding austerity); see also Roett, *Democracy and Debt in South America: A Continent's Dilemma*, 62 *For. Aff.* 695 (1984).

200. See, e.g., Rowe, *Latin Nations Ask for More Help*, *Wash. Post*, Feb. 9, 1985, at C1, col. 4; *Brazilian Debt Moratorium "No Longer Taboo," The Latin American Times*, No. 60, at 22 (1984); *Dangers of the U.S. Recovery, The Latin American Times*, No. 58, at 1 (1984).

theory.<sup>201</sup> All that can be done here is to explore, rather provisionally, the explanatory value of three influential paradigms of economic development: the modernization paradigm, which is closely tied to the process by which Western Europe and the United States developed; the dependency paradigm, generated by Third World (especially Latin American) scholars as a response to their perception that "modernization" is only the process by which industrialized countries render other countries permanently "underdeveloped" or dependent upon and subservient to their capital and technology; and a global interdependence paradigm, which views the world economic system as an interdependent one in which the leading industrial economies have a privileged and controlling role, but in which newly industrializing countries in Latin America and elsewhere are seeking to join their ranks.

The conclusion of Part III is that neither the modernization nor the dependency paradigm is a wholly satisfactory historical context for explaining and understanding the international debt problem (though each provides very useful insights). Indeed, the debt problem exposes some difficulties in those theories as general historical approaches to economic development. With some elaboration and refinement, a global interdependence paradigm is a more helpful historical explanation for the current crisis: it is a crisis in the capitalist world system, in which the post-1960's dysfunctions of Western core state economies threaten the ability of certain newly industrializing countries to advance in the world system, as well as the ability of the Western states to continue their own economic position in the world.

#### A. *The Modernization Paradigm*

Development theory emerged as a systematic discipline only after World War II, in part as an intellectual means for Western liberal thinkers to justify the dominance of Western countries in the post-War economy and to defend large expenditures of foreign aid. The "modernization paradigm" of development evolved among

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201. For example, I shall not explicitly deal with the influential Marxist school of development theorists, in part because two of the three paradigms are influenced by Marxist insights. Notwithstanding absorption of many Marxist ideas in other theories, there is a lively neo-Marxist school of development theory. See *Neo-Marxist Theories of Development* (P. Limquenco & B. McFarlane eds. 1983); Weaver & Berger, *The Marxist Critique of Dependency Theory: An Introduction*, in *The Political Economy of Development and Underdevelopment* 45 (C. Wilber ed. 1984).



Western or Western-influenced economists and sociologists.<sup>202</sup> Under the view that emerged, development was seen from an evolutionary, progressive perspective. An "underdeveloped" country of today was expected to evolve into the "developed" country of tomorrow. This evolutionary process would be basically imitative: the underdeveloped country would follow the steps taken by the United States and Western Europe in the nineteenth and early twentieth centuries, until it gradually assumed the characteristics of the developed Western "mass consumption society," including sustained internal capital accumulation, substantial and diversified industrialization, self-perpetuating growth, and middle-class mores and democratic institutions. The process would be gradual, inexorable, and non-disruptive.<sup>203</sup>

The first problem explored by Western development theorists was how countries achieve rapid economic growth. The post-War modernization thinkers started with the observation that the economies of most countries in the world had not reached the level of self-sustaining growth that the economies of Western Europe and the United States had maintained (notwithstanding the interruption of the Depression). Instead, underdeveloped countries seemed "stuck" at a more primitive level of economic organization. How could these countries become "unstuck"? What could stimulate self-sustaining growth as in the Western countries?

One framework for answering those questions was Keynesian economics, which had been perceived as useful in pulling the "underemployed" Western economies out of the Depression. Keynes and those influenced by him believed that an increase in aggregate investment would have a multiplier effect, increasing the overall level of economic activity geometrically.<sup>204</sup> Although Keynes him-

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202. Compare B. Hettne, *Development Theory and the Third World* 11-38 (1982) (origins and evolution of the modernization paradigm), with *Pioneers in Development* (G. Meier & D. Seers eds. 1984) (collection of essays by early modernization theorists reevaluating and, for the most part, reiterating their positions on development). See also Wilber & Jameson, *Paradigms of Economic Development and Beyond, in The Political Economy of Development and Underdevelopment* 4, 7-13 (C. Wilber ed. 1984).

203. "The ruling paradigm of the economics of development rests on the classical or neo-classical view of a world in which change is gradual, marginalist, non-disruptive, equilibrating, and largely painless. . . . Once initiated, growth becomes automatic and all-pervasive, spreading among nations and trickling down among classes so that everybody benefits from the process." Nugent & Yotopoulos, *What Has Orthodox Development Economics Learned from Recent Experience?*, 7 *World Dev.* 541, 542 (1979).

204. See J. M. Keynes, *The General Theory of Employment, Interest and Money* 113-31 (1936).

self did not write about long-term economic development, two Keynesians, Evsey Domar and Roy Harrod, explored these issues in the decade after World War II. They posited that growth is a function of the level of savings in a country and of the productivity of capital. Savings are translated into investment, which creates additional productive capacity, thereby creating more income (especially if the capital-to-output ratio is low). Higher income in one period generates more saving, investment, capital formation, and income in the following period.<sup>205</sup> The corollary of their theory was that in underdeveloped countries, every increase in output provides the groundwork for further growth because part of it is reinvested; once income levels become consistently high enough to yield a certain level of reinvestment, then growth may become self-sustaining.

The Domar-Harrod model focused on capital investment as the key to economic growth, and suggested that economic growth implies that capital stock grows more rapidly than the labor force.<sup>206</sup> Hence, a central concern of development theory in the 1950's was how "a community which was previously saving and investing 4 or 5 per cent of its national income or less, converts itself into an economy where voluntary saving is running at about 12 to 15 per cent of national income or more."<sup>207</sup> Much of the literature focused on social and economic traps, such as rapid population increases and nonproductive use of savings, which obstructed growth opportunities and threatened to maintain a country in a low-level Keynesian equilibrium (indefinite stagnation). Although Domar and Harrod seemed to assume that the capital needed for development could be generated within developing countries, these traps indicated that much more capital was needed than developing countries themselves could supply. Consequently, one means of development was to provide massive inflows of external capital that would stimulate a balanced growth (Keynesian general equilibrium)—thereby breaking the "vicious cycle of poverty" (the traps).<sup>208</sup> Possible sources of such seed money were foreign aid,

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205. E. Domar, *Essays in the Theory of Economic Growth* 70-108 (1957); R. Harrod, *Economic Essays* 254-90 (1952).

206. For a useful analysis of the contribution and limitations of the Domar-Harrod theory, see B. Herrick & C. Kindleberger, *Economic Development* 28-34 (4th ed. 1983).

207. Lewis, *Economic Development with Unlimited Supplies of Labour*, 22 *Manchester Sch. Econ. & Soc. Stud.* 139, 155 (1954).

208. A leading advocate of large-scale infusions of capital into underdeveloped countries

loans, and direct investment.

The second problem explored by Western development theorists was how societies change as they mature from traditional to modern ones. Sir W. Arthur Lewis provided the sociological insight that underdeveloped societies are typically dualistic: an advanced modern industrial sector co-exists with a traditional agrarian sector. According to Lewis, industrialization is a way out of this social conundrum, because it draws upon the surplus agricultural labor and puts it to productive use. When the profits are reinvested, demand for both consumption goods and capital goods will increase, leading to further industrialization and shifts of labor away from the agricultural sector. The industry-led growth will gradually absorb the labor of the traditional sector, thereby drawing the whole country into modernized social and economic structures.<sup>209</sup>

Neoclassical economists complemented Lewis's thesis with the argument that free international trade and investment are "engines of development." Free trade in the world economy creates an efficient international division of labor that yields benefits for underdeveloped countries by impelling them to specialize in the labor-intensive industries for which their dual economy is suited (in exchange for the capital-intensive imports from Western countries) and by reducing factor price discrepancies in the world.<sup>210</sup> Their well-known theory of comparative advantage of free trade posited that surplus value is created by trade when the trading countries have differing abilities to specialize in the traded products, and that the surplus value is shared among the trading countries.<sup>211</sup> To

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to break the cycle of poverty, like other modernization authors, did not consider the cycles or traps to be structural ones, but rather obstacles that could be surmounted by money. R. Nurske, *Problems of Capital Formation in Underdeveloped Countries* (1953). See also A. Hirschman, *The Strategy of Economic Development* (1958); H. Leibenstein, *Economic Backwardness and Economic Growth* (1957); G. Myrdal, *Economic Theory and Underdeveloped Regions* (1957).

209. See W. A. Lewis, *The Theory of Economic Growth* (1955); Lewis, *supra* note 207; see also B. Herrick & C. Kindleberger, *supra* note 206, at 63-67. Lewis reviews his contribution (and answers some of his critics) in Lewis, *Development Economics in the 1950's*, in *Pioneers in Development* 121 (G. Meier & D. Seers eds. 1984).

210. J. Viner, *International Trade and Economic Development* (1953); B. Hettne, *supra* note 202, at 24-25.

211. See J. Viner, *supra* note 210; B. Hettne, *supra* note 202, at 24-25. As early as 1949, however, classical economists questioned whether the gains of trade would be evenly divided between underdeveloped and developed countries. The so-called "Singer-Prebisch thesis" was that underdeveloped countries producing primary commodities received few of the trade advantages. If so, then such countries ought not to pursue existing comparative advantages, but rather to create new advantages by industrialization. See *id.* at 25.

the extent that trade is constrained by tariffs and other barriers, the same spreading of benefits can occur through Western multinational enterprises that transfer their technological innovations through the world economy and create their own internal markets that are efficient and wealth-enhancing for the host developing countries as well as the multinationals.<sup>212</sup>

Later theorists generated historical models, patterned on the experience of Western countries, for the evolution of a traditional, underdeveloped society to a modern, entrepreneurial one. The most celebrated is the five-stage model created by Walt Rostow.<sup>213</sup> In stage one (traditional society), the country creates an improved infrastructure, and in stage two (pre-take-off) a new entrepreneurial class. The leading growth sectors of the economy pull the other sectors into the critical third stage (take-off). At that point, the last major obstacles to economic development are removed, and the share of net investment and saving as a part of national income reaches a permanent plateau of 10% or more. Growth and development become self-sustaining, and in stage four (road to maturity), modernization spreads from the dynamic sectors to other parts of society, which are then integrated into the country's overall growth. The ultimate and inexorable result is stage five—the mass consumption society. The Rostow model had a great influence, in large part due to its optimism. Other scholars expanded upon that optimism by positing that late-developing countries have the advantage of borrowing technology and seed capital from the early-developing countries, thereby producing even faster growth and earlier take-off.<sup>214</sup>

The central concepts of the modernization paradigm—(1) Asian, African, and Latin American countries can “develop” along the same historical process as Western industrial countries; (2) the key to development is capital investment; and (3) trade, investment,

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212. See, e.g., R. Caves, *The Multinational Enterprise and Economic Analysis* (1982); A. Rugman, *Inside the Multinationals: The Economics of Internal Markets* 22-27, 133-55 (1981).

213. W. Rostow, *The Stages of Economic Growth* (1960); see *The Economics of Take-off into Sustained Growth* (W. Rostow ed. 1963); W. Rostow, *Politics and the Stages of Growth* (1971). Professor Rostow reviews his contribution in light of events of the last 20 years in Rostow, *Development: The Political Economy of the Marshallian Long Period*, in *Pioneers in Development* 229 (G. Meier & D. Seers eds. 1984).

214. See, e.g., A. Gerschenkron, *Economic Backwardness in Historical Perspective* (1962). But see S. Kuznets, *Economic Growth of Nations: Total Output and Production Structure* (1971) (empirical critique of Rostow model).

and loans from industrialized countries will trigger or speed up the linear process of development—were widely accepted by policy-makers in the 1950's and 1960's. They were the basis for Western infusions of foreign aid, and the U.N. proclamation of the 1960's as the "Decade of Development." Although its concepts are strongly ethnocentric (reflecting the experience of the United States and industrialized Europe, relatively ignorant of Third World experiences), the modernization paradigm was accepted, at least in part, by the leaders and technocrats of most developing countries.

Does the modernization paradigm help explain the origins of the international debt problem? In its pure theoretical form it does not. Indeed, quite the opposite: Faith in popular forms of the model probably contributed to the international debt crisis! The modernization paradigm teaches that once take-off occurs, modernizing growth spread throughout the society will ineluctably follow.<sup>215</sup> In the 1960's and early 1970's, Brazil, Mexico, and other developing countries achieved impressive rates of GDP growth and investment.<sup>216</sup> Based on the modernization paradigm, most Western financiers and Third World leaders probably assumed that these countries had reached some kind of self-perpetuating economic take-off. The continued and vigorous growth of these countries after 1970<sup>217</sup> (subsidized in large part by foreign debt) only confirmed those presuppositions. Of course, as noted above, there were other political and financial forces at work in favor of massive new lending in the 1970's, but the pervasive belief in modernization theory certainly helps explain the long-lived euphoria of so many intelligent people—from Western bankers to Third World technocrats to government regulators. So rooted in the popular world view, modernization was almost an ideology that could not be questioned. A surprising number of bankers and policymakers

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215. Sir W. Arthur Lewis, typically, put the matter most directly: "Once the snowball [i.e., economic growth and development] starts to move downhill, it will move of its own momentum, and will get bigger and bigger as it goes along." Lewis, *Industrialization in the British West Indies*, 2 Caribbean Econ. Rev. 36 (1950).

216. See *supra* text accompanying notes 91-95.

217. After the economic "shock" of 1975, the Chilean economy grew rapidly: Chile's GDP increased 5.0% in 1976, 8.6% in 1977, 6.0% in 1978, and 7.2% in 1979. See Foxley, *supra* note 109, at 399. GDP in Brazil grew an average 9.3% per annum in 1970-1975 and 5.8% per annum in 1975-1978, while average GDP growth in Mexico was 5.5% per annum and 4.0% per annum for the same periods. Graham, *supra* note 98, at 19. The Peruvian GDP grew an average of 5.5% per annum in 1970-1975. Schydrowsky & Wicht, *supra* note 93, at 102 (Table 4.3).

were not willing to believe or accept the facts smacking them in the face after 1979, because there was such faith in the continuous growth of the main debtor countries.

Of course, only a popularized form of modernization theory can be stigmatized as having helped "cause" the debt problem, for several of the theorists had explored the non-linearity of development even under a Western model. The debt problem certainly suggests that modernization theorists must explore socio-economic and demographic bottlenecks and traps more carefully, for it has emphasized the discontinuities in the economic history of most Latin American countries. Moreover, the debt problem indicates that most Latin American and other Third World economies simply have not and will not develop along the same historical lines as the economies of the United States and Western Europe. Sociological and anthropological studies suggest, for example, that modernization theory grossly oversimplifies the effect of a "modern sector" on the traditional parts of a Third World society. The former will not necessarily absorb the latter; they can and do remain separate.<sup>218</sup> Brazil, for example, was once thought to be a classic case of Rostovian modernization, but its take-off has crashed not only into high oil prices, world recession, and rising interest rates, but also into poor policy planning, internal tensions, and an increasing (rather than receding) division between "modern" and "traditional" segments of society. Luiz Bresser Pereira, a leading historian of Brazil's economic development, sees that country moving

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218. See, e.g., R. Stavenhagen, *Siete tesis equivocados sobre America Latina* [Seven Erroneous Theses about Latin America], 4 *Desarrollo Indoamericano* 23 (1966) (arguing that Latin American countries were intrinsically dualistic: the modern part of society developed in the way suggested by modernization theory, but it did not necessarily "draw in" the traditional sector). In a bitterly polemical but scholarly attack on Professor Rostow's five-stage model, Andre Gunder Frank has argued that the model does not correspond at all to the past or present reality of the underdeveloped countries whose development it is supposed to guide, and has challenged scholars to find one example of an underdeveloped country that had followed the pattern of the United States and Western Europe. Gunder Frank, *Latin America: Underdevelopment or Revolution*, in *Sociology of Development and Underdevelopment of Sociology* (A. Gunder Frank ed. 1969). Gunder Frank argues that underdevelopment may itself be an end, rather than a beginning, of a process. See also F. H. Cardoso & E. Faletto, *Dependency and Development in Latin America* (1979).

Many anthropologists have argued that the penetration of "modern" institutions (*i.e.*, Western modes of culture and economic arrangement) in underdeveloped societies has been limited by indigenous structures which will not go away. See, e.g., C. Gregory, *Gifts and Commodities* (1982); A. Lowry, *Legislating the Nuclear Family in Zaire: Integrating the Core and the Periphery* (Nov. 14, 1984) (unpublished manuscript, University of Virginia School of Law).

toward a condition of "industrialized underdevelopment," in which part of the economy creates manufactured export goods within a Western social and physical infrastructure, while a larger part of the economy remains undeveloped, if not marginalized from the dynamic sector.<sup>219</sup>

The international debt problem also provides evidence to rebut modernization theory's central proposition that large-scale capital accumulation is necessary and sufficient for growth and development. Obviously (though this point has received insufficient attention), large capital infusions are not sufficient to generate growth. The growth rates of the leading Latin American debtor countries are expected to be less than 2% for 1984, and they may not be much higher for several years, in part because most of each country's trade surplus must be paid over to Western banks as debt-servicing payments.<sup>220</sup> The optimism that helped generate this sizable debt has given way to the reality that capital accumulation will do a country little good if the capital is used inappropriately, if the terms of its acquisition are unfavorable, or if external conditions (e.g., interest rates) change drastically. In other words, capital-led development has risks.

Additionally, infusions of investment capital or increased domestic savings do not automatically generate growth when there are internal structures that impede the effective utilization of that capital. Neo-classical economist Ronald McKinnon argues that the level of savings and investment in an economy is less important than the existence of internal social, economic, and political barriers to the effective matching of capital and economic opportunities.<sup>221</sup> For example, when infusions of capital are controlled by the state or by Western multinational enterprises, the capital may be unproductively used, or its profits may be channeled out of the

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219. L. B. Pereira, *supra* note 90, at 214-16. "We will continue to be an underdeveloped country to the extent that the highly productive capitalist sector is unable to absorb all available labor power, so that the social system remains permanently disintegrated." *Id.* at 215.

220. See Riding, *supra* note 2, at 1:

<u>Country</u>	<u>Growth (1984)</u>	<u>Interest on Debt</u>	<u>Trade Balance (1984)</u>
Brazil	1.5%	\$10.9 billion	\$12.0 billion
Mexico	1.3%	\$13.2 billion	\$14.0 billion
Argentina	2.4%	\$ 3.8 billion	\$ 3.5 billion
Venezuela	1.0%	\$ 2.0 billion	\$ 0.7 billion

221. R. McKinnon, *Money and Capital in Economic Development* 5-21 (1973).

country. Even with a great deal of capital infusion, small-scale entrepreneurs (the real engines of development) might find themselves unable to obtain funds for their own expansion. McKinnon suggests that big capital infusions are not at all necessary to development; developing countries would be better off by creating capital through an endogenous process of firm growth rather than through outside infusions that are misdirected by structural impediments.<sup>222</sup>

Finally, the debt problem may be the occasion to question the modernization paradigm's traditional emphasis on economic growth, as measured by materialist indices. The debt problem reveals that a country can enjoy tremendous growth even while impoverishing large segments of its people and mortgaging its future. Uncritically adopted from classical economics, the idea of growth may be an inadequate basis on which to build a development policy for Latin American countries, for it ignores distributional consequences (the unfairness of increased income going exclusively to the elite class), leaves out unmeasurable factors that are nevertheless critical to the country's well-being (environmental purity, health, community feelings), and overemphasizes superficial statistical measurements without considering the need for constructing economic, social, and political structures that will benefit the country in the long term.<sup>223</sup> For instance, Mexico's rapid growth and development between 1950 and 1970 went largely to the top 30% of the population. Although the government tried to follow a policy of redistribution plus growth in the 1970's, its efforts were largely unsuccessful.<sup>224</sup> Brazil's rapid growth development has marginal-

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222. *Id.* at 170-74 (analyzing the example of Japan, which rapidly industrialized without reliance on foreign capital). See also Hughes, *supra* note 5, at 106 (Japan and China "have demonstrated that it is possible to transform backward, feudal societies with practically no external capital").

223. In the 1970's, the concept of "Another Development" (or "Alternate Development") was accepted by many scholars who rejected the normative assumptions or consequences of the modernization paradigm. As popularized by the Dag Hammarskjold Foundation and Development Dialogue, Another Development is (a) need-oriented (geared to meeting both material and non-material needs of all groups in society), (b) endogenous and self-reliant, (c) ecologically sound, and (d) based upon structural transformation. *Another Development: Approaches and Strategies* 10 (M. Nerfin ed. 1977); B. Hettne, *supra* note 202, at 75 ff; see also *Development Strategies in the Eighties* (J. Friedmann, T. Wheelwright & J. Connell eds. 1980).

224. See R. Newell & L. Rubio, *supra* note 81, at 128-32, 159, 161 (income share going to poorest Mexican families deteriorated between 1950 and 1967, though most poor Mexicans were better off in absolute terms); Graham, *supra* note 98, at 45 (Table 12) (comparing



ized 80% of the country's population, making much of it worse off in the 1970's than it was in 1960.<sup>225</sup> The austerity measures of the last two years, moreover, have been borne by this same marginal sector.

In short, the international debt problem supports the doubts of the critics of the modernization paradigm, or, at least, calls for substantial alterations in the paradigm. Specifically, the problem suggests that economic development might not proceed in a linear fashion toward Western industrial results. It also suggests that massive infusions of capital do not necessarily generate growth—even by emphasizing traditional industrialization policies. As Professor Irma Adelman has argued, the debt problem may represent the failure of a development policy of rapid industrialization, the debt from which is now choking off Latin American economies, and an agriculture-based growth policy may be a superior strategy in the next decade.<sup>226</sup> Furthermore, growth is not a panacea, nor is it necessarily the sole object of development. Alternative goals need to be considered more seriously. One of several notable alternative theories of development has been set forth by François Perroux, who rejects the traditional focus on growth and urges more attention to nonmaterialist features of community development and a dialectic which seeks a balance between autonomy and foreign inputs, atomistic independence and social cooperation, industry and agriculture.<sup>227</sup> Perroux and other theorists point the way toward considering development that is human need-oriented, endogenous and self-reliant, ecologically sound, and grounded in a transformation of social, political, and economic

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income inequality in Brazil and Mexico).

225. It appears that most, if not almost all, of Brazil's real growth has gone to those already well-off. One unofficial estimate of family income shares:

<u>Year</u>	<u>Poorest 40%</u>	<u>Top 10%</u>
1960	9.8%	50.0%
1970	8.4%	51.5%
1972	8.9%	53.6%
1976	7.8%	n.a.

G. Pfeffermann & R. Webb, *The Distribution of Income in Brazil 10* (World Bank Staff Working Paper No. 356 (1979)) (Table 1). For criticisms, both normative and positive/economic, of Brazil's industrialization policy in light of the unequal distribution of its benefits, see Aguiar, Arruda & Flores, *Economic Dictatorship Versus Democracy in Brazil*, 11 *Latin Am. Persp.* 13 (1984) (T. Groth trans.); Knight, *Brazilian Socioeconomic Development: Issues for the Eighties*, 9 *World Dev.* 1063 (1981).

226. See Adelman, *Beyond Export-Led Growth*, 12 *World Dev.* 937 (1984).

227. F. Perroux, *A New Concept of Development* (1983).

structures of the country.

### B. *The Dependency Paradigm*

The prevailing modernization paradigm came under strong intellectual challenge in the 1950's and 1960's. Marxists and other thinkers of the Left argued that modernization theory was a mere smokescreen for continued imperialist domination in the post-colonial era following World War II.<sup>228</sup> They viewed underdevelopment as a continuous historical status resulting from capitalist domination; the industrialized countries required subordinate markets and sources for investing their surplus capital once they had overgrown their national boundaries. Latin American economists and sociologists criticized modernization theory as an unrealistic portrait of the reality they saw.<sup>229</sup> International trade and foreign investment failed to lead to economic take-off, they argued. Indeed, it impeded the natural development of their countries, because the terms of trade and investment systematically favored developed countries.<sup>230</sup> Although substantially influenced by modernization theory, the Argentine economist Raúl Prebisch created a framework of "core" states, which benefited from trade, and states of the "periphery," whose raw materials and labor were still being exploited.<sup>231</sup> The dependency paradigm has evolved from these varie-

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228. See, e.g., S. Amin, *Imperialism and Unequal Development* 117-36 (1977); S. Amin, *Unequal Development* (B. Pearce trans. 1976); P. Baran, *The Political Economy of Growth* 9 (1957); A. Gunder Frank, *Latin America: Underdevelopment or Revolution* 149-61 (1969); Fitzgerald, *Sociologies of Development*, in *Neo-Marxist Theories of Development* 12 (P. Limqueco & B. McFarlane eds. 1983).

229. Most of the early Latin American thought in this direction grew out of the United Nations Economic Commission for Latin America (ECLA), the *Comision Economica para America Latina* (CEPAL). See generally F. Cardoso, *The Originality of the Copy: ECLA and the Idea of Development* (1977); F. Cardoso & E. Faletto, *Dependency and Development in Latin America* (M. Urquidi trans. 1979); T. Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile 66-71, 79-83* (1974); *Latin American Issues—Essays and Comments* (A. Hirschman ed. 1961).

230. See R. Prebisch, *Towards a Dynamic Development Policy for Latin America* (1964); Singer, *The Distribution of Gains Between Investing and Borrowing Countries*, 40 *Am. Econ. Rev.* 473 (1950), reprinted in *American Econ. Ass'n, Readings in International Economics*, at 306 (R. Caves & H. Johnson eds. 1968); see also Corporaso & Zare, *An Interpretation and Evaluation of Dependency Theory*, in *From Dependency to Development: Strategies to Overcome Underdevelopment and Inequality* 43 (H. Munoz ed. 1981).

231. See Economic Commission for Latin America [R. Prebisch, Exec. Sec'y], *Economic Survey of Latin America* (1950); R. Prebisch, *The Economic Development of Latin America and Its Principal Problems* (1950); Prebisch, *Five Stages in My Thinking on Development*, in *Pioneers in Development* 175, 176-77 (G. Meier & D. Seers eds. 1984).

gated lines of thought.

Although different authors have formulated the dependency approach in different ways, its central thesis is that global interests of metropolitan capitalist classes structure world development processes and power relationships to their advantage and to the detriment of the dependent countries of the world.<sup>232</sup> What this means for poorer countries is either permanent underdevelopment or, at best, "associated-dependent development," where the host country abandons its indigenous values and acquires a secondhand version of metropolitan capitalism enjoyed by a small band of local elites.<sup>233</sup>

This central tenet involves three corollary ideas. First, the major impediment to development is not lack of capital (internal), but rather the prevailing international division of labor (external), in which the core countries specialize in manufactured goods and the peripheral countries supply raw materials and labor. The periphery is dominated by the core—politically, culturally, and economically. Second, domination by the core countries, particularly through adverse terms of trade, leads to the systematic transfer of the periphery's productive surplus to the core, which in turn invests it for its own economic growth. In this way, development in the core states implies underdevelopment in the peripheral states. Third, because the periphery is doomed to underdevelopment through its dependency links with the core, and because the interest of the dominant states is in maintaining the periphery's underdevelopment, the only true path to development is delinkage from world trade. That is, the developing country should adopt a radical program of import substitution and pursue endogenous economic growth.

Early dependency theory focused on the subordinating effects of free world trade: the surplus value created by trade tended to go to

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232. "By dependence we mean a situation in which the economy of certain countries is conditioned by the development and expansion of another economy to which the former is subjected. The relation of interdependence between two or more economies, and between these and world trade, assumes the form of dependence when some countries (the dominant ones) can expand and can be self-sustaining, while other countries (the dependent ones) can do this only as a reflection of that expansion, which can have either a positive or negative effect on their immediate development." Dos Santos, *The Structure of Dependency*, 60 *Am. Econ. Rev.* 231 (1970). For a survey of the evolution and expression of the dependency paradigm, see, e.g., Corporaso & Zare, *supra* note 230; Palma, *Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?*, 6 *World Dev.* 881 (1978).

233. Cardoso, *Associated-Dependent Development: Theoretical and Practical Implications*, in *Authoritarian Brazil: Origins, Policies, and Future* 142-76 (A. Stephan ed. 1973).

the industrialized countries, and commodity-producing developing countries fell further behind.<sup>234</sup> In the 1960's, dependency theorists argued that a more potent engine of the asserted Western economic hegemony were the multinational corporations, which not only engaged in worldwide trade and the licensing of technology, but also set up operations (branches, joint ventures, subsidiaries) in various countries as part of a global plan for marketing and synthesizing their technologically sophisticated products.<sup>235</sup> Dependency theorists have criticized multinationals and their foreign direct investment as an invidious mode of Western domination.<sup>236</sup>

Drawing from dependency theorists' critique of multinational investment and some of the recent literature addressing the dominating aspects of foreign external debt, it is possible to construct an explanation for the international debt problem based upon the dependency paradigm.<sup>237</sup> Under this approach, outlined in Chart 5, the connection between the underdeveloped country and the industrial West creates a vicious cycle in which more foreign investment leads to more debt, which in turn leads to a double dependency and, ultimately, to crisis.

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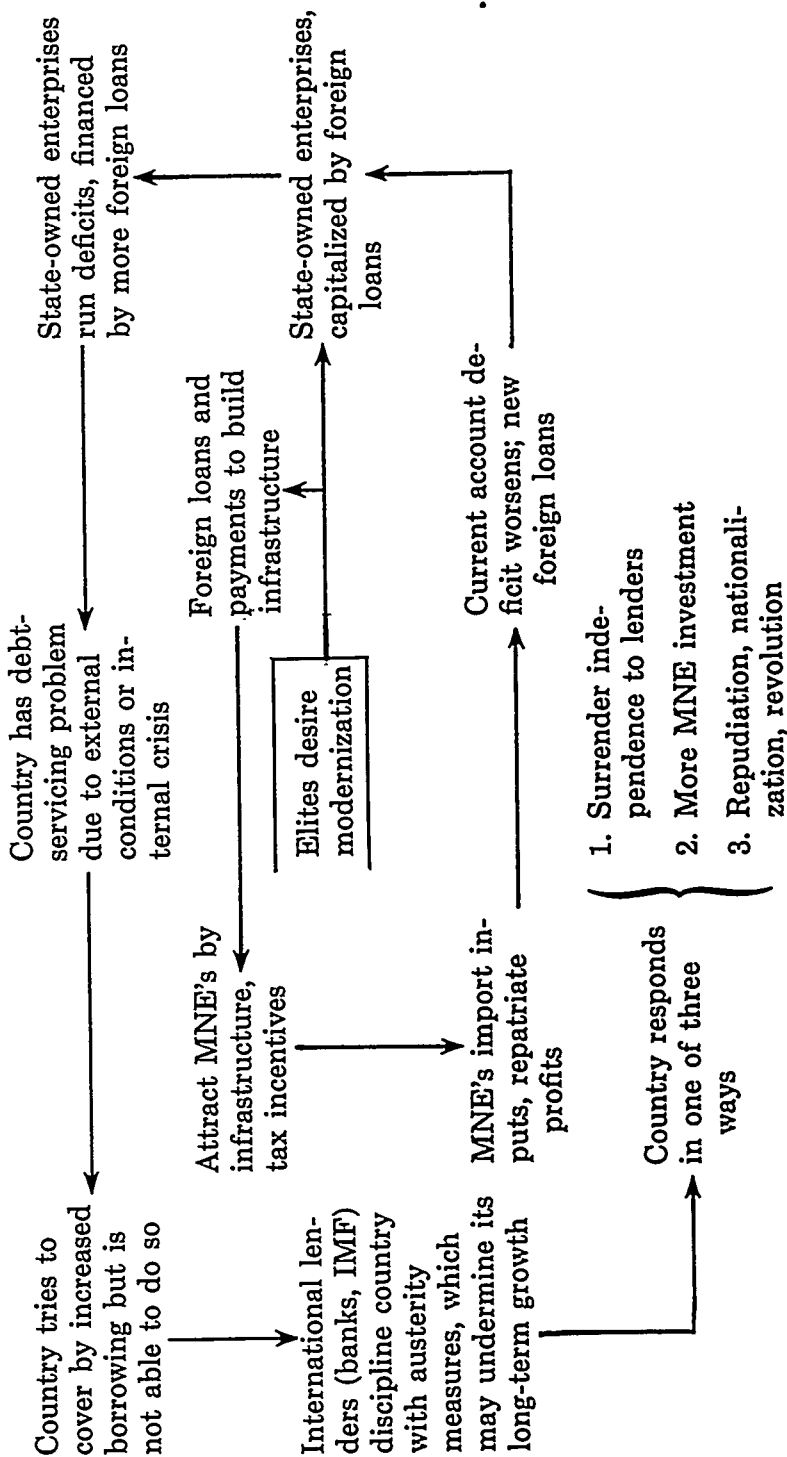
234. See *supra* notes 211 & 230; see also N. Hood & S. Young, *The Economics of Multinational Enterprise* 327, 344-47 (1979); Singer, *The Distribution of Gains from Trade and Investment—Revisited*, 11 *J. Dev. Stud.* 376 (1975), reprinted in *The Contemporary International Economy: A Reader*, at 393-94 (J. Adams ed. 1979).

235. On the rise of multinational enterprises generally, see C. Bergsten, T. Horst & T. Moran, *American Multinationals and American Interests* 3-15 (1978); R. Vernon, *Sovereignty at Bay: The Multinational Spread of U.S. Enterprises* 3-25 (1971); Report of the United Nations Centre on Transnational Corporations, Third Survey, *Transnational Corporations in World Development* 1-16, U.N. Doc. ST/CTC/46 (1983).

236. Some of the main dependency theory works directed specifically at multinationals' exploitation of host countries include R. Barnet & R. Muller, *Global Reach: The Power of the Multinational Corporations* (1974); C. Furtado, *Obstacles to Development in Latin America* (C. Ekker trans. 1970); Hymer, *The Multinational Corporation and the Law of Uneven Development*, in *The Papers of Stephen Herbert Hymer, The Multinational Corporation: A Radical Approach* 54 (R. Cohen et al. eds. 1979); Sunkel & Fuenzalida, *Transnationalization and Its National Consequences*, in *Transnational Capitalism and National Development: New Perspectives on Dependence* 67 (J. Villamil ed. 1979). For a useful digest of the competing arguments of the dependency and modernization paradigms as they relate to multinationals, see T. Biersteker, *Distortion or Development?: Contending Perspectives on the Multinational Corporation* 1-68 (1978); N. Hood & S. Young, *supra* note 234, at 179-228, 325-54.

237. There is surprisingly little scholarship dealing with the debt problem from the perspective of dependency theory. One good treatment is Corm, *supra* note 72 (examining the historical basis for the debt problems and dependence of the less developed countries).

Chart 5  
*Dependency Theory's View of Debt*



The beginning of the cycle of debt is the desire of the underdeveloped country's elites to emulate the West, itself an ideological dependency.<sup>238</sup> Material dependency follows, as elites seek more industry and technology, which are provided by two debt-creating sources. First, the government plays a major role in modernization by (1) creating infrastructures needed for industrialization (roads, communications, education), (2) subsidizing certain sectors of the economy to encourage their growth, and (3) establishing state trading and manufacturing companies that can supply the domestic market and produce goods and services competitive on the international market.<sup>239</sup> The government's activities generate debt in two ways. Because tax revenues are insufficient to pay for the increased public sector expenditures and domestic financing of the public debt is largely unavailable, the public sector debt is typically financed by borrowing from Western lenders.<sup>240</sup> Because government projects are given high priority and Western firms are often more experienced suppliers of goods and services, government-led development relies heavily on imported goods and services. The massive imports contribute to current account deficits, which are also financed by external loans.

A second major source of industry and technology is direct foreign investment—branch offices, subsidiaries, and joint ventures by Western multinational enterprises. Under conventional theory, one advantage of direct foreign investment is that it provides countries with capital, industry, and technology without creating new debts. Dependency theorists argue that this has not been the case: foreign investment not only places much of the domestic economy under foreign control, but also actually contributes to current account deficits and, thereby, to the growing external debt.<sup>241</sup>

To begin with, often the foreign investor will not bring in any

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238. "Most underdeveloped countries have already made the decision to emulate the economies of developed countries through a similar process of industrialization, and therefore dependency on outside technology, finance capital, and marketing techniques . . . is built into their model of development." R. Barnett & R. Muller, *supra* note 236, at 140.

239. See Hewlett & Weinert, Introduction: The Characteristics and Consequences of Late Development in Brazil and Mexico, in *Brazil and Mexico: Patterns in Late Development* 1, 2-4 (S. Hewlett & R. Weinert eds. 1984).

240. *Id.* at 1, 2-6.

241. See generally C. Furtado, *supra* note 236, at 58-64 (analysis of effects of multinational investment in Brazil, Mexico, and Argentina); Corm, *supra* note 72, at 59-64 (discussing the increase in Third World public debt and its significance for technological modernization through multinational investment).

outside capital at all, but will establish operations based upon local capital (which is more readily available to the creditworthy foreign multinational).<sup>242</sup> Although the foreign-owned subsidiary will generate some exports, they are often sold to other subsidiaries in the multinational chain and may be underpriced to avoid tariffs and other taxes. In any event, the balance-of-trade impact of the exports will typically be offset by the subsidiary's import of raw materials and other inputs from other firms in the multinational chain.<sup>243</sup> Within the host country market, the subsidiary will expect to make supernormal profits, either because the market for its goods in the host country has little competition or because the product is sharply differentiated from possible competitors' products.<sup>244</sup> Those profits will be repatriated to its parent company abroad.<sup>245</sup> If the host country tries to limit repatriations, the same result may be achieved either by overpricing imports from other companies in the multinational chain or by paying high royalties.<sup>246</sup> In short, according to dependency theory, the capital investment plus exports generated by multinational subsidiaries are often less than repatriated dividends plus imports on a year-to-year basis. As a result of such "development," Latin American countries such as Brazil and Mexico have suffered chronic trade

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242. See R. Barnet & R. Muller, *supra* note 236, at 152-53. According to U.N. Studies by Fernando Fajnzylber, U.S. multinationals financed 83% of their Latin American investments locally; other studies indicate that between 1960 and 1970, 78% of multinational operations in Latin America were financed out of local capital. *Id.* See C. Furtado, *supra* note 236, at 58-60.

243. R. Barnet & R. Muller, *supra* note 236, at 157-61. See also M. Brooke & H. L. Remmers, *The Strategy of Multinational Enterprise: Organization and Finance* 120-23 (2d ed. 1978) (transfer pricing practices); N. Hood & S. Young, *supra* note 234, at 190-93, 212-15 (examination of studies on transfer pricing); Aharoni, *On the Definition of a Multinational Corporation*, in *The Multinational Enterprise in Transition* 3, 11 (A. Kapoor & P. Grub eds. 1972) (transfer pricing as a method of regulating "earnings" to minimize tax burdens).

244. See Evans & Gereffi, *Foreign Investment and Dependent Development: Comparing Brazil and Mexico*, in *Brazil and Mexico: Patterns in Late Development* 111, 164 (S. Hewlett & R. Weinert eds. 1984) (Table A).

245. See R. Barnet & R. Muller, *supra* note 236, at 153-54 (52% of the profits of U.S. manufacturing subsidiaries in Latin America were repatriated, even though 78% of the investment funds needed to generate that amount of profit came from local sources).

246. See Newfarmer, *Multinationals and Marketplace Magic in the 1980s*, in *The Political Economy of Development and Underdevelopment* 182, 195-96 (C. Wilber ed. 1984).

"[I]n countries which impose a percentage limitation on the repatriation of profits," which includes many Latin American countries, "overpricing imports and underpricing exports are good ways to repatriate more profits than the local government allows." R. Barnet & R. Muller, *supra* note 236, at 159.

imbalances, which have contributed to growing indebtedness.<sup>247</sup>

Under conventional theory, subsidiaries of multinational corporations make long-term contributions of technology and industrial growth, which should ultimately strengthen the host country's current account position.<sup>248</sup> Dependency theory argues, however, that the long-term effects of direct foreign investment are enervating rather than strengthening. While multinationals may expose the host country to new technology through licensing agreements or joint ventures, the technology is typically not top-of-the-line and its use is often hedged in by restrictive contractual provisions.<sup>249</sup>

More important, exposure to technology is of little use if the host country does not develop the capacity to start with that technology and improve on it domestically. Direct foreign investment does not necessarily lead to such development. Typically, the research and development for the multinational—the brain work—is still done in the West; only the manufacturing—the hands-on work—is done in foreign subsidiaries.<sup>250</sup> Most important, foreign-owned companies often come to dominate the most dynamic sectors of the economy (the main export industries or the most profitable import substitution ones), depriving local entrepreneurs of valuable business opportunities and experiences.<sup>251</sup> Domestic enterprises that might compete with the multinational's subsidiary will find themselves at a tremendous competitive disadvantage because they have less capital and less access to domestic and foreign capital markets. Consequently, they are less able to compete through mass advertisements, product development and differentiation, and research. The magnetic pull of the foreign-owned company will ultimately extend to the talented entrepreneurs, who will

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247. See Evans & Gereffi, *supra* note 244, at 146-47.

248. See, e.g., A. Emmanuel, *Appropriate or Underdeveloped Technology?* 30 (1982).

249. See C. Michalet, *Transfer of Technology and the Multinational Firm* (1973), summarized and evaluated [favorably] in Wionczek, *Technology Transfer Through Transnational Corporations*, in M. Wionczek, *Some Key Issues for the World Periphery* 265, 267-74 (1982).

250. See J. Behrman, *National Interests and the Multinational Enterprise: Tensions Among the North Atlantic Countries* 59-67 (1970). Indeed, the foreign subsidiary may attract the bright host country scientists and technicians away from more productive national projects, and even export them to the West, thereby contributing to the celebrated "brain drain" from these countries. R. Barnett & R. Muller, *supra* note 236, at 163.

251. R. Newfarmer & W. Mueller, *Multinational Corporations in Brazil and Mexico: Structural Sources of Economic and Noneconomic Power*, Report to the Subcomm. on Multinational Corporations of the Senate Comm. on Foreign Relations, 94th Cong., 1st Sess. 35-38, 149-52 (Comm. Print 1975).



sell out or merge with their powerful competitors.<sup>252</sup>

According to dependency theory, growth fueled by government spending and/or direct foreign investment will inevitably lead to a large external indebtedness. The process by which the country comes to depend on external borrowing is itself harmful, because it discourages the mobilization of domestic savings (there is no need to create indigenous mechanisms when money is easily obtainable from abroad) and creates a structural dependency on foreign imports rather than domestic inputs, on foreign technology rather than local innovation, and on foreign entrepreneurial leadership in many of the leading manufacturing and mineral-extraction sectors of the economy.

Finally, a large external debt is per se undesirable, according to the dependency viewpoint. To the extent that the government encourages indebtedness as a means to rapid growth, that process creates further distortions in the economy: exports become less competitive in world markets, domestic investment is misallocated, and income distribution may be skewed (in favor of the already-existing elites).<sup>253</sup> Servicing the debt consumes an increasing portion of the developing country's income, and ultimately more money will be paid out in servicing the debt than will be sent into the country. In this way, the debt "becomes a self-sustaining and continually growing phenomenon completely beyond the control of the economic policy of the local authorities," and as a result, "the creditor countries, through their national credit organs and also the international bodies [IMF and World Bank] in which they usually wield a preponderant influence, do their best to control the economic management of the debtor countries."<sup>254</sup>

When a crisis comes, the toll will be paid from the borrowing countries' growth and development. For example, the effect of stringent IMF programs in the current crisis has been postponement of needed capital investment in Latin America, sharp drops in real wages, and reverse capital flows (from Latin America to the industrial countries).<sup>255</sup> In short, developing countries linked up

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252. See Evans & Gereffi, *supra* note 244, at 140-44; Newfarmer, *TNC Takeovers in Brazil: The Uneven Distribution of Benefits in the Market for Firms*, 7 *World Dev.* 25, 26 (1979) (multinationals place a higher value on local corporations than do domestic entrepreneurs).

253. See Corm, *supra* note 72, at 67-76.

254. *Id.* at 77.

255. See Diaz-Alejandro, *supra* note 73, at 360-66; *infra* note 266.

with Western multinationals mortgage their future twice: first, by turning many of their resources over to foreign companies, and second, by incurring massive external debts. In both situations, the country loses its freedom without advancing even its material interests.<sup>256</sup>

The dependency paradigm is in many respects a persuasive perspective for analyzing the international debt problem, for there is substantial evidence to support the factual correlations required by dependency theory. As developing countries have become increasingly integrated into the international system of trade and multinational investment in the last three decades, their external debt has increased.<sup>257</sup> Although the source of external indebtedness varies from country to country, public sector deficits and outflows by multinational operations have contributed to the external debt in most of the countries. Notwithstanding their greater economic "development," Latin American balance of payments shifted from positive balances in 1950 to negative ones in 1970,<sup>258</sup> a trend greatly magnified after 1973. These conclusions are difficult to dispute.

It is less clear whether these countries would have done "better" in material terms without the external debt. On the one hand, in most years between 1954 and 1979, Latin American economies (GDP's) grew more rapidly than the accumulation of debt, although the level of debt grew more rapidly than the level of exports.<sup>259</sup> Some analysts believe that most of the indebtedness was put to productive use.<sup>260</sup> While multinational companies have had some counterproductive effects in local economies, they have in many instances provided jobs (including skilled jobs), productive capacity, and some technology for countries that have insufficient

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256. "Given that the TNCs were . . . increasing their share of the ownership of the leading sectors of manufacturing [in Brazil and Mexico] during this period, the increases of loan capital must be seen as an addition to dependence on top of the effects of DFI." The overall impression is one of increasing dependence. Evans & Gereffi, *supra* note 244, at 153.

257. See Appendix, Tables 1 & 9.

258. See Appendix, Table 10.

259. See *supra* notes 91-95 & 119-122 and accompanying text; Appendix, Tables 5 & 9.

260. Notwithstanding the borrowing binge of NODC's in the 1970's, domestic savings increased in these countries from 19% to 21%, and gross domestic investment increased from 21% to 27%. World Bank, *World Development Report 1982*, at 118 (1982). William Cline suggests that these figures indicate the external debt was not used to finance local consumption (for in that event local investment and savings would be expected to drop). W. Cline, *supra* note 6, at 16.

levels of each.<sup>261</sup> And, they argue, to the extent that the borrowed money was "wasted" (not put to long-term productive use), it was most often wasted by the governments themselves—through graft and corruption, through distorting subsidies to unprofitable domestic sectors, and through losses by poorly run state trading companies.<sup>262</sup>

On the other hand, dependency theorists would respond that there was little "real" growth after 1954 because population increases absorbed most of the GDP increases, and that population increases in the 1980's threaten to outstrip GDP growth.<sup>263</sup> The level of external debt and high interest rates has made the "developing" countries net exporters of capital to the United States. What growth there has been has gone to the collaborative elites, the local surrogates, and allies of the multinationals, because the "productive" foreign investments are typically in capital-intensive industries that provide very few jobs for the masses.<sup>264</sup> The dependency theorist would further argue that most of the waste in the late 1970's was capital flight of money from Latin America to U.S. and European banks, which openly courted such deposits.

The debt problem also bears out the dependency paradigm's view that Western core countries have built-in advantages (capital, technology, social and physical structures) that tend to perpetuate their ascendancy over countries on the periphery. The core countries can usually absorb external shocks better because they have more diversified economies, more effective political systems, and more resources on which to fall back.<sup>265</sup> Moreover, they control the levers of finance and investment by which the world itself responds to major crises. Their policy decisions, from Bretton Woods to the ongoing restructuring agreements, determine the economic fate of the rest of the world. Hence, when a crisis occurs, a disproportionate share of the sacrifices will be made by the borrowing

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261. See "X.", *Multinationals at Work: An Inside Assessment*, 1983 Y.B. World Aff. 163, for an indication of the local production gains from the presence of multinationals.

262. Note the enormous deficits run by state enterprises in the main Latin American debtor countries between 1979 and 1982 (from 3.3% of Peru's GDP to 6.2% of Mexico's). See Appendix, Table 6.

263. See *infra* note 266; Graham, *supra* note 98, at 46-48 (average annual rate of population growth was 3.3% for Mexico in the period 1970-1975 and 2.5% for Brazil in the period 1970-1980).

264. Newfarmer, *supra* note 246, at 191-92 (case study for Brazil). See R. Barnet & R. Muller, *supra* note 236, at 166-70 (multinationals destroy jobs).

265. F. Perroux, *supra* note 227, at 139.

(subordinate) countries. For example, the effect of stringent IMF austerity programs and the banks' reluctance to lend money has been postponement of needed capital formation in Latin America, sharp drops in real wages, and severe curtailment of GDP growth in a period of population pressures.<sup>266</sup> Another consequence is that Latin American countries are at the mercy of core state economic decisions. The U.S. Federal Reserve Board's restrictive monetary policies in 1979-1980 and the enormous federal deficits of the last few years have been crippling for Latin American debtor countries, for which each percentage point increase in the real interest rate means hundreds of millions of dollars more in yearly debt-servicing payments. Moreover, the debtor countries' prospects of ever digging out of the debt hole are contingent upon the West's economic recovery *and* a relaxation of the recent trends toward protectionism, and upon following the policy constraints imposed by the restructuring agreements between the debtor countries and the IMF and commercial banks.

The international debt crisis is the most severe economic crisis facing Latin America since the Great Depression of the 1930's. In one way it is worse. The Depression cut Latin America off from Western markets, thereby stimulating some indigenous import substitution entrepreneurship. The current debt crisis threatens to tighten ties of dependency by bleeding Latin America of capital and impelling it to rely more heavily on multinational enterprise investment. In normative terms, the debt crisis seems to vindicate the dependency paradigm's indictment of the unfairness and subordination inherent in Latin America's relationship with industrial countries.

In historically explanatory terms, however, the dependency paradigm is not wholly satisfactory for two reasons. First, it seems overly simple in arguing that "dependent-underdeveloped" coun-

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266. See Diaz-Alejandro, *supra* note 73, at 360-67.

Changes in Aggregates at Constant Prices  
(1980-81 to 1982-83)

Country	GDP	Population	Capital Formation	Real Wages
Argentina	-7%	3%	-31%	-3%
Brazil	-1%	4%	-11%	1%
Chile	-12%	3%	-62%	-4%
Colombia	2%	5%	-10%	7%
Mexico	1%	5%	-32%	-24%
Venezuela	-1%	6%	-17%	-3%

tries inevitably sink further into their pit so long as they are tied to the dominant countries. This is simply not so. For example, Latin American countries are in some respects less dependent today than they were in 1930 or in 1950. Spanish America in 1970 was significantly less dependent on single commodity exports and upon the U.S. market than it was in 1950.<sup>267</sup> The reason is that Western technology has helped these countries to diversify. Brazil has been even more successful than Spanish America. It is no longer just an exporter of cocoa and caffeine to satisfy the addictions of the Western middle class,<sup>268</sup> for by the 1970's Brazil had become an important exporter of technologically sophisticated manufactured goods.<sup>269</sup> For all of their debt problems, Venezuela (a member of OPEC) and Mexico (a non-member but sometimes an OPEC ally) are hardly powerless producers of raw materials; both countries are trying in the long term to transmute their oil profits into industrial development. Even more striking is the success story of South Korea, which on a per capita basis is more heavily indebted than most of the Latin American countries.<sup>270</sup> While it is dependent upon Western loans and technology, it is hard to say that the country's material growth has been impeded by foreign dependence or that the foreign debt has grown more rapidly than the country's ability to service it (exports grew by 11% in 1983, for example).<sup>271</sup> Likewise, Taiwan is dependent upon Western loans and technology yet has established industries that compete successfully with U.S. multinational companies on a worldwide basis.<sup>272</sup> Neither of these countries is stuck in the periphery, and the debt crisis does not seem to have impeded their economic development, for both countries have strong governments that responded decisively and constructively to the external shocks.<sup>273</sup> Generally, dependent countries were not all equally vul-

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267. See Appendix, Tables 11-12.

268. Coffee constituted 42.0% of Brazil's export of goods in 1965-1969, but only 32.6% in 1968-1972, 21.7% in 1973, and 12.6% in 1974. Baer, *supra* note 92, at 50 (Table 5).

269. See *supra* notes 106-107 and accompanying text.

270. Burgess, *South Korea Booming: Officials Say Debt is Manageable*, *Wash. Post*, Oct. 21, 1984, at K 1, col. 3.

271. *Id.*

272. See generally Crane, *The Taiwanese Ascent: System, State, and Movement in the World-Economy*, in *Ascent and Decline in the World-System 93* (E. Friedman ed. 1982) (discussing Taiwan's move from "periphery" to "semi-periphery" resulting from concerted government action and U.S. support); S. Kuo, *The Taiwan Economy in Transition* (1983) (discussing Taiwanese economic development between 1951 and 1981).

273. See Balassa, *Adjustment Policies in Developing Countries: A Reassessment*, 12

nerable to the debt problem. A recent study by Bela Balassa argues that "inward-oriented" economies were more vulnerable than "outward-oriented" ones to the external shocks of 1973-1982, because the former accumulated more debt and then failed to take strong measures when the situation deteriorated.<sup>274</sup> In other words, Balassa found that countries following a policy of partial delinking did less well than those which were more completely tied into the capitalist economy.

Second, the debt problem suggests some of the ways in which core countries themselves are vulnerable and dependent. The structures of international sovereign lending, explained above, make this clear. Just as the debtor countries are dependent upon the Western banks to obtain development funds, so too the banks, and indeed the whole Western financial structure, have become dependent upon the willingness of the debtor countries not to default on their loans (which is what they regularly did in the nineteenth century). While certainly in a superior bargaining position so long as the borrowers do not act as a group, the banks are surprisingly vulnerable: if even one of the major debtors were to default, a number of large banks could become insolvent, and a general financial panic together with a loss of faith in the remaining banks could result.<sup>275</sup> The lesson of the debt crisis is not that the peripheral countries are at the mercy of the core countries and must necessarily make *all* the sacrifices. In an odd and ironical way, each group is at the mercy of the other: the debtor countries can default and wreak havoc upon Western finance, which can exclude the debtor countries from capital markets and impede their further development.

### C. *A Global Interdependence Paradigm*

The Third World's dependency paradigm and the West's mod-

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World Dev. 955 (1984).

274. *Id.* at 966-71. Outward-oriented economies (South Korea, Taiwan, Singapore) relied on vigorous export promotion and import substitution to respond to the shocks of 1974-1976 and 1979-1981 and accepted short-term growth reductions; inward-oriented economies (Brazil, Argentina, Mexico) financed the 1974-1976 shocks by external debt but have had to undertake deflationary measures since 1980. Balassa's conclusion is that "[t]he policies applied led to economic growth rates substantially higher in outward-oriented than in inward-oriented economies, with the differences in growth rates offsetting the differences in the size of external shocks several times." *Id.* at 971.

275. See Palmer, *The Debt-Bomb Threat*, *Time*, Jan. 10, 1983, at 42-51.

ernization paradigm are both incomplete theoretical explanations for the post-War economic development in the world. While each paradigm still has a great deal of popular acceptance (the modernization view in Western countries, the dependency view in countries supporting the New International Economic Order<sup>276</sup>), neither is completely satisfactory as a theoretical historical basis for discussing the international debt problem. Indeed, the debt problem is an antidote to the determinism of both paradigms: development is neither inevitable nor foreclosed. On the other hand, the two theories do provide important insights and are in some ways complementary views of the same phenomena. One might even say they establish a dialectic suggesting a third (synthetic) approach to economic development. Thus the westernization of the modernization paradigm is set against the indigenization of the dependency paradigm, suggesting a synthesis of universalization. (Or, the endogenous development of the former is set against the exogenous underdevelopment of the latter, suggesting a synthesis of global shared development.) Not surprisingly, one important new direction for development theory has been toward models based upon the global interdependence of the states of the world community and the need for developmental cooperation.

Global viewpoints became very popular in part due to ecological and population concerns of the 1960's (the "global village" idea). Various U.N. studies, Third World demands for a New International Economic Order, and worldwide reformist proposals such as those of the Brandt Commission Report presupposed a global approach to problem solving.<sup>277</sup> Business school theorists and economists stressed the increasing importance of international trade and multinational corporations as sources of economic integration in the world.<sup>278</sup> Unifying all these views was the realization that there is a world economy, a structural whole, and that the constituent

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276. On the New International Economic Order in general, see Garcia-Amador, *The Proposed New International Economic Order: A New Approach to the Law Governing Nationalization and Compensation*, 12 *Law. Am.* 1 (1980).

277. See Report of the Independent Commission on International Development Issues, *North-South: A Program for Survival [Brandt Commission Report]* (1980) (emphasizing crisis in the world system and the need for international cooperation); B. Hettne, *supra* note 202, at 55-58.

278. See, e.g., Sunkel & Fuenzalida, *supra* note 236 (growth of multinationals and international organizations such as the IMF and the OECD fosters a system of transnational capitalism in which nation-states and particular cultures are absorbed into the internationally integrated marketplace of goods and services).

parts are dependent (in varying degrees) on what goes on in the whole.

There are several models of development based on notions of global interdependence. One is Immanuel Wallerstein's socio-historical "world systems" model.<sup>279</sup> Professor Wallerstein argues that the "capitalist world system" was created in the sixteenth century through the emergence of "core" states in Western Europe, which had strong governments and money-based economies dominated by a dynamic bourgeoisie, risk-taking international merchants, and mass-producing industrialists.<sup>280</sup> The capital-oriented dynamism of the metropolitan entrepreneurial class has extended far beyond the political borders of the core states and has served as an organizing influence within the arena of the world system. Thus "peripheral" areas supply cheap labor and raw materials to the industrial network of the core states. "Semi-peripheral" areas have trade and industry but are not the dynamic sectors of the world economy; they are buffers between the dynamic core states and the passive periphery.<sup>281</sup>

Wallerstein's model is influenced by dependency theory but avoids some of the theory's drawbacks. For one thing, it is a less static analysis: states and regions can move from one arena to another (core to semi-periphery, and vice versa).<sup>282</sup> For example, Wallerstein traces the decline of Spain from core status to the semi-periphery because of its structural socioeconomic weakness in the sixteenth century. Its own repeated debt crises (five defaults

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279. Professor Wallerstein's theory is set forth in I. Wallerstein, *The Capitalist World-Economy* (1979), a collection of his essays. See also sources cited in note 280, *infra*. Professor Wallerstein has also written numerous articles and is the editor of a series of volumes on *Political Economy of the World-System Annuals*.

280. I. Wallerstein, *The Modern World-System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century* 38-63 (1974) [hereinafter cited as Wallerstein, *The Modern World-System I*]. For a discussion of developments in the seventeenth and eighteenth centuries, see I. Wallerstein, *The Modern World-System II: Mercantilism and the Consolidation of the European World-Economy, 1600-1750* (1980).

281. Wallerstein's core-periphery terminology is obviously taken from dependency theory and, in particular, the writings of Prebisch. See *supra* note 231. His category of semi-peripheral countries is more original. The role of the semi-periphery is explicated in Wallerstein, *Dependence in an Interdependent World: The Limited Possibilities of Transformation Within the Capitalist World Economy*, 17 *African Stud. Rev.* 1 (1974), reprinted in I. Wallerstein, *supra* note 279, at 66 [hereinafter cited as Wallerstein, *Dependence*]; Wallerstein, *Semiperipheral Countries and the Contemporary World Crisis*, 3 *Theory & Soc'y* 461 (1976), reprinted in I. Wallerstein, *supra* note 279, at 95 [hereinafter cited as Wallerstein, *Semiperipheral Countries*].

282. See Wallerstein, *Dependence*, *supra* note 281, at 72-74.



on foreign loans between 1550 and 1650) were symptoms of its slippage in the emergent world system.<sup>283</sup> While Wallerstein does not believe it easy for a country to break through to a higher level in the world system, there are, he says, "limited possibilities of transformation within the capitalist world-economy."<sup>284</sup> Also, Wallerstein envisions the possibility of a global change to a socialist world system that would smooth out many of the malign distributional consequences of the capitalist system.<sup>285</sup> The important point is that notwithstanding the problems with core state dominance, Wallerstein's response is not to withdraw from the world system, since it yields many advantages, but to transform the system into a larger cooperative mechanism.

Because Wallerstein's and other global historical approaches to development theory are relatively novel, they require several imaginative leaps to apply them to the international debt problem. The attempt that follows is simply one way to view the problem along these theoretical lines, with the hope that the larger theory will shed some light on the nature and possible resolution of the crisis.

The thirteen English colonies on the eastern shore of North America were originally part of the periphery: they were sources of raw materials for English manufacturing; they were part of the triangular trade between England, North America, and the Caribbean; and they represented an expanded market for English ex-

283. I. Wallerstein, *The Modern World-System I*, supra note 280, at 164-96. As Wallerstein notes, Spain's decline was the result of its economic and financial inability to manage a large empire. Interestingly, there is a parallel between Spain's dependence on foreign loans and a similar dependence in the 1970's on the part of its former Western Hemisphere colonies.

Genovese bankers monopolized the profits from the exploitation of American mines; Genovese outfitters controlled the provisioning of the fleets. Far from reacting, the monarchy became more and more involved in dangerous financial disorders that tied it to the capitalist machinery on the far side of the Pyrenees; at first this tie was indispensable, then ruinous, and finally sterile.

J. V. Vives, *Approaches to the History of Spain 97-98* (2d ed. 1970); see Elliot, *The Decline of Spain, 20 Past & Present* 52, 69 (1961).

284. Wallerstein, *Dependence*, supra note 281, at 66. See also Wallerstein, *Semiperipheral Countries*, supra note 281, at 99 (suggesting that semi-peripheral countries can become core countries). Professor Wallerstein envisions this possibility in times of crisis or economic downturn, when core producers will tend to compete with one another for investment opportunities, products, or raw materials in semi-peripheral countries. *Id.* at 99. Only some countries of the semi-periphery can move "up," however, because "a semiperipheral country rising to core status does so, not merely at the expense of some or all core powers, but also at the expense of other semiperipheral powers." *Id.* at 101.

285. Wallerstein, *Crises: The World-Economy, the Movements, and the Ideologies, in Crises in the World-System* 21 (A. Bergesen ed. 1983).

ports. By 1800, the newly independent United States had moved into the semi-periphery, for it had a dynamic middle class, indigenous merchants, and nascent industries. By 1900, the United States was on a par with other core countries, and after World War II it was the preponderant core country in the world.

The capitalist world system after 1945 was in large part molded by the United States:<sup>286</sup> the liberal norm of free trade and investment was adopted in the Bretton Woods system<sup>287</sup> and later in the General Agreement on Tariffs and Trade,<sup>288</sup> not to mention dozens of bilateral commercial treaties entered into by the United States and Western European countries with one another and with less developed countries. The United States was the world's largest market and the leading exporter of manufactured and agricultural goods. The dollar was the keystone of the world financial system, and the international financial institutions established by the Bretton Woods system (IMF, World Bank) provided development assistance, fixed exchange rates, and monitored trade balances.

For twenty years or so, the world system enjoyed this *Pax Americana*. The United States was the sparkplug and organizing force of the capitalist world system, but within that system there was substantial jockeying for position. The countries of Western Europe recovered from the devastations of World War II and remained at the core, albeit clearly subordinate to the United States. In 1956-1957, six countries formed the European Economic Community to coordinate their economic and trade policies and to create a substantial internal market that would abet the further recovery and development of the member states' economies. The United Kingdom, a waning member of the core, joined the Community in 1972. Meanwhile, Japan also recovered from the War and joined the core through a very successful policy of using and improving on Western technology through indigenous development.

Just as the West European countries were adapting to a reduced importance in the core and as Japan was joining the group of core societies, the periphery of the world system was expanding to include countries in Africa and the Middle East. And, as the periph-

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286. See, e.g., McMichael, *Social Structure of the New International Division of Labor*, in *Ascent and Decline in the World-System* 115, 119-24 (E. Friedman ed. 1982).

287. See *supra* notes 127-131 and accompanying text.

288. General Agreement on Tariffs and Trade, opened for signature Oct. 30, 1947, 61 Stat., pts. 5, 6 (1947), T.I.A.S. No. 1700, 55 U.N.T.S. 194.

ery was expanding, many of the countries in the old periphery were themselves attempting to move into the semi-periphery and ultimately (like Japan) to become core states. Latin American countries, especially Brazil, Mexico, and Argentina, were among the chief newly industrializing countries (NIC's) of the period after 1945.<sup>289</sup> The development strategy of the Latin American and other NIC's was tied to the capitalist world system led by the United States, with technology and capital coming from U.S. aid and loans, the multilateral financial institutions, and U.S. multinational corporations. The United States was the chief supplier of capital goods to the NIC's and the chief purchaser of their new manufactured products.

The NIC's were obviously dependent upon the United States and other core countries. But, as an historical matter, their strategy seems to have been quite reasonable. Absent a revolution and delinking from the world system such as that employed by the People's Republic of China in the 1940's or Cuba in the 1950's (both with mixed success), the NIC's were going to be dependent. Given the socio-political structures of the Latin American NIC's described in Part II, and (more important) their proximity to the intimidating political and economic power of the United States, a revolutionary delinkage may not have been a plausible strategy in the 1960's and 1970's. Instead, these NIC's opted to improve their position in the world system, just as Japan had done after World War II.

The United States was dependent upon the other core countries and the NIC's of the semi-periphery for its own continuing position, as events after 1966 established. To the extent that the Bretton Woods system was based upon the convertibility of the dollar into gold *and* to the extent that the dollar was subject to continuing U.S. trade deficits, the system was bound to become unraveled at some point because both trends could not continue indefinitely.

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289. The concept of newly industrializing countries was developed in the late 1960's, when economists realized that certain "developing" countries were predominant in trade relations with the developed countries. They imported far more from the West than all other developing countries combined, and they exported manufactured goods to the West in much greater amounts. Among the NIC's most often mentioned in the 1960's were Argentina, Brazil, Chile, Colombia, Mexico, Hong Kong, India, Singapore, South Korea, Taiwan, and Yugoslavia. Bradford, *The Rise of the NICs as Exporters on a Global Scale*, in *The Newly Industrializing Countries: Trade and Adjustment* 7, 9-10 (L. Turner & N. McMullen eds. 1982). To that list today might be added oil-exporting countries such as Venezuela, Nigeria, and Saudi Arabia (and other Arab oil-producing countries).

That point came in the 1960's, when the Vietnam War, trade deficits, and inflation exposed the political and economic limitations of the United States.<sup>290</sup> Increasingly vulnerable to international demands that dollars be converted into gold, the United States in 1971 renounced convertibility. The oil price shocks of the 1970's revealed the extent to which the *Pax Americana* had been dependent upon cheap sources of energy. Growth in the U.S. economy became less impressive; recessions, sometimes combined with high inflation, seemed to characterize the economy in the 1970's, capped off by the major recession after 1979. After 1966, the world system entered into a new period of uncertainty about the economic future because the sparkplug U.S. economy misfired repeatedly and the international financial stability formerly guaranteed by the United States waned. In its place was emerging an international economic system dominated by private entrepreneurs—multinational corporations, transnational financial institutions, giant trading and shipping companies—whose allegiance was not necessarily tied to any single country.

The flux and dysfunction of the world system after 1966 presented both challenges and opportunities to the NIC's. One obvious challenge was whether those countries could continue their ascent in the face of higher oil prices, uncertain export markets, and (after 1978) unusually steep real interest rates. Linked to the challenge, though, was the opportunity the NIC's had to "seize the moment," that is, take advantage of the economic uncertainty to assure their rise in the world system, much as Japan had seized the moment after World War II.<sup>291</sup> NIC's that met the challenges of

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290. McMichael, *supra* note 286, argues that U.S. political hegemony disappeared with the U.S. humiliation in Vietnam and the rise of Europe and Japan. Contributing to the loss of economic hegemony were (1) the growing U.S. government deficit and its accompanying inflation, (2) a deteriorating trade balance, and (3) the rise of the Eurodollar market (in part due to U.S. capital controls policy). "In short, as revealed in the rise of the Eurocurrency system, the decline of U.S. hegemony devolved a growing power to the international capital market as a force shaping global economy." *Id.* at 125. "Given the particular features of U.S. hegemonic decline, the structuring of global economy is undertaken increasingly by transnational capital, which internalizes world exchange relations as one of its circuits." *Id.* at 126.

291. Tylecote & Lonsdale-Brown, *State Socialism and Development: Why Russian and Chinese Ascent Halted*, in *Ascent and Decline in the World-System* 255, 278-81 (E. Friedman ed. 1982), argue that Japan ascended in the world system because it had or developed the basic socio-political institutions needed for progress:

—The economy is structured around independent enterprises linked primarily by market relationships and controlled by workers democratically.

—State intervention should be limited to high-technology sectors which are by

the 1970's and exploited the opportunity of faltering Western economies to improve their own position as exporters of manufactured and technological goods included Taiwan, Singapore, Hong Kong, and South Korea. Other NIC's, like India, Egypt, and those of Eastern Europe, coped with the challenges but failed to move forward in the world system, and may even have slipped somewhat because of the oil price dilemma. A third group of NIC's overextended themselves and failed to meet the challenge. The debt crisis arose in large part out of these countries' historic failure. Most of the Latin American NIC's—Mexico, Brazil, Argentina, Venezuela, Chile, Peru—are in this third category of countries, which tried to seize the moment but failed. Their growth has been severely curtailed, and the still-crushing interest-and-principal payments on their foreign debt may harm their development prospects for the next decade.

Historically and descriptively, the international debt crisis is a reflection of the failure by many similarly situated NIC's to seize the moment.<sup>292</sup> In the wake of the external shocks of 1966 to 1982, some countries have continued their ascent; others have fallen back. Why did some countries advance and others decline or stagnate? Part of the answer may lie, ironically, in the unique dependency of the advancing NIC's. Taiwan and South Korea have probably benefited from their special relationship with the United States as the result of the latter's resistance to world communism: they have received massive military and economic aid, favorable trade conditions for the critical U.S. market, and important flows of technology.<sup>293</sup> Likewise, Hong Kong's and Singapore's trade ties

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nature interdependent. State management should be through monetary and fiscal policies and taxes/subsidies.

—The most important aim of state management of the market is to reduce inequality. On the other hand, incentives are preserved, because the more efficient control more resources and have more authority. Another type of motivation is also fostered: the widening of one's frame of altruism, by conceptualizing the firm as a "family" whose members one wants to help.

—Strict control of market relations was maintained (and has been only slightly relaxed even after Japan reached the core). Thus trade is restricted, and multinationals are not permitted free entry.

Id.

292. See H. Marcussen & J. Torp, *The Internationalization of Capital: The Prospects for the Third World* 158-60 (1982) (crisis in the core countries gives some countries of the periphery the opportunity to advance).

293. See P. Kuznets, *Economic Growth and Structure in the Republic of Korea* 84-110 (1977) (South Korea grew at an annual rate of 9.1% between 1960-1962 and 1970-1972);

with Great Britain have provided them with some advantages; for instance, British colonial administrators and traders encouraged and relied on local entrepreneurs who were then able to expand their operations after 1950 when world trade expanded.<sup>294</sup> These "four little tigers" are further evidence that dependency ties need not stifle. But the question remains: how did these four Asian NIC's escape the downside results of dependency that seem to afflict the Latin American NIC's. Three endogenous reasons may help explain why they have succeeded in the world system.

One reason is the constructive role of the state. Bruce Cumings has characterized the governments of these Asian NIC's as "bureaucratic-authoritarian industrializing regimes," in which the state is ubiquitous in the economy and society, and relatively autonomous of specific groups and interests.<sup>295</sup> The strong governments have contributed to the rapid development of these states, and their continued success notwithstanding the debt problem, in two ways. First, the governments of Taiwan, South Korea, and Hong Kong have been a tool for indigenous capital accumulation and efficient capital use. The governments established state enterprises and guided development but, just as important, subjected state enterprises to market discipline (in some cases even returning to private ownership).<sup>296</sup> Second, the Asian NIC's responded decisively and prudently to external shocks such as those after 1966: measures were taken to prevent currency overvaluation, to contain government spending and public sector deficits, and to turn a profit in the state enterprises.<sup>297</sup> Perhaps the most striking differ-

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Crane, *supra* note 272, at 99-102. See generally S. Kuo, *supra* note 272; Little, *An Economic Reconnaissance, in Economic Growth and Cultural Change in Taiwan: The Postwar Experience of the Republic of China* 448 (W. Galenson ed. 1979) (explaining Taiwan's exogenous growth).

294. See A. Rabushka, *Hong Kong: A Study in Economic Freedom* (1979); see also Hamilton, *Capitalist Industrialization in the Four Little Tigers of East Asia, in Neo-Marxist Theories of Development* 137, 152-53 (P. Limqueco & B. McFarlane eds. 1983) (noting the strong roots of the indigenous capitalist classes in Singapore and Hong Kong).

295. Cumings, *The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles and Political Consequences*, 38 *Int'l Org.* 1, 7, 28 (1984).

296. Amsden, *Taiwan's Economic History: A Case of Etatism and a Challenge to Dependency Theory*, 5 *Mod. China* 341, 342 (1979); Crane, *supra* note 272.

297. See Crane, *supra* note 272, at 105 ("Taiwan's ascent has been a function of both the favorable climate of the world-system as a whole and the role of the state enterprises"); Burgess, *supra* note 270 (notwithstanding enormous external debts, South Korea is improving its economic position because of tight government supervision and stringent fiscal policies); Cumings, *supra* note 295, at 35-40.

ence between the Latin American NIC's and Taiwan, South Korea, Singapore, and Hong Kong, therefore, lies in the degree of their respective political coherence. The successful NIC's have been willing to impose short-term sacrifices that the others have not. Because of the cycles of democracy and authoritarian governments and the *liberum veto* exercised by the major corporatist political groups in the Latin American polities, the policy responses to the external shocks after 1966 were short-sighted and immature. Foreign debt was used to forestall unpleasant economic realities and to placate obstreperous interest groups, a policy doomed to trouble. In contrast, South Korea and Taiwan used their foreign debt for more long-range productive purposes.

Another reason for the success of the Asian NIC's may be historical. Their special relationships with the United States or Great Britain have been historically fortunate, as has been their choice of export industry. Much of the dynamism in these countries was generated by exports of clothing and textiles.<sup>298</sup> The advantage of that strategy is that the textile industry is relatively labor intensive. Thus, small local entrepreneurs have dominated production, and the role of multinational enterprises has been modest in all the countries except Singapore.<sup>299</sup> A further advantage is that there has been a relatively sustained demand for textile products from 1960 onward, though the Asian NIC's have already begun to diversify their exports. The lesson is that the Asian NIC's have developed their own entrepreneurial dynamism, which aids them in coping with new challenges.

A final reason for the relative failure of rapid industrialization in Latin American countries may be social and cultural. While the judgment is at best an informed, impressionistic one, it appears that one component of the success of at least some of the Asian NIC's has been a more equitable distribution of income (in Taiwan, for example, capitalism has actually narrowed income disparities).<sup>300</sup> And their populations as a whole appear goal-oriented,

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298. Hamilton, *supra* note 294, at 163-64 (textiles constituted 40-50% of total exports in Hong Kong over three decades, 50% in Taiwan [1979], 34% in Korea [1971-73]). Singapore's exports have been concentrated in electronics, electrical machinery, and petroleum goods. *Id.* at 164.

299. *Id.* at 166 ("[I]n the early 1970's, foreign-controlled companies accounted for about 10% of Hong Kong's manufactured exports, at least 20% of Taiwan's, at least 15% of Korea's, and nearly 70% of Singapore's.").

300. See generally S. Ho, *Economic Development of Taiwan, 1860-1970*, at 165-70 (1978) (discussing Taiwan's land reform and its effect on the redistribution of wealth); Crane,

hardworking, and determined to forge ahead. These intangibles have provided incentives to broad groups of society to contribute to the social product (and to make sacrifices in response to crises) and have created a broader internal market.<sup>301</sup> In contrast, the gross inequalities in most of the Latin American countries deprive them of internal markets and kill incentive (not to mention the socio-political risks which gross inequality entails).<sup>302</sup> In Taiwan, farmers own their land, and the agricultural sector has been an important support for development. In most of Latin America, land-owning is still concentrated in the archaic elites, and the most recent attempt to change that status quo (Allende's nationalization of estates in Chile) met with political upheaval and military reaction.

By focusing on a combination of exogenous and endogenous factors, the world systems model is a more sophisticated tool for explaining the historical dimensions of the international debt crisis. But this historical, descriptive analysis should not obliterate the normative analysis. Like dependency theory, world systems theory sees "development" in the capitalist system as an exploitive phenomenon—a zero-sum game in which Taiwan's win is Argentina's loss. The role of Wallerstein's semi-periphery is to exploit the periphery and to be exploited by the core. The fairness concerns of dependency theory are sounded anew: the Latin American debtors are participating in a financial system increasingly stacked against them. It may be hard for them to dig out of the debt problem, not only because of the imposing transfer payments they are making to Western banks, but also because they are losing export markets to other NIC's which coped with the debt problem in different ways.

### CONCLUSION

This Article has set forth three contexts in which the international debt problem can be analyzed. The short-term economic

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supra note 272, at 98 (citing factors contributing to Taiwan's land reform).

301. See D. McClelland, *The Achieving Society* 43, 57-70 (1961) (arguing that a paramount reason for underdevelopment is the lack of a "need for achievement," or "n-achievement," among individuals in the culture). See also D. McClelland & D. Winter, *Motivating Economic Achievement* (1969).

302. See, e.g., Selowsky, *Income Distribution, Basic Needs and Trade-Offs with Growth: The Case of Semi-Industrialized Latin American Countries*, 9 *World Dev.* 73 (1981) (severe income inequalities hamper the development of Latin American states with special concentration on Brazil, Mexico, Peru, Colombia and Ecuador).



perspective (Part I) focuses on the complex interconnected events and decisions that immediately caused or generated the debt "crisis" starting in 1982. It is a mechanical perspective, and I mean "mechanical" in its benign sense: it seeks to discover what went wrong in an otherwise acceptably operating system. The long-term structuralist perspective (Part II) is more historical and systematic: it examines the system itself and, in this case, finds that there were certain risks or malfunctions built into it. The broadest perspective is that of development theory (Part III), which views the debt problem as a manifestation of dysfunctions in the way national economic systems change and interrelate in the international arena. This perspective is also more explicitly normative, for it raises questions whether the world system itself is fair and what strategy a national economic system might follow in response to its evaluation of its prospects within the world system.

Apart from their value as explanations of the international debt problem, these perspectives reveal the divergent roles of "law" in the system of transnational sovereign finance. Specifically, each of the three differing perspectives operates within its own appropriate sphere of analysis and presumes a different attitude about private international law. For example, the bank creditors and their counsel, the borrowing countries and their counsel, and even the national and international financial regulators usually, if not always, think about the sovereign debt problem from the short-term, operational perspective, because their task is simply to deal with the local manifestations of the problem. Their job should never be underestimated, for it involves not only skill but also substantial creativity.

These day-to-day participants have been dealing with a classic legal problem—the debtor does not have enough money to pay all its creditors—to which there was no established set of legal remedies before 1982. Hence, the participants have had to create a legal regime of rights and remedies by negotiation. The negotiated transnational law is embodied in contractual restructuring agreements and agreements with the IMF. These agreements establish limitations on the domestic and import-export policies of the borrower countries in return for commitments by official and private lenders to continue lending and to spread out the repayment schedule of maturing loans.

In negotiating restructuring arrangements, the shocks-and-mistakes explanation explored in Part I is a very useful intellectual construct that fits with the problem-solving role of private interna-

tional law, for it identifies the reasons individual borrowing countries have been unable to service their external indebtedness, the ways in which the different contributing reasons have interacted, and the basic mechanical policies that will result in repayment to the creditor and in the restoration of the borrowing country to creditworthy status. As a basis for creating negotiated law it is a perspective that has worked well in the short term. Unless a fresh disaster strikes (a revolution or new external shocks), the classical economic theory underlying the shocks-and-mistakes explanation will probably prevent a major breakdown.

The problem, of course, with the short-term economic perspective is that it tends to be too ad hoc, "muddling through" each situation without trying to generate long-term solutions. Entrenched or systemic problems tend to recur, even if in a variety of unanticipated forms. For example, it can be anticipated that international bankers will not repeat the exact mistakes of the 1970's at any time in the near future, but they may well repeat the general pattern (a mania of a certain type of lending, followed by a panic). The structuralist perspective teaches that private international law should attempt to be more than a problem-solving device. Law should seek to alter or redirect existing political and economic structures to minimize risks of large-scale problems. Thus private international law might assume a longer range "reformist" role of making the system of international sovereign finance work better.

Two of the systemic problems identified by the structuralist perspective—the tendency of Latin American and other political systems to postpone hard decisions and avoid present sacrifices, and the mania-to-panic syndrome of periodic financial crises—may be intractable. If left to their own devices, many Third World countries will tend to overborrow, and banks may still overlend in some circumstances (underlend in others). Moreover, once overlending occurs there is a prisoners' dilemma which encourages all the banks to cease making loans all of a sudden, thereby precipitating a panic and crash.

The structuralist analysis reveals, however, an important way to mitigate such tendencies. One structural origin of the debt problem is the erosion of the Bretton Woods system of publicly regulated international finance. That system cannot be resuscitated, but new thought should be directed toward increasing the role of multilateral institutions (IMF, BIS, World Bank) and monitoring the activity of banks more carefully at the national level. Specifically, the OECD countries must increase their capital commit-

ments to the multilateral financial institutions and coordinate their efforts at bank regulation. There should be information about individual and aggregate private sovereign lending, as well as mechanisms to discourage excessive concentration of loans.

Increased participation in sovereign lending by international agencies could have several structural advantages. First, it would contribute an additional layer of caution in a volatile arena of economic activity. Experience reveals that IMF officials and national bank regulators do not necessarily have any greater insight into the risks of sovereign lending than the bankers have. But when there are two levels of analysis of loan decisions, there is a somewhat greater chance that risky trends will be headed off, especially if more information becomes available concerning lending trends by all banks to certain countries. Second, greater public participation would reintroduce conditionality into the system. If linked to specified policy efforts or results, or if linked to particular projects, increased lending from private or official lenders ought to be more productively employed and not lost to capital flight as it was after 1979. Third, when a problem or dislocation does arise (due to external shocks or internal political pressures), public involvement tends to prevent panics and crashes. The public sector is better able to mobilize rescue packages and to organize the private sector to act in constructive ways (sometimes through jawboning, other times through mild coercion). In economic argot, the public sector can organize private actors to create public goods (continued lending) or to break the incentives of the prisoners' dilemma.

The first two perspectives of the international debt problem justify its appellation as "crisis," that is, a dramatic set of events impelling a change of direction (possibly for the worse). In a broader sense, though, the international debt problem is not a crisis at all, but rather a manifestation of larger trends within the historical context of the capitalist world system. The third perspective, that of development theory, takes this broad view of the system itself and, further, asks whether it is coherent and fair. From a normative perspective, the answer seems to be that the world system does not operate fairly. The advantages of it go largely to existing world elites, and the burdens of its dysfunctions rest mainly with the already disadvantaged.

If there is a "crisis" posed by the debt problem under the broad perspective of development theory, it is a crisis of confidence in the prevailing modernization paradigm. Inspired by a *New Yorker* cover, sociologist and development theorist Andre Gunder Frank

asserted in his essay on the sociology of development that the modernization paradigm that has been the basis of most Latin American development policy and Western capital transfers revolves around "twin gods"—Santa Claus and Sigmund Freud.<sup>303</sup> Underdeveloped countries in the South achieve economic development, first, by receiving gifts from the friendly Santa Claus of the North, and second, by learning the lessons taught by Sigmund Freud (e.g., improvement by self-examination). The international debt problem has exposed the wishful thinking involved in this modern bit of mythology. Santa Claus has only delivered thistles to Latin America lately, and Freudian self-analysis provides little solace when these countries are making outrageous sacrifices due in large part to events beyond their control (the shocks and the mildly irrational behavior of the Western system of international finance). The "crisis" is the questioning anew of the received wisdom about how countries develop and whether in the capitalist world system there is much prospect for improvement of the lives of most people in the world. Fairness should be a moral concern of people in both the core and the periphery. Western leaders should be more attentive to the equity concerns of the disadvantaged, not only because it is "right," but also because it is expedient given the interdependency of the international financial system.

In early 1984, an idea occurred to several Latin American political leaders: "There is only an international debt 'problem' or 'crisis' if we recognize the legitimacy of paying unprecedented real rates of interest on loans fueled by transfer payments from our own productive capacity. It makes no sense for our people to pay out more money to the banks than we achieve as a current accounts surplus after cutting imports to the bone and expanding exports to our breaking point." The leaders discussed forming a debtors' cartel and declaring unilateral moratoria on servicing their loans. Westerners for whom the modernization paradigm (Santa Claus and Sigmund Freud) is the only conceivable view of development dismissed the idea. And the more accommodating approach of Latin American leaders and the banks themselves suggests that this is not an idea whose time has come. But it is an idea whose time might come, unless Western governments and institutions show more sensitivity to the worldwide fairness concerns raised by the plight of Latin American and other less advantaged countries.

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303. A. Gunder Frank, *supra* note 228, at 77.

## Appendix

Table 1  
 Non-Oil Developing Countries: Current Account  
 Financing, 1973-1983

(billions of U.S. dollars)	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Current account deficit <sup>1</sup>	11.3	37.0	46.3	32.6	28.9	41.3	61.0	89.0	107.7	86.8	68.0
By area:											
Africa	1.9	3.2	6.6	6.1	6.6	9.4	9.9	12.9	14.0	13.2	13.5
Asia	2.6	9.9	8.9	2.7	0.8	7.2	14.8	24.3	22.2	15.6	17.5
Europe	-0.6	4.4	4.9	4.7	8.4	6.7	9.9	12.5	10.5	7.1	4.0
Middle East	2.6	4.5	6.9	5.4	5.1	6.2	8.5	9.4	11.1	12.9	12.0
Western Hemisphere	4.7	13.5	16.3	11.8	8.5	13.3	21.4	33.4	45.4	34.9	21.5
Use of reserves	-10.4	-2.7	1.6	-13.0	-12.5	-17.4	-12.6	-4.5	-2.1	7.1	n.a.
Nondebt-creating flows, net	10.3	14.6	11.8	12.6	14.4	17.9	23.9	24.1	28.0	25.1	n.a.
Direct investment flows, net	4.2	5.3	5.3	5.0	5.4	7.3	8.9	10.1	13.9	11.4	n.a.
Net external borrowing <sup>2</sup>	11.4	25.1	32.9	33.0	27.0	40.8	49.7	69.3	81.8	54.6	n.a.
Long-term borrowing, net <sup>3</sup>	11.9	18.1	27.1	28.0	24.6	37.2	36.5	47.2	62.7	41.0	n.a.
From official sources	4.9	6.8	11.7	10.5	11.4	13.8	13.3	17.6	23.0	19.5	n.a.
From private sources	6.8	11.3	15.4	17.5	13.2	23.4	23.2	29.6	39.7	21.5	n.a.

<sup>1</sup> Net total of balances on goods, services, and private transfers, as defined in the Fund's Balance of Payments Statistics (with sign reversed).

<sup>2</sup> Includes any net use of nonreserve claims on nonresidents, errors and omissions in reported balance of payments statements for individual countries, and minor deficiencies in coverage.

<sup>3</sup> On a balance-of-payments basis.

Source: IMF, Annual Report 1982, at 18, 33 (1983).



Table 3  
Debt Indicators for Nine Large Sovereign Debtors, 1973-1982

Country	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
<i>Total debt (billion dollars)</i>										
Brazil	13.8	18.9	23.3	28.6	35.2	48.4	57.4	66.1	75.7	88.2
Mexico	8.6	12.8	16.9	21.8	27.1	33.6	40.8	53.8	67.0	82.0
Argentina	6.4	8.0	7.9	8.3	9.7	12.5	19.0	27.2	35.7	38.0
Spain	5.7	8.6	10.7	13.5	16.3	18.4	22.2	27.4	33.2	n.a.
South Korea	4.6	6.0	7.3	8.9	11.2	14.8	20.5	26.4	31.2	35.8
Venezuela	4.6	5.3	5.7	8.7	12.3	16.3	23.7	27.5	29.3	31.3
Chile	3.6	4.4	4.7	4.5	4.9	6.4	8.2	10.7	15.0	17.9
Peru	2.4	3.8	4.9	5.3	6.4	6.7	7.4	9.0	9.8	11.1
Colombia	2.8	3.1	3.4	3.6	4.0	4.3	5.7	6.8	8.3	n.a.
<i>Debt service<sup>1</sup>/exports (percentage)</i>										
Brazil	36.7	36.0	40.8	45.3	48.7	59.3	65.6	60.8	66.9	87.1
Mexico	28.7	21.9	30.3	40.7	53.6	64.9	67.7	36.4	48.5	58.5
Argentina	19.9	21.3	31.9	26.2	19.1	41.6	21.3	32.2	37.5	102.9
Spain	5.2	4.2	9.3	10.7	13.3	19.5	15.7	15.5	19.0	n.a.
South Korea	11.5	11.8	12.5	9.8	10.2	12.0	13.9	17.3	18.8	21.1
Venezuela	3.8	3.3	3.5	8.4	10.0	15.6	16.4	15.6	19.0	20.7
Chile	35.1	37.4	42.7	41.7	45.9	49.7	44.4	41.3	61.0	60.4
Peru	35.8	30.1	45.7	47.2	45.1	64.4	44.6	50.9	n.a.	53.4
Colombia	21.1	23.6	21.4	16.7	13.7	14.9	19.0	16.3	23.9	n.a.
<i>Net debt/exports (percentage)</i>										
Brazil	106.2	145.9	194.3	195.8	207.6	252.5	269.3	259.1	266.6	365.3
Mexico	154.6	182.0	243.8	286.5	309.7	278.2	241.7	205.7	209.0	248.6
Argentina	140.8	145.2	211.5	145.7	96.8	96.1	97.3	182.5	275.3	353.5
Spain	-4.1	21.0	37.7	60.3	60.3	37.4	30.0	46.0	66.2	n.a.
South Korea	88.9	106.5	110.2	73.4	63.0	70.2	89.8	103.8	103.9	104.5
Venezuela	51.2	-5.9	-37.3	-32.9	-8.7	35.6	41.5	33.2	29.3	104.2
Chile	239.9	183.9	250.4	170.1	169.9	178.8	131.1	121.5	192.9	274.0
Peru	138.5	131.7	258.2	286.3	280.6	260.7	141.6	143.8	204.6	259.9
Colombia	141.7	136.8	131.8	88.2	63.3	46.1	38.6	35.5	72.9	n.a.

<sup>1</sup> Interest on long-term and short-term debt plus amortization on long-term.  
Source: W. Cline, *International Debt: Systemic Risk and Policy Response 294-96* (1984) (tables E-1, E-2 and E-3).

Table 4

Non-Oil Developing Countries: Distribution of Outstanding Debt Among  
Selected Groups of Countries, End-1982

(In billions of dollars and percentages, as indicated)

	Major Borrowers <sup>1</sup>	Low- Income Countries (except China and India)	Other Countries <sup>2</sup>
<b>I. In billions of U.S. dollars</b>			
Total debt	447.0	56.6	108.8
Short-term debt	99.7	3.0	10.0
Long-term debt	347.3	53.6	98.8
Guaranteed, to official creditors	93.7	44.8	54.7
Other	253.6	8.8	44.1
<b>II. In percent of corresponding totals for all non-oil developing countries</b>			
Total debt	73.0	9.2	17.8
Short-term debt	88.4	2.7	8.9
Long-term debt	69.5	10.7	19.8
Guaranteed, to official creditors	48.5	23.2	28.3
Other	82.7	2.9	14.4

<sup>1</sup> The 20 countries (in the non-oil developing group) with the largest estimated external debts to private creditors: Mexico, Brazil, Argentina, Chile, Peru, Ecuador, Colombia, South Korea, Philippines, Thailand, Malaysia, Greece, Morocco, Egypt, Yugoslavia, Israel, Turkey, Portugal, Romania, and Hungary.

<sup>2</sup> Residual group (including China and India).

Source: IMF, Annual Report 1983, at 30 (1983) (Table 9).



Table 5  
Export Growth Compared with Interest Rates  
1973-1982  
(percentage)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
LIBOR + 1 percent	10.2	12.0	8.0	6.6	7.0	9.7	13.0	15.4	17.5	14.1
<i>Export growth, nominal</i>										
Non-oil LDC's	n.a.	36.4	1.4	16.5	21.2	17.2	28.9	26.1	5.8	-3.8
Net oil importers	n.a.	33.1	1.6	16.3	21.9	16.9	26.8	24.2	5.4	-3.8
Net oil exporters	n.a.	57.3	-0.1	18.9	18.8	18.0	40.4	35.4	7.8	-3.6
Brazil	57.1	33.2	6.1	13.5	19.7	7.2	24.2	29.3	15.7	-13.4
Mexico	26.8	31.6	-0.2	13.3	14.0	39.1	40.2	54.3	21.9	7.3
Argentina	61.6	25.8	-23.9	30.8	43.6	16.3	26.2	13.0	5.1	-15.7
South Korea	85.6	29.4	9.7	60.8	38.2	31.3	13.8	15.6	21.7	2.3
Venezuela	54.4	126.8	-15.7	2.8	5.5	-0.8	50.2	36.4	10.1	-22.0
Chile	49.0	60.1	-21.7	31.7	8.1	13.8	59.0	32.2	-2.6	-3.8

Source: W. Cline, International Debt: Systemic Risk and Policy Response 6-7 (1984) (Table 1.2).  
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Table 6  
Economic Indicators for Selected Latin American Countries  
1979-1982

	<u>Argentina</u>	<u>Brazil</u>	<u>Chile</u>	<u>Mexico</u>	<u>Peru</u>	<u>Venezuela</u>
<b>Real Exchange Rates</b> (per constant dollar)						
1979	69.3	103.2	88.0	92.5	112.7	96.4
1980	60.2	106.9	72.0	81.7	99.4	85.7
1981	75.4	99.3	71.5	76.8	90.9	81.5
1982	132.0	105.6	93.0	116.9	96.7	79.6
<b>Government Deficits as</b> <b>Percentage of GDP</b>						
1979	7.2	8.1	-4.8	6.8	1.7	-1.1
1980	8.6	7.1	-5.6	7.7	6.4	-1.2
1981	14.3	12.1	-1.1	14.8	8.6	3.4
1982	14.2	13.8	4.0	18.6	8.8	11.0
<b>State Enterprise Deficits</b> <b>as Percentage of GDP</b> (average 1979-1982)	3.8	4.2	0.95	6.2	3.3	3.4
<b>Inflation, Percent per year</b>						
1979	159.6	52.7	33.4	18.2	66.7	12.4
1980	100.8	82.8	35.1	26.4	59.2	21.5
1981	104.5	105.6	19.7	27.9	75.4	16.2
1982	164.8	98.0	9.9	58.9	64.4	9.9
<b>Real Domestic Interest</b> <b>Rate (Nominal Rate—</b> <b>Inflation)</b>						
1979	-86.86	-20.45	n.a.	-3.25	n.a.	n.a.
1980	-28.80	-32.30	n.a.	-3.65	n.a.	n.a.
1981	-17.74	+9.45	n.a.	+3.12	n.a.	n.a.
1982	-61.38	-80.80	n.a.	-46.36	n.a.	n.a.
1983	-257.29	-154.90	n.a.	-26.10	n.a.	n.a.

Source: T. Enders & R. Mattione, *Latin America: The Crisis of Debt and Growth* 65-66 (Brookings Institution, 1984) (Tables B-5 to B-8); Kubarych, *The Financial Vulnerability of LDCs: Six Factors*, in *A Dance Along the Precipice: The Political and Economic Dimensions of the International Debt Problem* (W. Eskridge ed. 1985) (forthcoming) (Table 1-7).

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Table 7  
 U.S. Investment in Spanish America, 1936-1970, with  
 Investment/National Government Revenue Ratios  
 (in millions of dollars)

Country	1936		1943		1950		1960		1970	
	\$	Ratio	\$	Ratio	\$	Ratio	\$	Ratio	\$	Ratio
Argentina	348	.92	380	1.37	356	.26	472	.38	1,281	.73
Bolivia	18	2.25	13	.89	11	.17	31	1.03	50	.48
Chile	484	11.11	328	5.70	540	1.62	738	1.10	748	.46
Colombia	108	2.81	117	2.14	193	.89	424	1.33	698	1.01
Costa Rica	13	2.17	30	3.90	60	3.87	62	.99	101	.76
Cuba	636	9.74	526	6.31	642	2.79	956	2.36	0	0
Dominican Republic	41	3.76	71	5.77	106	1.37	105	.69	168	.69
Ecuador	5	.67	11	1.09	14	.54	50	.63	182	1.07
El Salvador	17	2.39	15	1.88	17	.48	31	.41	71	.63
Guatemala	50	4.76	87	7.01	106	2.47	131	1.53	187	1.25
Honduras	36	5.71	37	6.49	62	4.19	100	2.54	198	2.30
Mexico	480	4.48	286	2.87	415	1.04	795	.76	1,786	.68
Nicaragua	5	1.72	4	1.90	9	.70	18	.55	65	.79
Panama	27	3.41	110	8.66	58	1.85	405	6.98	1,251	7.82
Paraguay	5	.82	9	—	6	—	13	.61	26	.38
Peru	96	2.47	71	1.84	145	1.45	496	1.51	688	.69
Uruguay	14	.16	6	.06	55	—	47	.93	73	.22
Venezuela	186	3.01	373	3.67	993	1.75	2,569	1.67	2,704	1.26
Total/Average:	2,599	3.46	2,494	3.62	3,788	1.59	7,443	1.44	10,244	1.18

Source: D. Palmer, Peru: The Authoritarian Tradition 80 (1980) (Table 5.7).  
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Table 8  
Foreign Branches of U.S. Banks

<u>Year</u>	<u>U.S. Banks with Foreign Branches</u>	<u>Number of Foreign Branches</u>	<u>Total Assets of Foreign Branches (billions of \$)</u>	
			<u>Gross</u>	<u>Net<sup>1</sup></u>
1950	7	95	—	—
1960	8	131	3.5	—
1965	13	211	8.9	—
1969	53	460	41.1	—
1970	79	532	52.6	—
1971	91	577	67.1	55.1
1972	107	627	77.4	72.1
1973	125	699	118.0	108.8
1974	125	732	140.5	127.3
1975	126	762	162.7	145.3
1976	126	723	193.9	174.5
1977	130	730	227.9	205.0
1978	137	761	257.6	232.0
1979	139	789	312.9	279.5
1980	159	787	343.5	310.5
1981	159	841	390.9	343.3
1982	162	900	388.5	341.3

<sup>1</sup> Net of claims on other foreign branches of the same bank.

Source: J. Spindler, *The Politics of International Credit: Private Finance and Foreign Policy in Germany and Japan 187* (1984) (Table 7-2).

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Table 9

Indicators of Dependency in Spanish America: Foreign Debt and Debt/Export Ratios by Country, 1929-1970  
(public debt in millions of \$)

Country	1929		1950		1970	
	Debt	Ratio	Debt	Ratio	Debt	Ratio
Argentina	\$1,202.40	1.30	\$ 400.00	.29	\$ 1,788	1.02
Bolivia	90.96	1.78	50.00	.67	334	3.67
Chile	499.20	.71	355.40	1.26	1,734	1.07
Colombia	88.20	.71	157.50	.40	1,079	1.57
Costa Rica	18.00	.99	12.00	.21	120	.90
Cuba	70.20	.25	95.80 <sup>a</sup>	.14	6,000 <sup>b</sup>	2.22
Dominican Republic	18.80	.81	10.00	.11	184	.76
Ecuador	20.10	1.18	31.90	.43	179	1.05
El Salvador	19.20	1.04	22.40	.33	75	.66
Guatemala	13.80	.57	.40	.01	91	.61
Honduras	27.30	1.11	1.30	.02	65	.76
Mexico	826.20	2.49	509.10	.98	2,963	1.12
Nicaragua	2.90	.27	4.60	.17	119	1.45
Panama	16.30	2.91	13.00	.54	122	.76
Paraguay	3.90	.29	15.30	.46	82	1.17
Peru	113.00	.69	107.20	.57	858	.86
Uruguay	138.20	1.44	105.50	.42	265	.80
Venezuela	3.90	.03	249.80 <sup>c</sup>	.22	514	.24
Total:	\$3,172.56	1.03	\$2,141.20	.41	\$16,572	1.15

<sup>a</sup>1945.

<sup>b</sup>1973.

<sup>c</sup>1955.

Source: D. Palmer, Peru: The Authoritarian Tradition 81 (1980) (Table 5.8).  
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Table 10

Indicators of Dependency in Spanish America: Balance-of-Payments Ratio  
(Imports/Exports), 1930-1970

Country	1930	1950	1970
Argentina	1.20	.87	.85
Bolivia	.59	.85	.86
Chile	1.06	.87	.75
Colombia	.68	.92	1.03
Costa Rica	.67	.82	1.24
Cuba	.97	.84	1.25
Dominican Republic	.82	.51	1.30
Ecuador	.88	.55	1.05
El Salvador	.90	.71	.82
Guatemala	.71	.90	.90
Honduras	.42	.61	1.14
Mexico	.76	1.07	1.57
Nicaragua	1.03	1.08	1.02
Panama	5.18	2.54	2.53
Paraguay	1.07	.58	1.18
Peru	.62	.93	.68
Uruguay	.92	.78	.91
Venezuela	.37	.51	.65
Average:	1.05	.89	1.10
	Panama = .80	Panama = .79	Panama = 1.02

Source: D. Palmer, Peru: The Authoritarian Tradition 83 (1980) (Table 5.10).  
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Table 11

Indicators of Dependency in Spanish America: Principal Export/Total Exports, 1928-1971

Country	1928	1947	1971
Argentina	23.8	31.0	23.7
Bolivia	77.3	71.0	48.6
Chile	47.6	63.0	73.0
Colombia	66.0	77.0	63.8
Costa Rica	63.1	47.0	28.4
Cuba	71.6	86.0	76.9
Dominican Republic	61.6	62.0	57.2
Ecuador	30.1	34.0	51.0
El Salvador	93.0	85.0	40.6
Guatemala	79.2	61.0	33.8
Honduras	80.7	47.0	51.0
Mexico	14.7	24.0	7.8
Nicaragua	58.1	40.0	22.5
Panama	70.8	50.0	56.4
Paraguay	24.0	17.0	31.9
Peru	20.9	30.0	30.9
Uruguay	30.5	43.0	33.8
Venezuela	73.7	95.0	92.2
Average:	54.0	53.5	45.8

Source: D. Palmer, Peru: The Authoritarian Tradition 82 (1980) (Table 5.9).  
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Table 12  
 Indicators of Dependency in Spanish America: Principal Foreign  
 Market/Total Exports, 1928-1971

Country	1928	1947	1971
Argentina	28.7	30.0	15.0
Bolivia	83.2	59.8	37.8
Chile	34.3	44.5	19.7
Colombia	77.7	88.2	38.4
Costa Rica	53.7	77.2	40.1
Cuba	72.8	66.7	50.0
Dominican Republic	44.5	41.4	74.4
Ecuador	37.4	42.4	35.9
El Salvador	29.1	77.5	23.4
Guatemala	54.2	86.4	32.7
Honduras	76.3	72.9	52.0
Mexico	68.1	76.6	62.5
Nicaragua	51.5	77.4	35.2
Panama	91.6	85.4	48.1
Paraguay	88.2	75.0	27.4
Peru	28.5	29.3	28.8
Uruguay	22.6	28.6	11.8
Venezuela	35.4	50.0	37.9
<b>Average:</b>	<b>54.4</b>	<b>61.6</b>	<b>37.3</b>

Source: D. Palmer, *Peru: The Authoritarian Tradition* 84 (1980) (Table 5.11).  
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