

Introduction

What constitutes an effective bargaining strategy for weak actors?¹ This paper evaluates the success of two diametrically opposed LDC bargaining strategies, Argentina's "distortion" (uncertainty-maximization) strategy and Venezuela's "cooperative" (uncertainty-minimization) strategy, in commercial debt rescheduling negotiations during the period 1983-1987.²

Bargaining strategy has a significant and independent effect on debt negotiation outcomes. The key is the link between incomplete information and bargaining behavior. Under conditions of extreme uncertainty (that is, extremely incomplete information), actors may take incremental actions that are designed not to derive information about the opponent but merely to avert the collapse of negotiations. The case of Argentina's debt negotiations is a good illustration of this. Argentina's strategy of keeping bankers off-balance with regard to its intention and its capacity to repay debt meant that banks operated in an environment of extreme uncertainty. Banks responded by making incremental concessions that were designed to keep Argentina at the bargaining table.

By contrast, Venezuela's repeated assurances that it would honor its financial commitments allowed banks to make decisions in an environment of nearly complete information. Banks responded by taking a hard line -- and Venezuela's cooperative strategy of minimizing the uncertainty of the banks' environment failed to translate into concessions. This led to a paradoxical outcome: in an effort to reduce the uncertainty surrounding their bargaining environment, banks made more concessions to debtor countries that they argued deserved fewer concessions than they made to debtors they wanted to reward.³

An evaluation of both the short-term and the long-term impact of LDC bargaining strategies during the debt crisis suggests that uncertainty-maximization was more effective in the short term -- *and not necessarily less effective in the long term.*

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²This paper does not provide a detailed discussion of the origins or history of the debt crisis. For details on the crisis, see Miles Kahler (ed.), *The Politics of International Debt*. (Ithaca: Cornell University Press, 1986). and Karin Lissakers, *Banks, Borrowers, and the Establishment* (BasicBooks: 1991). For a game theoretic analysis of debt negotiations, see Vinod K. Aggarwal, *Debt Games* (Cambridge, Cambridge University Press, in press). For a discussion of the factors that prompted Third World countries to embrace high levels of indebtedness, see Jeffrey A. Frieden, "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea." *International Organization*, Vol. 35, No. 3.

Strategies of the Weak

On August 20, 1982, Mexican Finance Secretary Jesus Silva Herzog made an announcement that shook the international financial world: Mexico did not have the necessary money to make the foreign debt principle payments that were coming due in the next few months.⁴ Other countries quickly followed suit: By spring 1983, no fewer than fifteen countries had approached private commercial banks to renegotiate their debts. U.S. banks were not well prepared for the crisis. Developing countries owed more than \$100 billion to U.S. banks alone.⁵ Yet few banks had significant loan-loss reserves.

Beyond fears about the fate of individual U.S. banks, international financial analysts worried that widespread debtor default could result in a global financial crisis. The exact dimensions of the threat were unclear -- and it was this very uncertainty that sent shivers running up the spines of Wall Street. The threat that a major debtor might default was frightening not just because banks might have to write off billions of dollars; there was a fear that other bad things might happen as well. Perhaps other debtors would jump on the bandwagon, default, and make profit losses even higher. Perhaps a precedent for default might be set that could plague the activities of banks for decades. Perhaps this precedent would not just apply to LDC loans but also to other kinds of loans (such as domestic loans). Perhaps banks' stocks would plummet and generate an international financial crisis. Perhaps this financial crisis would spark a severe and lingering global recession.⁶

³Although this conclusion is based on personal conversations with many commercial bankers, few of them would agree with my assessment. For example, while I argue in that banks made greater concessions to Argentina than to Venezuela, several bankers disputed my interpretation of the negotiations -- or even what should be considered "concessions."

⁴For a detailed analysis of the Mexican crisis, see Joseph Kraft, *The Mexican Rescue*. (New York: Group of Thirty, 1984). Mexico had announced the problem to U.S. government, IMF officials, and its leading private creditors the previous week. Kraft details the behind-the-scenes scrambling to put together an emergency rescue package for Mexico.

⁵This figure is the amount owed by non-oil producing LDCs; as such, Venezuelan debt is not included. See the remarks of Comptroller of the Currency C. T. Conover in U.S. Congress, Committee on Banking, Housing, and Urban Affairs, Subcommittee on International Finance and Monetary Policy, "International Debt," February 14, 15, and 17, 1983. Washington DC: Government Printing Office, 1983.

⁶Fears that debt problem would become disastrous were reflected in the titles of journalistic reports during the early 1980s. See, for example, Darrell Delamaide, *Debt Shock* (Garden City, NY: Doubleday, 1984); C. Huhne and H. Lever, *Debt and Danger* (Harmondsworth: Penguin Books, 1985); *The Economist*, "The Crash of 1982," October 22, 1983; *Time Magazine*, "The Debt Bomb: The Worldwide Peril of Go-Go Lending," January 10, 1983; Bruce Steinber, "How the Debt Bomb Might Be Defused," *Fortune*, May 2, 1983; Arlene Hershman, "Bankruptcy Scare," *Dun's Business Month*, September 1982, pp. 33-37; Tim Anderson and Peter Field, "The Tremors That Threaten the Banking System," *Euromoney*, October 1982, pp. 17-31; Jack Egan, "Banks on the Brink: Flirting with Global Collapse," *New York*, October 25, 1982, pp. 28-31.

Table 1: Exposure of Major Banks to LDCs, Yearend 1982
(Percentage of capital)

	<u>Argentina</u>	<u>Brazil</u>	<u>Mexico</u>	<u>Venezuela</u>	<u>Chile</u>	<u>Total</u>
Citibank	18.2	73.5	54.6	18.2	10.0	174.5
Bank of America	10.2	47.9	52.1	41.7	6.3	158.2
Chase Manhattan	21.3	56.9	40.0	24.0	11.8	154.0
Morgan Guaranty	24.4	54.3	34.8	17.5	9.7	140.7
Manufacturers Hanover	47.5	77.7	66.7	42.4	28.4	262.8
Chemical	14.9	52.0	60.0	28.0	14.8	169.7
Continental Illinois	17.8	22.9	32.4	21.6	12.8	107.5
Bankers Trust	13.2	46.2	46.2	25.1	10.6	141.2
First National Chicago	14.5	40.6	50.1	17.4	11.6	134.2
Security Pacific	10.4	29.1	31.2	4.5	7.4	82.5
Wells Fargo	8.3	40.7	51.0	20.4	6.2	126.6
Crocker National	38.1	57.3	51.2	22.8	26.5	196.0
First Interstate	6.9	43.9	63.0	18.5	3.7	136.0
Marine Midland	n.a.	47.8	28.3	29.2	n.a.	n.a.
Mellon	n.a.	35.3	41.1	17.6	n.a.	n.a.
Irving Trust	21.6	38.7	34.1	50.2	n.a.	n.a.
First National Boston	n.a.	23.1	28.1	n.a.	n.a.	n.a.
Interfirst Dallas	5.1	10.2	30.1	1.3	2.5	49.2

Note: Bank capital includes shareholders' equity, subordinated notes, and reserves against possible loan losses.

Source: William R. Cline, *International Debt: Systemic Risk and Policy Response* (Washington, DC: Institute for International Economics, 1984), p. 24, as compiled from annual reports for individual banks; *American Banker*, March 17, 1983 and April 6, 1983; Prudential-Bache Securities, "Banking Industry Outlook," May 6, 1983; and *Veja* (Brazil), June 1, 1983.

Table 2: Developing Countries' Total Debt Stocks
(billions of dollars)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Argentina	\$ 43.6	\$45.9	\$ 48.9	\$50.9	\$ 52.4
Brazil	92.2	97.5	104.3	104.6	112.0
Chile	17.3	17.9	19.7	20.4	21.1
Mexico	86.0	93.0	94.8	96.9	100.9
Peru	12.3	12.0	13.1	14.2	16.0
Philippines	24.5	24.3	24.2	26.6	28.3
Venezuela	32.1	38.2	36.8	35.2	34.6

Note: Includes public, publicly guaranteed and private debt.

Source: *World Debt Tables 1989-90*. Washington, DC: International Bank for Reconstruction and Development, 1989.

Table 3: Developing Countries' Debts to Commercial Banks
(billions of dollars)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Argentina	\$ 6.9	\$ 13.1	\$ 14.4	\$20.7	\$23.3
Brazil	34.2	41.0	50.5	50.1	54.3
Chile	3.5	4.7	8.5	10.1	11.0
Mexico	38.5	50.2	54.0	55.7	55.4
Peru	2.2	2.9	3.6	3.8	3.8
Philippines	3.6	4.0	4.2	5.0	8.9
Venezuela	10.0	11.7	16.1	15.0	22.4

Note: Includes public and publicly guaranteed debt.

Source: *World Debt Tables 1989-90*. Washington, DC: International Bank for Reconstruction and Development, 1989.

Banks' fears notwithstanding, debtor countries had important reasons to sustain the goodwill of their creditors. Debtors depended on commercial banks on several levels. If the relationships between debtors and banks were severed, LDC debtors would suffer on numerous levels. At the most basic level, a debtor's decision to renege on international obligations could prompt the injured banks to cut off new loans. Countries that defaulted on their loans would suffer a huge drop in international credibility, perhaps affecting their ability to attract foreign direct investment. Moreover, banks were an important source of short-term trade credits for LDCs. At best, a country that lost access to trade credits would have to conduct international transactions in a more circuitous way, through barter or countertrade relationships; at worst, it would be economically isolated. For debtors, then, the stakes were high.

The central strategic choice facing Argentina and Venezuela was what message to send banks about the possibility of default. The term "strategy" is used in widely different ways among social scientists. In game theoretic terms, "strategy" has a precise definition: "a complete plan that specifies the exact course of action a player will follow, whatever contingency arises."⁷ Thus, if we were to map out a set of negotiations using an extensive form game tree, a player's strategy would include a plan for behavior no matter on what branch she finds herself during the course of negotiations.

Focusing on this technical definition is useful when attempting to construct mathematical models of bargaining situations. But it runs the danger of obscuring other aspects of the term. Consistent with the above definition -- but not emphasized in that definition -- is the fact that strategy is an attempt by one player to alter the behavior of another player, often by manipulating the beliefs or perceptions of that player. As Schelling suggests, a strategy "is concerned with influencing the choices that another party will make, and doing it by influencing his expectations of how we will behave."⁸ Thus, while it makes sense to define strategy as a "complete game plan," it is also useful to push this definition a step further. What do the individual choices in this complete game plan imply for the bargaining situation? That is, it is useful to examine not only the formal offers and counteroffers of the negotiations but also the other kinds of information that is communicated between players. Or, in game theoretic language, it may be useful to examine the information that is communicated to the opponent, *apart from* the actions taken at particular decision nodes.⁹

⁷The definition is taken from Steven J. Brams, *Theory of Moves* (Cambridge: Cambridge University Press, 1994), p. 227. Brams has an extensive glossary of game theoretic terms; see pp. 220-228.

⁸Thomas C. Schelling, *The Strategy of Conflict* (Cambridge, MA: Harvard University Press, 1980), p. 13. Schelling is using deterrence as an example of what he calls "a typical strategic concept."

⁹Of course, the content of individual decision nodes depend entirely on the decisions that are made in developing the game tree. It is conceivable that a formal model could include decision nodes for every signal one actor may send the opponent -- not just the definitive or substantive actions that a player may take. To develop such an all-inclusive game would quickly get unwieldy. Moreover, the addition of many "signaling" decisions to the game runs the risk of obscuring the decisions regarding the substance of the negotiations.

Strategic decisions involve the amount and content of information that one player wants the other to have. Information may be given freely, given selectively, distorted, or withheld from the opponent. Indeed, one influential (non-game theoretic) study of negotiations defined the word “bargaining” as “a game of managing impressions or manipulating information.”¹⁰ “Strategy” -- broadly conceptualized to include informational exchanges and informal signaling -- is about the manipulation of information. Consistent informational flows increase the certainty of the opponent about the “game” that is being played -- the distribution of power, the payoffs to each player, and the penalties associated with a breakdown of negotiations.¹¹ By contrast, inconsistent informational flows decrease the certainty of the opponent about the “game” that is being played -- and, therefore, what responses are likely to achieve bargaining goals.

Strategic Choices for Weak Actors: Distortion Strategies

Consider first the strategy of sending inconsistent informational flows, what is called here a “distortion” strategy. Given the serious consequences of default, a debtor country is likely to want to avoid a breakdown of negotiations. At the same time, however, it has a strong incentive to convince the strong actor that it is willing to risk a breakdown of negotiations in order to win concessions.¹²

One way around this apparent contradiction is for the debtor to employ a variation of what Schelling calls “brinkmanship” tactics. Schelling argues that actors may deliberately increase the likelihood of an outcome that is wishes to avoid (such as war), because doing so may scare the opponent into making concessions:

Brinkmanship is thus the deliberate creation of a recognizable risk of war, a risk that one does not completely control. It is the tactic of deliberately letting the situation get somewhat out of hand, just because its being out of hand may be intolerable to the other party and force his accommodation...

In sum, it may make sense to try to keep the enemy guessing as long as we are not trying to keep him guessing about our own motivation. If the outcome is partly determined by

¹⁰Samuel B. Bacharach and Edward J. Lawler, *Bargaining: Power, Tactics and Outcomes* (San Francisco: Jossey-Bass Publishers, 1981), p. 42. Bacharach and Lawler's primary focus is on the importance of power in bargaining situations; indeed, they suggest that power determines bargaining tactics (p.x). This approach is not as structurally deterministic as first appears, because Bacharach and Lawler stress the psychological component of power, that is, the ability to influence an opponent's behavior by manipulating her beliefs about relative power. Thus, while their study does not stress the importance of bargaining strategy as much as this article, the two approaches are not incompatible.

¹¹Consistent informational flows need not be true informational flows; if an actor is very good at bluffing, she may be able to make her opponent quite certain of a false reality.

¹²This is not to suggest that a weak player is more risk averse than the strong player -- simply that it has greater incentives to misrepresent its risk tolerance. On the one hand, given the fact that weak players have more to lose from a breakdown in the interdependent relationship, a weak player may be more risk averse than the stronger player. On the other hand, psychological research has suggested that actors are more risk-acceptant in the domain of losses than in the domain of gains; this would suggest that weak players might be *more* risk acceptant than strong players. See D. Kahneman and A. Tversky, “Prospect Theory: An Analysis of Decisions Under Risk,” *Econometrica*, 47, 1979, pp. 263-291. I owe this insight to Steven Weber.

events and processes that are manifestly somewhat beyond our comprehension and control, we create genuine risk for him.¹³

The effectiveness of what Schelling calls brinkmanship is that it can make credible a threat that is clearly not in the interest of the actor who issues it. We can be sure that no country will choose nuclear war as its preferred outcome. But by escalating the risk of war, a country can increase the credibility of its threat, even though carrying out that threat contradicts its own best interests.

Similar logic can be applied to bargaining in the economic sphere. If an actor threatens to take an action that would clearly hurt itself as much as (or even more than) its opponent, that threat may not be credible. But by convincing its opponent that it may have no choice but to carry out the threat -- that events beyond its control may compel it to do so, even against its wishes -- an actor can make that same threat quite credible. As we shall see, this is exactly what some debtors did during the crisis. Some debtors successfully convinced creditor banks that they might be forced -- against their will -- to default. Even though such an action would hurt their economies as much as it would damage the banks' profit margins, banks believed that the possibility of default was real.

At first glance, the distortion strategy may appear little different than convincing the opponent that certain circumstances will compel one to defect -- that is, maximizing the certainty of the opponent that defection will occur unless certain conditions are met. Not so. Distortion strategies involve the delicate job of sending mixed rather than clear signals. The weak actor may suggest, for example, that even she does not know what circumstances will prompt her to default, but that if certain conditions are not met, she "may" be forced to do so.

For a weak actor, this strategy can be more attractive than issuing direct threats. First, direct threats are not likely to be convincing. For a weak player to say, "If you fail to do X, I will definitely do Y" is likely to harm the issuer of the threat as much or more than the target.¹⁴ Self-destructive threats are hard to make credible. In the case of debt negotiations, it was hardly credible to state, "If you don't grant me this concession, I will default," since the repercussions of defaulting were so costly for the debtor. A country would face potential economic devastation because it would be cut off from international financial markets, face potential trade sanctions, incur possible reductions in foreign aid, and so on. The more credible threat was one that was less definite: "Our economy is headed for a tailspin; if this is true, economic crisis and domestic political repercussions may render us unable to service our debt. We would prefer to remain at the bargaining table and to honor our commitments. It is in both our interests that you banks make concessions."

¹³Schelling, *op. cit.*, pp. 200, 201.

¹⁴This is in addition to the other problems that inhere in making direct threats -- most obviously, the problem of what to do if the target decides that you are bluffing.

A second reason that distortion may be an attractive bargaining strategy for weaker players is simply that their situations often *are* more uncertain than those of the stronger players. The economic situations of LDCs (by definition) are more precarious than those of advanced industrial countries. Political and social instability exacerbate economic problems. Commitments made by one set of bargainers may be rendered unenforceable by unhappy legislators, social instability, electoral political opposition, economic crisis, or any number of other factors.

Third, distortion strategies allow the weak player to attempt to gain at least some goodwill from its opponent. The weak actor may stress that its true desire is to cooperate and to preserve the interdependent relationship. Circumstances beyond the negotiators' control, not bad faith, make the weak actor unable to make any firm promises about its intentions. For example, a downturn in economic circumstances may restrict the debtor's access to foreign exchange. Or domestic political considerations may force a governing coalition to take decisions to satisfy nationalist groups rather than international creditors. In other words, the negotiators keep their creditors at the bargaining table by stressing their intention to honor their obligations if circumstances permit. They argue that it is up to the creditors to help ensure that circumstances do indeed permit the debtor to manage to repay.

In this way, the LDC negotiators can not only recognize their disadvantaged bargaining position; they can embrace that weakness. With constant references to the uncertainty surrounding the bargaining environment, the negotiators can attempt to transform the weakness itself into a bargaining strength -- at the same time that they are verbally assuring their opponent of their good faith. To the extent that creditors have a direct interest in seeing their money repaid, this may be a persuasive argument.

Distortion strategies emphasize short-term over long-term goals. The short-term focus risks sacrificing long-term benefits, and, specifically, continued access to international financial markets. However, this tradeoff is not absolute. Although uncertainty-maximizing strategies give priority to short-term considerations, they need not involve the conscious sacrificing of longer-term goals. A weak actor may make a strategic "bet" that long-term circumstances will change significantly enough that it will suffer no negative repercussions from the distortion strategies -- or will at least be "forgiven" by the opponent. Indeed, distortion strategies might achieve short-term concessions that might *facilitate* longer-term cooperation later. By refusing to implement economic adjustment programs or to make large debt payments, a governing coalition might consolidate its power, win domestic political allies and devote scarce resources to domestic economic priorities. Done successfully, this might allow the country to return to the bargaining table (or to international capital markets) when it is in a better position to embrace

difficult austerity policies. Thus, while there is an short-term/long-term tradeoff implicit in distortion strategies, uncertainty-maximization may also be an element of a long-term strategy.¹⁵

Strategic Choices for Weak Actors: Cooperative Strategies

An alternative to distortion strategies exists. When facing short-term negotiations, such as a particular debt rescheduling agreement, actors that value long-term goals face a choice: how much should short-term gains be sacrificed in order to preserve long-term goals? In the case of debt rescheduling, the tradeoff appears clear. An active pursuit of short-term gains endangers the debtor's credibility and, therefore, long-term access to international financial markets. A debtor that wants to preserve its credibility might embrace a cooperative attitude toward banks, including the acceptance of higher interest rates and fewer concessions than it would in more confrontational negotiations. Indeed, the ultimate long-term strategy would be to avoid rescheduling altogether and to continue to make interest and principal payments on the debt. For debtors facing severe repayment difficulties, this extreme option of continued repayment is impossible. The trick is to combine the short-term necessity of winning concessionary repayment agreements with the longer-term goal of maintaining international credibility.

One strategy that attempts to achieve short-term concessions *without* sacrificing long-term goals is to embrace a norms-oriented rather than a threat-oriented approach to negotiations. In the case of debt, implicit norms evolved within the banking community regarding the ways that debtor countries should behave. Most of these centered around the insistence by banks that debtors demonstrate a commitment to sound economic policies. Debt negotiations were linked to such issues as inflation controls, exchange rate policies, and limits on debtor government deficits. Banks also stressed the need to see evidence that debtors were committed to repaying their debt. Such evidence took the form of orthodox economic policies, the involvement of the International Monetary Fund in economic planning, and the continuation of debt servicing throughout the rescheduling negotiations.¹⁶

By adhering closely to the expectations of creditor banks and the IMF, for example, a debtor could argue that it deserved better terms than those countries that refused (or were unable) to play by the rules. Rather than obscuring its intentions, the cooperative debtor attempts to facilitate creditor

¹⁵The largest constraint on the long-term viability of distortion strategies is temporal. Although a weak actor may be able to win concrete concessions from this strategy, it is reasonable to expect that her opponent will attempt to increase her bargaining strength on that issue area. The most obvious way to do so is to decrease the level of resource dependency on the actor. For example, during the oil crises of the 1970s, advanced industrial countries simultaneously negotiated with OPEC and attempted to decrease their reliance on OPEC producers. By looking for alternative suppliers and exploring new energy sources, these countries hoped to decrease the bargaining leverage of OPEC. In the case of debt, commercial banks negotiated with LDCs while they took steps to decrease their exposure to LDC debt. By slowly building loan loss reserves, they were able to decrease their dependence on LDC resources -- and hence the bargaining power of the debtors. To the extent that an actor can decrease her dependence on her opponent's resources, an uncertainty-maximization strategy will decrease in effectiveness over time.

¹⁶See, for example, Charles Lipson, "The International Organization of Third World Debt." *International Organization* Vol. 35, No. 4, (1981), pp. 603-32.

decisionmaking by sending consistent messages. And rather than threatening (or hinting) to sever the relationship, the debtor issues assurances to its opponent that it values the long-term relationship. This strategy stands in stark contrast to the implicit threats of distortion strategies.

This cooperative strategy need not be exclusively long-term in focus; it may also aim to win short-term concessions by fostering good will among creditors. By focusing on its compliance with existing norms, the weak actor may argue that it “deserves” to win concessions. And by assuring banks of eventual repayment (at least) and of future lucrative investment opportunities in a revitalized LDC economy (at best), the debtor may argue that short-term concessions are also in the banks’ own interests. The remainder of the article examines the short-term and long-term implications of cooperative and distortion strategies during commercial debt negotiations.

Venezuela's Cooperative Strategy: 1982-85

During the 1970s Venezuela was reputed to have one of the soundest economies in Latin America. Venezuela enjoyed strong economic growth, due mainly to its oil exports. Its reputation as a solid credit risk was enhanced by its supplies of bauxite, iron ore, and hydroelectric power -- as well as by the fact that Venezuela was the most stable democracy in South America. Thus, when soaring interest rates, falling oil prices, and decreased international demand pushed Venezuela into the same recession that many other developing countries faced during the early 1980s, Venezuela was in the unusual position of having an impressive \$12 billion in foreign currency reserves. (See table 4.)

Table 4: Developing Countries' Foreign Currency Reserves
(billions of dollars)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Argentina	4.5	2.8	2.6	4.7	4.4
Brazil	4.0	4.6	12.0	11.6	6.8
Chile	2.6	2.6	2.8	3.0	2.9
Mexico	1.8	4.8	8.0	5.7	6.7
Peru	2.0	1.9	2.1	2.5	2.2
Philippines	1.7	0.9	0.8	1.1	2.6
Venezuela	11.8	12.0	12.4	14.0	10.9

Source: *World Debt Tables 1989-90*. Washington, DC:

International Bank for Reconstruction and Development, 1989.

From the beginning, Venezuelan officials argued that the crisis was temporary, due to adverse international economic conditions and an excess of short-term debt held by quasi-independent state agencies. In September 1982, Finance Minister Luis Ugueto announced that Caracas did not plan to

negotiate a formal rescheduling agreement with banks, but rather preferred to work with international bankers on a two-option conversion deal. One option creditors had was to lengthen the maturity of short-term state agency debts to at least two years; in return, the government would issue a guarantee for those loans. Alternatively, creditors could stretch the state agency short-term debt out even longer -- to three, five or seven years -- and Caracas would convert those loans into official government debt.¹⁷ The Venezuelan plan envisioned that some \$3 billion of state agency short-term debt would be exchanged under this plan, while the agencies that held the debt would refinance another \$1 billion directly.¹⁸

Ugueto lobbied for his plan by stressing Venezuela's strengths and fundamental creditworthiness. Venezuela was different, stronger, and healthier than most of Latin America. As such, he argued, Venezuela was suffering unnecessarily from creditor banks' tendency to write off the entire Latin American region as a "problem zone." Ugueto stressed, unlike other debtor countries, that Caracas had decided not to pursue new foreign credits until at least 1985. He also pointed to a number of economic policies that Caracas had embraced before approaching its private creditors. Shortly before requesting the debt conversion, Caracas increased the value of its gold reserves from \$42 per ounce to \$300 per ounce. Moreover, the government increased its foreign exchange reserves by requiring that all government-owned companies deposit their reserves with the Central Bank. Finally, the Venezuelan central bank decided in late September to seize the offshore dollar reserves of Petroleos de Venezuela; Caracas portrayed the move to its creditors as a measure to centralize its foreign exchange reserves.¹⁹

Initially, bankers appeared interested in Ugueto's plan. Within two weeks of Ugueto's trip, Caracas received four major refinancing offers from private creditors. But the optimism did not last long. For example, problems emerged with the conversion of the debts of the national housing agency, Instituto Nacional de la Vivienda (Inavi). To the surprise of some financial observers, the problem banks were not smaller banks but some of the larger financial institutions. Three large banks decided not to participate because of problems they faced in funding the loans in the interbank market. This was a circumstance that would not necessarily reflect poorly on Venezuela; however, another British bank also decided to cut its contribution to the loan package from \$30 million to \$15 million. Because this British bank faced no difficulties in raising the money for the loan, observers interpreted the decision as evidence that large banks as well as small banks were attempting to reduce their exposure in Venezuela.²⁰ Other government agencies faced similar problems.

In December 1982, Arturo Sosa replaced Ugueto as finance minister. Like Ugueto, he attempted to rally support for the conversion effort by stressing Venezuela's economic strength: "Anyone who says

¹⁷*The Banker*, "Short Term Treatment", November 1982, p.69.

¹⁸*Journal of Commerce*, October 27, 1982.

¹⁹*Journal of Commerce*, September 29, 1982.

²⁰*Financial Times*, November 26, 1982.

Venezuela is in a crisis today is incompetent.”²¹ Sosa also stressed that he believed Caracas would easily be able to refinance the \$5.5 billion in short-term loans that it owed during 1983. But by this time, his remarks were made to a skeptical international community. A number of banks dropped out of the conversion effort, leaving the overall acceptance rate at between 70 percent and 80 percent. By yearend 1982, Caracas had only succeeded in converting approximately \$1.1 billion of its short-term debt -- far short of the \$3 billion goal.²² The difficulties that Caracas faced in financing the conversion scheme created an embarrassing situation for a country that was attempting to capitalize on its good reputation.

Having failed to gain enough bank participation in the conversion plan, Venezuela was forced to announce that it would seek a rescheduling agreement after all. Venezuela asked creditors to restructure approximately \$15.8 billion in short-term debt -- more than half of its estimated \$27 billion in publicly-held foreign debt. Sosa announced that unlike other LDC debtors, Venezuela would not seek new loans, and would continue to make payments on medium- and long- term debt during the negotiations.

Again, Venezuelan negotiators stood by their basic negotiating position, that is, that Caracas should receive concessions because of its “special” position in Latin America. Rather than emphasizing the size of their debt, Venezuelan officials pointed out that their debt was in fact less than that of Mexico, Brazil or Argentina.²³ Moreover, they stressed their sizable foreign exchange reserves and their decision not to ask for new money as reasons that they should not have to submit to an IMF package and that they should receive easier terms.

Nonetheless, the tone of the rescheduling negotiations was tense. The major issues under dispute were (1) the terms of the rescheduling, (2) whether Venezuela would have to accept an IMF austerity package, and (3) the issue of private debt arrears. With regard to the rescheduling terms, the bank advisory group suggested that Caracas offer its private creditors 1 1/4 percentage points over the London Interbank Offer Rate (LIBOR) and 1 1/8 points over the US prime rate for the refinancing of its short-term debt.²⁴ In early June, Caracas presented a counter-proposal to the advisory committee. Under the plan, bankers would agree to refinance \$13.7 billion of the loans due in 1983 and \$2.6 billion of the loans due in 1984. The refinancing would take place over an eight-year period for the 1983 loans and a seven-year period for those due in 1984. Venezuela would also enjoy a four year grace period, during which time it would only pay interest on the debt. Caracas suggested that the interest rates on the restructured debt would be similar to the original rates.²⁵

²¹*The Banker*, March 1983, p. 67.

²²*Financial Times*, January 10, 1983.

²³Eduardo Mayobre, “The Renegotiation of Venezuela's Foreign Debt During 1982 and 1983” in Miguel S. Wionczek, ed. (in collaboration with Luciano Tomassini), *Politics and Economics of External Debt Crisis* (Boulder, CO: Westview Press, 1985) p. 335.

²⁴*Wall Street Journal*, April 15, 1983.

²⁵*Wall Street Journal*, June 7, 1983.

Even more controversial than the actual terms of repayment was whether Venezuela would have to accept an IMF austerity package as a prerequisite to its commercial rescheduling package. Venezuela's private creditors were in favor of making any rescheduling agreement contingent on the implementation of an IMF austerity package. Sosa objected, arguing that Venezuela was under no obligation to reach an agreement with the IMF before concluding an agreement with creditor banks.

In December 1983, Accion Democratica (AD) candidate Jaime Lusinchi was elected as president. The new administration took steps almost immediately to implement an IMF-like austerity program, although the president warned that he would not accept a formal IMF package.

The final sticking point in the negotiations was the question of private debt payment arrears, which had reached almost \$500 million by November. RECADI, the organization that had been established to deal with private debt, faced bureaucratic paralysis. Commercial bankers were frustrated with the existence of convoluted regulatory and bureaucratic procedures that impeded the ability of private sector debtors to repay their debt. The advisory committee insisted that Caracas demonstrate significant progress on the issue of private debt before publicly-held obligations could be rescheduled. Venezuelan negotiators stated that the government was committed to removing the constitutional and legal obstacles to private debt repayment, but argued that the question of private debt should be handled on a separate basis. Bankers were unpersuaded. In mid-December, during a negotiating session, some seventy bankers applauded when one banker said that Caracas' reasons for the late payments were inadequate. Press reports called this a "rare display of animosity."²⁶

In May 1984, Venezuela underscored its cooperative bargaining strategy, while creditors became even more confrontational. Venezuela refused to sign a proposal made by Mexico, Brazil, Argentina and Colombia that urged a Latin American summit to focus on negotiating better debt repayment terms. Venezuela's decision was made in spite of its rhetorical support for the idea of joint Latin American efforts to resolve the debt issue. Caracas issued a statement of support for the document, but did not formally endorse it. Government spokesmen explained the decision by noting that Venezuela differed from other Latin countries both in terms of development plans and ability to repay debt. Venezuela was unwilling to throw its lot in with less stable countries -- and unambiguously rejected the notion of a debtors' cartel.²⁷ Again, Venezuelan negotiations had sent a clear message to banks: Caracas had no intention of suspending payments on its foreign obligations. Bankers were not left to wonder about Venezuela's ability or intention to repay: Caracas had underscored its commitment on both counts.

Yet creditors became more confrontational. The U.S. government upped the ante of debt negotiations when regulators instructed U.S. banks to reclassify their loans to the Venezuelan government

²⁶*Financial Times*, December 16, 1983.

²⁷*Washington Post*, May 27, 1984.

and private sector. The loans were moved to the “substandard” category. This was the first time that a major Latin American debtor had been moved to the “substandard” category since the debt crisis erupted in 1982. Some bankers suggested that the move was an effort on the part of the United States to persuade Caracas to accept an IMF austerity program. Although officials at the Federal Reserve Bank of New York emphasized that regulatory decisions such as this were based only on economic judgments, other banking industry insiders were skeptical -- pointing out that Venezuela no more deserved to be labeled “substandard” than did other major Latin debtors such as Argentina. They speculated that the reclassification reflected the belief that other debtors were making more of a “good faith effort” than Venezuela, and, consequently, that this was more of a political move than any economically-instructed decision.²⁸

In early July, the details of the final agreement began to emerge. The IMF gave its seal of approval to the tenor of the negotiations, even though Caracas remained firm in its opposition to a formal IMF adjustment package. Venezuela had won on the issue of IMF austerity. However, this victory turned out to be the only major victory for Caracas in the negotiations. With regard to repayment terms, Caracas submitted a new proposal in late July to its creditor committee. Because the negotiations had been more protracted than expected, Caracas requested that debts due to mature in 1985 be included in the rescheduling. The proposal would reschedule \$22.3 billion of Venezuela's publicly-held debt over 15 years, with an eighteen month grace period. Caracas suggested that Caracas would pay equal total interest and principal payments of \$4.2 billion annually on both the restructured and the remaining debt. The proposed interest rate was 7/8 percentage point over LIBOR.²⁹

The advisory committee rejected the Venezuelan proposal. Bankers objected to the fifteen year repayment period -- both because they believed that economic conditions in Venezuela did not warrant such a long-term rescheduling, and because they were hesitant to establish a precedent for other debt negotiations.³⁰ They were also leery of the grace period, since it would allow Lusinchi to put off the debt problem until his term of office expired. Moreover, they argued, because Venezuela continued to enjoy a solid level of foreign reserves and oil income, Caracas should be able to commence repayment immediately.³¹ Bankers also maintained that the \$4.2 billion in annual payments was too small, and did not give enough weight to principal repayments.³² They stressed that they wanted to see a shorter

²⁸The new categorization did not require bankers to do anything different, but it did represent a bit of political muscle. Venezuelan officials were faced with the possibility that U.S. banks might be less willing to lend to a country whose debts were “substandard” -- or might attempt to cut its ties with the country in other ways, such as cutting trade credits. *Wall Street Journal*, May 11, 1984.

²⁹*Financial Times*, August 10, 1984.

³⁰*Journal of Commerce*, August 8, 1984.

³¹*Washington Post*, July 13, 1984.

³²*Financial Times*, August 10, 1984.

repayment period, higher interest rates, and larger annual payments whose levels were based on Venezuela's export revenues.³³

The rescheduling agreement, which was signed in May 1985, rescheduled \$20.75 billion in foreign debt over a period of 12 1/2 years (as opposed to Venezuela's request to reschedule \$22.3 billion over fifteen years). According to the agreement, Caracas would make an initial payment of \$750 million when the agreement was signed. It would repay \$5.5 billion in principal by 1989; the rest of the principal would be repaid by 1997. The interest rate would remain the original rate until the agreement was signed; at that time, Caracas would pay 1 1/8 percentage point over LIBOR (as opposed to Venezuela's request for 7/8 percentage point over LIBOR).³⁴ No grace period was included.

How good were the terms of the Venezuelan package? The single biggest concession that Caracas won was the agreement by banks to sign the rescheduling package without a formal IMF program. However, it is not clear just how beneficial this was. While symbolically important, the concession yielded little in substantive terms. Caracas had taken most of the policy decisions that would normally be part of an IMF package. Without this "voluntary adjustment program," Venezuela would probably not have been able to persuade its creditors to forgo a formal IMF economic program. Other than the IMF issue, Venezuela was not able to win the kind of rescheduling package that it thought it deserved. For one thing, the cooperative strategy itself dictated that Caracas could not be too confrontational in its negotiations with the banks. Venezuela's negotiating strategy was to stress its strengths, not its weaknesses. Negotiators consistently stressed that the country was merely facing a liquidity rather than a structural crisis. Given this negotiating stance, Caracas voluntarily accepted some less favorable terms than other debtor countries did. For example, Caracas decided not to ask for new money from the banks -- and continued to pay principle and interest on the portion of its debt that was not being restructured. Venezuelan negotiators used both of these facts in their arguments as to why the banks should make concessions to Caracas in other areas.

Moreover, the strategy backfired in at least one respect. To the extent that bankers believed in Venezuela's fundamental economic strengths, they became *more* confrontational. Given Caracas' level of foreign currency reserves, bankers were less forgiving of late interest payments from Venezuela than from other countries. Bankers complained that Caracas did not give the issue a high enough priority; one

³³And finally, the entire agreement remained contingent on the resolution of the estimated \$6-\$7 billion private sector debt problem. This issue was resolved in December, Caracas embraced three new policies that were designed to facilitate the flow of private interest payments overseas. First, the government streamlined the mechanisms for registering private debt and requesting preferential exchange rates. Second, Caracas allowed La Electricidad de Caracas and a number of Venezuelan finance houses to purchase zero coupon bonds in the U.S. market that would serve as collateral for their foreign debt. Third, Caracas pledged to deal with the one of the most controversial private debt problems: the failure of Banco de los Trabajadores to meet its foreign currency obligations. For details on the private debt scheme, see the *Financial Times*, November 28, 1986, *The Wall Street Journal*, December 4, 1986 and the *Financial Times*, December 15, 1986.

³⁴*Washington Post*, September 24, 1984.

banker estimated that only four or five government officials were working on a solution to the debt problem.³⁵ There were charges that Venezuela was merely “jumping on the rescheduling bandwagon;” as a result, some bankers resented having to participate in negotiations at all.³⁶ For these reasons, they were unwilling to make large concessions on such matters at interest spread, the linkage between publicly and privately held debt, grace period, and repayment period.

Venezuela's Cooperative Strategy: 1986-87

As in the first round of negotiations, Venezuela's strategy yielded few tangible results for Venezuela during the second round of negotiations. On April 23, 1986, Venezuelan President Jaime Lusinchi announced that Venezuela would renegotiate its commercial debt. In doing so, he invoked a contingency clause that had been included in Venezuela's previous debt agreement; the clause stated that Caracas could propose amendments to the agreement in the event of unforeseen changes in economic circumstances.

Bankers acknowledged the problem that Venezuela faced from declining international petroleum prices and in December, negotiations reopened. From all initial indications, Venezuela was in a good position to win a favorable agreement from bankers. For one thing, Caracas was continuing to pay interest *and* principal on its debt. Most other debtors were simply servicing their debts. The fact that Caracas had kept current on its principle payments was a highly publicized aspect of the negotiations. Throughout the negotiations, Venezuelan officials repeatedly suggested that banks should reward Caracas for its good performance in making debt payments. For another thing, Venezuela's proposed restructuring terms were moderate compared to the initial proposals made by other debtors. There was just one aspect of the agreement that was controversial: Venezuela wanted to lower the interest rate of its earlier agreement (1 1/8 percentage point over LIBOR) to a rate of 13/16 point over LIBOR: the same rate that Mexico had reached in its contentious 1986 commercial debt negotiations.

Another aim for Venezuela was to raise new loans. However, Caracas did not pursue this goal in the same way as most other debtors. Specifically, Venezuelan officials announced that they would not request a formal new money package from commercial creditors as part of the rescheduling agreement. Instead, Venezuela would rely on gaining access to voluntary credit from commercial banks. Caracas announced that its strategy to acquire international capital had four primary elements:

- new loans from the World Bank (which would mark the first time the Bank lent to Venezuela in fifteen years,³⁷

³⁵*Journal of Commerce*, January 17, 1983.

³⁶Personal conversations.

³⁷Caracas had not requested World Bank loans, because its sizable oil income and significant foreign reserves had made it ineligible for World Bank lending. See *Financial Times*, February 10, 1987 and *Journal of Commerce*, January 30, 1987.

- a \$1.2 billion loan package from the Inter-American Development Bank;
- new foreign currency loans from international banks in order to finance the expansion of the Venezuelan steel and aluminum industries; and
- the issuance of dollar-denominated government bonds on international markets.

In February, after the Venezuelan negotiations had begun, Brazil suspended interest payments on its debt and froze \$15 billion in short-term credits of private foreign banks.³⁸ Venezuelan Finance Minister Manuel Azurua Arreaga (who had replaced Sosa) immediately announced that Venezuela would continue to negotiate with banks. Moreover, economic authorities in Venezuela publicly stressed the differences rather than the similarities between their economic situation and that of Brazil. They noted especially that, unlike Brazil, Venezuela had already successfully concluded a rescheduling agreement with the banks in 1986 -- and was merely renegotiating because of the change in commodity prices.³⁹ And although Lusinchi held discussions with Argentine President Raul Alfonsin and Brazilian President Jose Sarney in late February, Venezuelan press summaries of these conversations were remarkably non-threatening.⁴⁰

The deal that eventually was reached between Venezuela and its creditors was a marked improvement over its earlier agreement. In late February, Venezuela and creditor banks agreed in principle to restructure \$20.34 billion of Caracas' external debt (virtually all of the government's medium- and long-term debt). Under the new accord, the debt would be stretched out for fourteen years at an interest rate of 7/8 percentage point over LIBOR; bankers did not agree to the grace period that Venezuelan officials had requested. Moreover, Caracas would repay \$1.35 billion in principle during the period 1987-89 (rather than the \$3.36 that it had owed under the original agreement).⁴¹ No new money accompanied the deal, although creditor banks pledged to be as forthcoming as possible with voluntary credit.

Both the banks and the Venezuelan negotiators portrayed the agreement as a success for Venezuela. Bankers stressed that the interest rate had been decreased because Venezuela was continuing to repay principal and because it had not requested new bank loans. The interest rate that Venezuela received under the agreement was the most favorable given to any debtor other than Mexico. Lusinchi lauded the agreement, stressing that the new interest rate would save Venezuela roughly \$50 million during 1987.⁴² But reaction throughout the rest of Venezuela was less than enthusiastic. Critics within the government and throughout the rest of the country disagreed violently with the assessment that the

³⁸See *New York Times*, February 26, 1987.

³⁹*FBIS Latin America Daily Report*, February 25, 1987, p. L1.

⁴⁰See, for example, *FBIS Latin America Daily Report*, February 26, 1987, p. L1.

⁴¹*FBIS Latin America Daily Report*, March 4, 1987, p. L1., *Financial Times*, February 28, 1987 and *Wall Street Journal*, March 2, 1987, p. 25.

⁴²See *FBIS Latin America Daily Report*, March 5, 1987, pp. L1-L2.

agreement was a victory for Venezuela. Specifically, they lambasted Lusinchi for accepting a deal that had less favorable terms than those that Mexico had received just a few months earlier.

The fact that Caracas agreed to this deal only a few days after Brazil decided to suspend interest payments only fueled the anger of those policymakers who wanted Venezuela to take a harder line vis-a-vis its creditors. Presidential rival Carlos Andres Perez argued that Venezuela should have waited to see whether Brazil managed to win major concessions from creditors. The controversy weakened an already-struggling Lusinchi, who found himself in the less-than-enviable position of having respond to charges that he had caved in to international pressure rather than standing firm with other Latin debtors.⁴³

The attractiveness of the debt agreement was weakened by two further developments. First, just two months after Venezuela concluded its agreement, Argentina rescheduled its foreign commercial loans at the *same* interest rate as Mexico; Argentina's package also had a number of other favorable features (see below). All of a sudden, the 7/8 spread did not appear nearly as concessionary as it had in February. The Argentina deal was made more bitter by the fact that Venezuela had consistently attempted to divorce itself from the positions of Argentina and Brazil, arguing that Venezuela's greater economic stability deserved more favorable consideration from bankers than did the hyper-inflation economies. Unlike Venezuela, Argentina had suspended principal payments on its debt -- and was often in arrears on its interest payments.

The second factor was that, although bankers had informally pledged to lend Venezuela more money, those credits were simply not forthcoming. Caracas had relied upon a kind of "gentleman's agreement" on the issue of new money: that is, Venezuelan negotiators had resisted making any formal requests for new loans in return for bankers' assurances that they would continue to make loans to the country. But as bank lending to Latin America dried up in the mid-1980s, Venezuela suffered along with other debtors. Caracas began to rely on deficit spending and on reserves to repay its debt -- which meant that its level of foreign reserves started to fall dramatically.⁴⁴ By June, even the staunchest supporter of the cooperative approach, Finance Minister Azpurua, was less than enthusiastic in his support for the agreement: "Venezuela will fulfill its commitment to the extent that it receives new loans, because we cannot sacrifice our economic growth."⁴⁵ The cooperative strategy had yielded less concessionary terms

⁴³The cries for a harder line cut across class lines in Venezuela. The country's largest trade union, the Confederation of Venezuelan Workers (CTV), had been supporting the idea of a moratorium for months. In May, Venezuela's most influential business group, Fedecamaras, also endorsed a moratorium -- arguing that the foreign currency shortage that would result from debt servicing would hinder the ability of businesses to obtain vital industrial inputs. As a result of the public outcry, the members of the AD Party began to suggest that Caracas should demand better terms from international creditors -- such as pledges of new loans -- before signing the official agreement. Presidential hopeful Perez was publicly advocating an international debtors club. See, for example, *Christian Science Monitor*, June 1987.

⁴⁴See *FBIS Latin America Daily Report*, May 22, 1987, pp. L3-4.

⁴⁵*FBIS Latin America Daily Report*, June 23, 1987, p. T1.

than those received by other countries -- and Venezuela had not received its envisioned payoff -- greater access to international financial markets.

Argentina's Distortion Strategy: 1982-84

When the debt crisis erupted, Argentina was in the process of democratic transition. After the April 1982 Malvinas-Falklands dispute, the Argentine army forced the head of government, Lieutenant General Leopoldo Fortunato Galtieri to resign. His replacement, General (ret.) Reynaldo Benito Antonio Bignone, immediately pledged to hold democratic elections the following year and to hand over the reins of government no later than March 1984. This meant that Bignone's administration was a lame duck almost from the moment he took office.

Economic conditions in Argentina were terrible. Industrial output had fallen to levels comparable to the 1960s. The number of industrial workers in mid-1982 was 23 percent below the number in 1970; unemployment was at a five-year high.⁴⁶ Even the most optimistic analyses of Argentina's economic performance predicted that the country's trade revenues in 1982 would be less than one-third of the country's foreign debt obligations for the year.⁴⁷ Moreover, during the Falklands-Malvinas controversy, Argentina had lapsed into arrears on \$2.5 billion of its foreign debt payments.

In December 1982, the Bignone regime concluded a \$2.15 billion loan agreement with the International Monetary Fund. The IMF package cleared the way for Buenos Aires to begin negotiations with its private creditors on rescheduling its debt. However, because the IMF funds would not be disbursed until January 1983, Argentina approached creditor banks for a \$1.1 billion bridge loan from its creditor banks for the period January 1983 to March 1984.⁴⁸ Its longer-term requests were for a \$1.5 billion five-year commercial loan as well as a restructuring of \$5.5 billion of the debt payments that would be due in 1983.⁴⁹ The bridge loan was signed on December 31, 1982 -- and talks regarding the longer-term issues began.

Talks with the advisory committee were fraught with tension. Although Argentine negotiators stressed their willingness to honor foreign obligations, bankers were never entirely convinced that this was the case. Not only was the military government a lame duck, but there was disagreement within the military regime regarding the debt issue. Powerful nationalist segments of the military opposed the idea of accommodating foreign creditors; they remained a haunting background threat to the negotiations.

⁴⁶Jose Maria Dagnino Pastore, "Progress and Prospects for the Adjustment Program in Argentina" in John Williamson, ed., *Prospects for Adjustment in Argentina, Brazil and Mexico: Responding to the Debt Crisis* (Washington, DC: Institute for International Economics, 1983), p. 12.

⁴⁷*The Guardian*, June 22, 1982.

⁴⁸*Economist*, November 20, 1982.

⁴⁹*Financial Times*, December 13, 1982.

Legal disputes surrounding Article 4 of Argentina's bankruptcy law also plagued the negotiations. The law stipulated that once formal bankruptcy proceedings started, creditors within Argentina had priority over overseas creditors. The dispute over Argentina's bankruptcy law was sparked by the case of Celulos Argentine, a pulp and paper company that had declared bankruptcy. The court-appointed supervisor of the bankruptcy proceedings invoked Article 4. Orion Bank (a subsidiary of Royal Bank of Canada) had lent roughly \$50 million to Celulosa; under the bankruptcy plan, the Canadian bank would have to wait up to fifteen years for repayment.⁵⁰ Foreign bankers protested the decision. The Argentine government, anxious to close a deal with its creditors, took moves to change the bankruptcy law. But when President Bignone sent a bill to modify the bankruptcy law to the surrogate military parliament, no action was taken. The intra-governmental dispute over Article 4 added months to the negotiations.

Another particularly dramatic illustration of Argentine nationalism occurred a few weeks before the national elections. A federal judge imprisoned Argentine Central Bank Governor Sr. Jorge Gonzalez del Solar; the judge ruled that some of the clauses in public sector debt rescheduling contracts violated Argentina's national sovereignty!⁵¹ Less than a month later, the ruling was overturned by a higher court -- but it had made its impression on the international financial community.⁵²

Democratic elections were held in October 1983, and moderate UCR (Union Civica Radical party) leader Raul Alfonsin was elected. The Alfonsin government announced that it wanted to renegotiate its external debt, but on better terms than the military regime had been willing to accept. The president stressed that Argentina would meet its debt obligations, but also said it was vital to renegotiate the terms of the debt. The new government's estimates of its total debt and the amount it wanted to reschedule were necessarily vague: even as Alfonsin announced Argentina's intentions to reschedule, the government was attempting to catalogue the debts that had been incurred by the military government.

But Argentina's new negotiating stance was not backed up by specifics. Not only did Buenos Aires not have a firm estimate of its debt position; it was also vague on the details of its demands. For example, Economy Minister Sr. Bernardo Grinspun suggested an existing contract closer in line with "the national interest," but gave few details as to what this meant. Alfonsin suggested that some of the debts incurred by the military regime were illegitimate and that the democratic government should not be obliged to honor them -- but did not discuss amounts.

From the very beginning, the democratic government sent out a barrage of mixed signals as to whether it would be willing or able to repay its foreign debt. On the one hand, Alfonsin repeatedly

⁵⁰*Latin America Weekly Report*, May 20, 1983.

⁵¹*Financial Times*, October 12, 1983. The judge, Pinto Kramer, objected to clauses in a contract concerning Aerolineas Argentinas that submitted to the jurisdiction of New York courts. For a brief explanation of the matter, see Marcelo Diamond and Daniel Naszewski, "Argentina's Foreign Debt: Its Origins and Consequences," in *Politics and Economics of External Debt Crisis*, op. cit., p. 261.

assured bankers that Buenos Aires intended to honor its international obligations. On the other hand, the president insisted that repayment could not come at the expense of economic growth. Indeed, the new regime announced that it would simultaneously seek debt and development; therefore, economic adjustment would take the form of heterodox (as opposed to austerity-oriented orthodox) policies that would attempt to achieve economic expansion and reduce inflation. This did not sit well with IMF officials or international creditors, who insisted that monetary restraint and orthodox adjustment were necessary for Argentina's economy.⁵³

Although international creditors reacted skeptically to the seemingly incompatible goals, Buenos Aires insisted that it would combine its IMF negotiations with a growth-oriented adjustment policy. The government's economic policy envisioned a 5 percent growth rate in 1984 -- part of which included a 1000 peso increase in all salaries (i.e., a 56 percent increase in the minimum wage).⁵⁴ Publicly, Alfonsín attempted to walk a fine line between responding to the domestic demands (especially of labor) and those of international creditors; at the same time that he implemented some adjustment policies, he declared that Argentina would not be strong-armed by the IMF into adopting policies that would push the country into recession.

Alfonsín never gave an unconditional guarantee that Buenos Aires would repay its debt. As a result, the idea that Argentina might be willing and able to sustain the consequences of repudiation was treated as a real possibility within the international banking community.⁵⁵ Although bankers did not worry that an Argentine default alone could bring down the banking system, they did speculate about the possibility of a snowball effect. According to one Federal Reserve official, "Argentina was not a risk per se; it did not threaten a collapse of the system. [The problem was that] if they took an unorthodox approach, others would as well."⁵⁶

The biggest issue facing the rescheduling negotiations was the question of interest arrears. The banks maintained that Buenos Aires would have to catch up on its \$2.7 billion in interest arrears by March 31, 1984. (No interest had been paid since October 1, 1983.) The deadline was hardly arbitrary; it was the date at which U.S. banks' quarterly balance sheet reports were due. For U.S. banks, any debts that were beyond 90 days in arrears were legally bound to be declared "nonperforming" -- an accounting move that would cut into banks' quarterly profits because they would not be able to count interest due on roughly \$1.1 billion of loans as part of their earnings.

⁵²*Financial Times*, November 4, 1983.

⁵³See the discussion in Chris C. Carvounis, *The Debt Dilemma of Developing Nations* (Westport, CT: Quorum Books, 1984), Chapter 8.

⁵⁴Despite the growth goals of the government, the policies fell short of the goals espoused by Peronist union leaders. As a result, the Alfonsín government was bracing itself for clashes with labor. See the *Financial Times*, December 19, 1983.

⁵⁵Personal interviews. For an example of this line of reasoning, see the *Financial Times*, February 6, 1984.

⁵⁶Quoted in Aggarwal, *Debt Games*, op. cit.

Argentina requested a loan to make the overdue interest payments. Banks responded that the arrears must be paid before any new credits would be considered. There was more at stake than just quarterly profits. Bankers voiced concerns that if Argentina failed to make the March 31 deadline, some creditors might declare the country in default. This would trigger the cross-default clauses written into Argentina's loan contracts -- leading to a creditor race to attach assets. At the same time, there was danger in the idea of a new credit. The Alfonsín government had canceled the IMF agreement reached by the military regime, and although Argentina was willing to embrace a new program, it had not finalized any program with the Fund or even announced the details of its economic policy. Bankers waited for a signal from the IMF that Argentina had made progress in its talks. They argued that to make a loan without an IMF agreement in place would risk setting a precedent for other debtors.

Grinspun continued his talks with the IMF as the March 31 deadline inched closer. But disagreements on budget targets and inflation policy made the talks difficult. Grinspun insisted that Argentina was not about to make significant concessions merely to make the March 31 deadline: "Deadlines... are simply deadlines for banks and not for Argentina."⁵⁷ He also warned that Buenos Aires would not allow interest payments to continue to eat up two-thirds of Argentina's annual export income.

Press reports speculated that a last-minute deal might be worked out at the annual meetings of the Inter-American Development Bank in Punta del Este. Grinspun spoke to a crowded room of bankers at the meeting; his words did not inspire much hope. The Economy Minister stressed that Argentina was willing to pay the banks, but could not because the country's foreign reserves were only \$700 million and "have not yet reached a level which we would consider as a minimum."⁵⁸

A last-minute deal was indeed worked out, but not quite in the way that anyone expected. A loan was quickly arranged, with an unusual group of creditors. Four debtor countries -- Mexico, Venezuela, Brazil and Colombia -- announced that they would be willing to lend Argentina a total of \$300 million. Mexico and Venezuela each contributed \$100 million, while Brazil and Colombia lent \$50 million each. Eleven banks also agreed to contribute a total of \$100 million to the loan, at a rate of 1/8 percentage point over LIBOR. This was an unusually low spread; most of the commercial loans to Latin America were being made at 1 1/4 to 1 3/4 percentage point over LIBOR.⁵⁹ Buenos Aires would use the \$400 million, along with \$100 million from its foreign reserves, to pay its interest arrears. The final participant in the loan was the U.S. government, which agreed to lend Argentina \$300 million once Buenos Aires signed an agreement with the International Monetary Fund. This money would be used to repay the four Latin countries; Argentina would then use part of its IMF loan to repay the United States.

⁵⁷*Wall Street Journal*, March 29, 1984.

⁵⁸*Economist*, March 31, 1984.

⁵⁹The Latin American countries would receive an interest spread of 1 percentage point over LIBOR. The size of each of the bank's contribution was proportional to its exposure to Argentina.

The plan raised immediate controversy in the United States, especially in Congress. Some critics charged that the U.S. government was bailing out big banks at the expense of the American taxpayer. Others focused on the terms won by Argentina, especially the low interest rate and the fact that Buenos Aires only used a small portion of its own currency reserves to pay the interest arrears. Indeed, one analysis suggested that the rescue loan demonstrated that “the country that plays hardball, doesn't straighten out its economy and doesn't adhere to an IMF program gets rewarded.”⁶⁰ European finance ministers also criticized the United States at the IMF's interim committee meeting in April for having agreed to lend money without an IMF package in place.⁶¹

The driving force behind the loan was the risk that if Argentina missed the March 31 deadline, the repercussions would extend beyond a mere loss of profits. As U.S. Treasury Secretary Regan explained (delicately) to a congressional committee:

Losses in foreign loans could over time lead to a significant erosion of the underlying capital of U.S. banks. . . For some, shrinkage of their capital base would force them to cut back on their assets -- meaning their outstanding loans -- or at least on their new lending. That cutback would be a large multiple of their loss of capital. Banks would thus be forced to make many fewer loans to all borrowers, domestic and foreign, and fewer investments in securities, such as municipal bonds. Reduced access to bank financing would not only force a cutback in the expenditures which private corporations and local governments can make, but it would also put upward pressure on interest rates.⁶²

Argentina's part of the deal was its promise to complete a deal with the IMF within a month. This was no small pledge; there remained serious disagreements with the Fund. One of these centered on the Argentine government's failure to reduce inflation, which was hovering at an annual rate of roughly 500 percent. Another sticking point was Buenos Aires' determination to implement growth-oriented reforms. Specifically, Fund officials were opposed to Alfonsin's plan to increase wages by six to eight percent in 1984. Moreover, IMF officials told Grinspun that Argentina should bring its budget deficit to eight percent of gross domestic product. Buenos Aires balked at the austerity implications of the target. According to Central Bank spokesman Salvador Treber: “To reach eight percent, we'd have to reduce public-sector salaries by an average of twenty percent in real terms. This would create a wave of discontent that would be practically impossible to handle.”⁶³ Argentine negotiators argued that a more realistic goal would be to limit the government deficit to 10 percent of GDP, down from 21 percent in 1983.⁶⁴ IMF officials were unimpressed.

⁶⁰*Wall Street Journal*, April 2, 1984.

⁶¹See *The Banker*, May 1984, p. 91.

⁶²“The Argentinean Debt,” Hearing before the Senate Banking, Housing and Urban Affairs Committee, Subcommittee on International Finance and Monetary Policy, May 3, 1984., Washington, DC: Government Printing Office, p. 7.

⁶³*Wall Street Journal*, May 9, 1984.

⁶⁴*Financial Times*, June 7, 1984.

In fact, because 70 percent of public spending in Argentina was earmarked for wages and salaries, the goals of budget reduction and wage increases seemed irreconcilable.⁶⁵ IMF estimates suggested that public sector salaries had increased by more than four percent in real terms during the first six months of 1984; IMF officials stressed that the Alfonsin government would have to show much greater restraint in its wage policies. Argentine negotiators responded that budget reduction could be accomplished through other means: reductions in defense spending, cutbacks in subsidies to state-affiliated corporations, higher taxes, and improved tax collection.

As June 30 approached, bankers faced a second deadline; again, worries mounted that loans would have to be reclassified as non-performing. This time, though, Argentine negotiators faced pressure not only from the creditor committee but also from their Latin American creditors and the U.S. government. Buenos Aires did bend somewhat, but not nearly as much as its creditors had hoped. Grinspun announced that, although Argentina would not finalize an IMF agreement before June 30, it would be able to arrange a temporary deal with its creditors regarding its interest arrears. As with the March 30 deadline, a last-minute arrangement was concluded. Buenos Aires agreed to use \$225 million of its foreign currency reserves to pay interest arrears; the eleven creditor banks agreed to lend \$125 million to Argentina for this purpose. Bankers also agreed to defer the June 15 repayment deadline on a \$750 million loan installment (the balance of the bridging loan that the banks made to Argentina in 1983) until mid September as well as to stretch out the maturity of the \$100 million bank loan made in March.⁶⁶

The agreement brought Argentina current in its interest payments through April 2, 1984 -- again, just within the 90-day deadline for banks to avoid reclassifying the loans as nonperforming. But again, the decision was controversial. Fights occurred within the creditor committee as to the wisdom of giving more funds to Argentina without an IMF agreement. Some bankers were only convinced to go ahead with the loan when they heard a speech by Alfonsin in which he called for economic reform. Bankers also justified the package by noting that the money they would receive in overdue interest payments was greater than the \$125 million loan they were making to Buenos Aires.

September loomed as the third ninety-day deadline. Argentine negotiators announced that they would attempt to defer a \$750 million loan installment that was due on September 15. Given the fact that Buenos Aires had still not finalized an IMF package, creditor banks balked. They argued that they had deferred the payment several times already, thinking that an IMF package was just around the corner. Bankers, especially from the smaller banks, were losing patience. As bankers began to worry that creditor cohesion might erode, some took precautionary measures. For example, some of Argentina's

⁶⁵*Wall Street Journal*, February 27, 1984.

⁶⁶*Financial Times*, June 30, 1984.

larger creditors began to keep tabs on the whereabouts of Argentine grain shipments, just in case banks began to compete to attach assets.⁶⁷ This time Argentina made the payment.

In late 1984 Argentina reached an agreement with the IMF. The plan targeted Argentina's inflation problem, aiming to decrease the inflation from the current 650 percent to no more than 300 percent during the twelve months leading up to September 1985. Argentina also agreed to a scheme to eliminate debt service arrears completely by June 1985.⁶⁸ The austerity plan also aimed to limit the growth of total foreign debt to no more than \$4.5 billion during 1984 and 1985.⁶⁹ Buenos Aires agreed that its public deficit would not exceed 5.4 percent of GDP in 1985 (as compared to 8.1 percent in 1984.) But on the controversial issues of wages and exchange rate, the MOU contained no specific targets.

As part of the agreement, the IMF agreed to lend Buenos Aires \$1.4 billion, but, like most standby credits, would not release the funds until Argentina came to an agreement with its bank advisory committee. Argentina indicated that it would like to have IMF approval of the standby credit by yearend 1984, but also stressed that it needed (1) to reschedule \$17 billion of principal payments due between late 1982 and 1985 and (2) to receive new loans totaling roughly \$5.45 billion. The banks objected to the size of the new money request, especially given Argentina's history of late interest payments. The advisory committee suggested that a commercial loan between \$2.8 billion and \$3.5 billion might be more appropriate.⁷⁰

In early December, Argentina reached a tentative deal with the banks. The advisory committee agreed to reschedule \$16 billion of Argentine debt (due in 1984 and 1985) over twelve years, with a three-year grace period at an interest rate of 1 3/8 percentage point over LIBOR.⁷¹ Moreover, the banks agreed to lend Argentina \$3.7 billion in fresh money for a period of ten years (with three years grace) at an interest rate of 1 5/8 percentage point over LIBOR or 1 1/4 percentage point over the U.S. prime rate.⁷² Banks also agreed to give Argentina \$500 million in the form of a short-term trade credit facility with a maturity of four years. In addition, Argentina received \$1 billion from creditor governments and official agencies, including a \$270 million credit from the IMF's Compensatory Financing Facility. This combination of loans allowed Buenos Aires to raise the funds it needed to meet the terms of the IMF plan.

In conclusion, commercial bankers made important concessions during the course of the negotiations in order to keep Argentina at the bargaining table. For example, the agreement to lend Buenos Aires money in March 1984 and in June 1984 -- *before* the completion of an IMF accord -- violated the banks' own standards for restructuring debt. However, the advisory committee decided that

⁶⁷*Wall Street Journal*, August 24, 1984.

⁶⁸For the plan to eliminate interest arrears, see the *Financial Times*, December 4, 1984.

⁶⁹*Financial Times*, September 27, 1984.

⁷⁰*Financial Times*, November 16, 1984.

⁷¹Not all the \$16 billion was public sector debt. A total of \$5 billion of private sector debt was included in the rescheduling.

an exception should be made in order to facilitate the negotiating process. With regard to the final agreement, Buenos Aires fared well. Argentina received a large new loan from its creditors. Moreover, the interest rate was 1 3/8 percentage point over LIBOR -- moderate compared to many rescheduling agreements in the early 1980s. The length of the repayment period was better than that received by Venezuela. Argentina also received a grace period, whereas Caracas had to begin repayments immediately. More important, however, was that Argentina was able to meet its two most important goals. First, it was able to raise over \$5 billion in new loans -- and was therefore able to fund its economic program without undue austerity. Second, Buenos Aires' hard-line strategy had won some tolerance from the IMF and the banks for its "adjustment with growth" approach to domestic economic policy. The vagueness of the economic adjustment package, especially on the issues of wages and the exchange rate, was an important victory for the Argentine negotiating team.

Argentina's Negotiations: 1987

During the mid-1980s, Alfonsín continued his dual tasks of democratic consolidation and economic stabilization. On the economic front, this was no easy task: during the first half of 1985, inflation hit an annual rate of 1000 percent.⁷³ Although the government's June 1985 heterodox Austral Plan brought temporary relief, by 1987 inflation had again reached three-digit levels.

Compounding economic tensions were political pressures. The Argentine labor union -- Confederación General de Trabajadores CGT -- led nine general strikes between September 1984 and January 1987; four of these were in 1986 alone. And in early 1987, trade-union leaders publicly denounced the costs that debt servicing had imposed on the country, arguing that Argentina had lost almost \$16 billion since 1984 because of the debt crisis. By their published estimates, if the government had put the equivalent of one year's debt service to domestic use, it could have generated 300,000 industrial jobs, 600,000 homes, 2,600 hospitals, or 5,000 schools.⁷⁴

Thus, economic problems and labor opposition set the stage for the second round of rescheduling negotiations. Argentina began its negotiations with its bank advisory committee in February 1987, with a \$1.8 billion IMF agreement in hand. That same month, Brazil announced that it was suspending interest payments on its external debt. The decision radically changed the mood in the international financial community. Worried that Argentina might follow Brazil's lead, bankers and government officials did whatever they could to encourage Buenos Aires to remain at the negotiating table.

⁷²*The Times*, December 4, 1984.

⁷³The World Bank, *Argentina: Economic Recovery and Growth, A World Bank Country Study* (Washington, DC: The World Bank, 1987), p. 3.

⁷⁴*El Periodista*, nos. 130-34 (1987), various issues, as cited by Peter Ranis, *Argentine Workers: Peronism and Contemporary Class Consciousness*. (Pittsburgh: University of Pittsburgh Press, 1992), p. 65.

From the beginning, Argentine negotiators stated that, while they preferred to work out a deal with private creditors, they were prepared to suspend interest payments if necessary. In particular, Argentina wanted:

- a reduction of interest on the \$32 billion it owed to foreign creditor banks,
- \$2.15 billion in new money (\$1.85 billion of which would come from banks),
- the elimination of provisions that allowed foreign banks to decide which Argentine business received part of the new bank loans, and
- a requirement that any debt-equity swaps be accompanied by one dollar of new investment money for each dollar of debt that was converted.

Bankers were not enthusiastic about any of these proposals. They were wary of new money, either in the form of \$1.85 billion in new loans or in the form of the one-for-one new money requirement in the debt-equity proposal. The advisory committee argued that it wanted to retain control over the ways in which the new money would be re-lent within Argentina. And while they expected to make concessions on the interest rate of rescheduled money, they stressed that they did not envision repeating the 13/16 rate they had given to Mexico in 1986.

Argentine negotiators countered that the new package must allow Argentina to achieve an economic growth rate of 4 percent in 1987. This, said Treasury Secretary Mario Brodersohn, was not negotiable. In fact, days before leaving for the initial talks in New York, Brodersohn implied that Buenos Aires would suspend payments if bankers did not come up with enough new money to allow Argentina to achieve its growth targets:

If the banks don't grant us the \$2.15 billion we asked for, priority will be given to growth of the gross domestic product rather than meeting foreign debt payments. . . If they put nonsense to us, we will reply with nonsense."⁷⁵

To underscore his determination, Brodersohn stopped off in Brazil for consultations with Brazilian Finance Minister Dilson Funaro before he continued to New York. The implied coordination between the two large debtors put bankers on edge.

Meanwhile, Washington officials did their part to keep Argentina at the negotiating table by arranging a \$500 million bridge loan for Buenos Aires -- to be repaid when the new bank loans were available. The United States contributed half the total; the rest was given by Japan, Canada and various European governments. The Treasury Department announced that the short-term loan was a show of support for Argentina's economic package; observers pointed out that creditor governments were

⁷⁵*New York Times*, February 21, 1987.

attempting to alleviate some of the domestic pressure on Alfonsín from domestic unions, businesses and members of his own Radical Party to stop debt payments.⁷⁶

The tension hit a high point at the April 1987 Interim Committee Meeting of the International Monetary Fund. Argentine Economy Minister Sourrouille gave a fiery speech at the meeting, during which he threatened to break off the negotiations. According to Sourrouille, the “narrow interest” of bankers was preventing any significant progress from being made, while Argentina had been attempting to negotiate in good faith. As a result, said Sourrouille, “we are clearly stating that it will be impossible for us to continue negotiating on that basis.”⁷⁷ The threat was taken seriously by bankers and government officials. U.S. Treasury Secretary James Baker, who was present at the speech, reportedly took down the names of the hold-out U.S. banks and spoke to them personally. Bankers, too, became more willing to accommodate Argentina rather than to risk the declaration of another unilateral moratorium by a major debtor.⁷⁸

Within a week of the speech, the negotiators announced a preliminary agreement. By virtually all measures, the deal was highly concessionary. The most visible concession was that, after swearing that they would never again accept the interest rate that Mexico received in 1986, bankers agreed to reschedule \$24 billion of Argentina's debt at exactly the interest rate that Mexico had received: 13/16 of a percentage point over LIBOR.⁷⁹ The concession was so visible that it provoked an immediate cry of outrage from other debtor countries, especially the Philippines and Venezuela.⁸⁰

Other concessions were apparent in the agreement. For example, the advisory committee agreed to lend Argentina the full \$1.9 billion in new commercial money that it had requested, despite the earlier suggestions by bankers that they did not want to commit that much in new lending. (The banks did say that they would attempt to obtain joint financing with the World Bank for part of the amount, but

⁷⁶See *New York Times*, *February 27, 1987*. The same article points to another motivation for the bridge loan. In the face of extreme debt fatigue -- and a widespread conviction that the international financial community was splintering -- Treasury was attempting to demonstrate that creditor countries were still able to cooperate in major debt decisions.

⁷⁷*New York Times*, April 10, 1987.

⁷⁸See the *Wall Street Journal*, April 28, 1987 and the *New York Times*, April 10, 1987.

⁷⁹It should be pointed out that the deal was not as concessionary as Mexico's in less visible -- and less controversial -- ways. For example, the debt was rescheduled over a period of 19 years, with a seven year grace period. Mexico's debt had been rescheduled over 20 years. Moreover, the 13/16 rate only applied to the debt that had been incurred before 1984. Under the same agreement, the banks and Argentina agreed to reschedule the \$4.2 billion that had been lent since 1984; the debt was to be stretched out over 12 years (with five years grace) and carried an interest rate of 7/8 point over LIBOR.

⁸⁰When Argentina's deal was announced, Philippine Finance Minister Jaime Ongpin furiously announced that the banks had acted in bad faith and that Manila would renegotiate its debt. Although he never carried through on his threat to renege on the agreement, his complaint attracted much attention in the U.S. press. There were also some veiled hints and speculation that Venezuela would renegotiate its agreement, but Caracas never pushed the matter.

basically agreed to come up with the total \$1.9 billion.) Incentives -- in the form of higher fees -- were created to encourage banks to commit to the new money package as early as possible.⁸¹

Equally significant was the fact that the banks accepted Argentina's proposal that debt-equity swaps be accompanied by a dollar of new money for each dollar of capitalized debt. There had been resistance within the advisory committee to the idea, primarily because it meant having to provide even more new loans to the debtor country. Nonetheless, the provision was incorporated into Argentina's debt-equity program. In return, creditor banks were given some control in directing a portion of the loans to the Argentine borrowers of their choice.⁸²

Short-Term Implications of Bargaining Strategy

The differences in negotiation outcomes for Argentina and Venezuela are stark. For Caracas, the adoption of a cooperative strategy entailed a conscious decision not to be overtly confrontational with creditors. Venezuelan negotiators focused on the shared interests of Venezuela and its creditors -- pointing to the country's economic strengths and its commitment to remain in good standing in international financial markets.

But Venezuela's strategy was flawed in at least two ways. First, the strategy relied on pointing to norms and rules -- and stressing Caracas' good record in adhering to those norms. While this might have impressed the banks, it involved no threat, and, consequently, translated into little bargaining leverage. Second, the strategy did as much harm as it did good for Venezuela. Bankers who accepted the argument that Venezuela was only facing a liquidity crisis were unwilling to make large concessions to the country. To the contrary, they hardened their position. As one account suggested of Venezuela: "[A]lready extremely nervous about Latin America in general, [banks] are particularly unsympathetic towards a country which has taken on the reputation of being the lazy millionaire of the area."⁸³

Argentina's distortion strategy yielded dramatically different results. Although Argentine government officials continually expressed their desire to honor their debts, they made it clear that their willingness to do so was not unconditional. Argentine negotiators insisted that the demands of democratic consolidation, economic growth and political stability would not be sacrificed to those of economic austerity. Given the importance of these other goals, Argentine negotiators intimated that they

⁸¹This was done primarily to avoid the problems that had occurred in putting together Mexico's new money package. The reluctance of smaller banks to participate in the package had added months of delays to the process -- thereby holding up Mexico's access to the new funds.

⁸²A number of other important provisions were included in the agreement. For example, the agreement was unprecedented in the way it encouraged commercial banks to agree to lend new money. For the first time, banks were given the option of accepting "alternative participation instruments" -- that is, exit bonds -- for up to \$5 million of debt. This allowed the smaller creditors (who held less than \$5 million in Argentine debt) to eliminate their exposure to the country. It also meant that, for the first time, smaller debtors were given the choice of opting out of the new money package. For details, see the *Wall Street Journal*, April 16, 1987.

⁸³*The Banker*, "Heading for the Rocks," March 1983, p. 68.

were prepared to hold out for maximum concessions from bankers -- and even to see the breakdown of the negotiations before agreeing to unacceptable conditions.

Argentina's creditors were unsure both about Argentina's intentions and about the consequences of default. This uncertainty pushed them to make a number of unpalatable concessions. Some of these, such as the banks' \$100 million loan to Argentina in March 1984, were made during the process of negotiations to keep Buenos Aires at the negotiating table. Others, such as the concessions on Argentina's adjustment style, were included in the final agreement.

From a short-term perspective, Argentina fared more favorably than Venezuela in its negotiations with banks. It is important to note that the banks' concessions were not conscious decisions to treat Argentina more favorably than Venezuela. As much as possible, banks regarded negotiations as case-by-case endeavors. That is, concessions made to one debtor should have had little bearing on what those given to another. Rather, the concessions that were made to Argentina were a direct response to the extreme uncertainty in which the creditors were operating.

Long-Term Implications of Bargaining Strategy

Distortion was more successful than cooperation in achieving short-term concessions in debt rescheduling. But this is still only half the story. What about the long-term implications of these strategies? Given the short-term focus of distortion strategies, we might expect a cooperative strategy to be more effective in achieving long-term benefits.

This was not the case. Both Argentina and Venezuela have been able to attract foreign capital during the 1990s. The form of these financial flows is radically different than during the 1970s: lending to Latin America is now overwhelmingly in the form of bonds rather than commercial loans. During the four-year period from 1989 to 1994, foreign investors have purchased more than \$40 billion worth of Latin American bonds.⁸⁴

Latin American investment decisions during the 1990s have not been based on the "good" or "bad" behavior of debtors during the 1980s. Rather, investors were enthusiastic about "emerging markets" in Latin America because of one factor: yields. Latin American investments provided tremendous opportunities for short-term profits during the 1990s. For investors that are facing more limited opportunities at home (for example, falling U.S. interest rates shrinking leveraged buyout opportunities and the collapse of the U.S. real estate market), emerging markets look even more attractive.⁸⁵

⁸⁴*Financial Times*, February 15, 1994.

⁸⁵See *Euromoney*, September 1990.

In short, institutional investors have flocked to both Venezuela and Argentina during the 1990s in search of high yields; “emerging markets” investment became a lucrative field in the 1990s, despite any “lessons” that might have been gleaned from the debt crisis. And although Venezuela was able to re-enter capital markets slightly before Argentina, it has not sustained any type of special access. There are even signs that Argentina has been more successful than Venezuela in raising capital: from 1990-1992, for example, net capital inflows to Argentina consistently exceeded those to Venezuela.⁸⁶ Venezuela has received no special treatment from its attempt to behave in a creditworthy manner during the 1980s.

In sum, the cases of Argentina and Venezuela suggest that cooperative strategies do not necessarily yield greater long-term benefits than distortion strategies. This is not the same as saying that distortion strategies will be more effective than cooperative strategies, simply that they need not be less effective. The selection of a bargaining strategy entails a gamble not just about the reaction of the opponent to one's current bargaining stance but also about future events. Venezuelan policymakers gambled that capital decisions in the post-debt crisis era would be linked to actions taken during the crisis. They were wrong. Because circumstances can change dramatically in international politics, a “bad” reputation may not haunt an actor for long. As the parameters of bargaining games change, so can the motives and strategies of the players. If circumstances change, distortion strategies need not create difficulties for an actor's ability to pursue its long-term goals.

Conclusion

In evaluating the outcomes of negotiations between “strong” and “weak” actors, the existence of incomplete information -- effectively incorporated into a bargaining strategy -- can lead strong actors to make concessions. Cognitive studies have long demonstrated that policymakers are uncomfortable making decisions in uncertain situations. Indeed, George has suggested that, in the absence of a deadline, decisionmakers are likely to avoid making decisions in situations of uncertainty.⁸⁷ But when faced with a

⁸⁶See the table in International Monetary Fund, *Private Market Financing for Developing Countries* (Washington, DC: International Monetary Fund, December 1992) p.39. The data in that table also suggest Table 7.2 also that, as a percent of GDP, foreign capital flows to Argentina exceeded those to Venezuela during the period 1990-92.

⁸⁷See Alexander L. George, *Presidential Decisionmaking in Foreign Policy* (Boulder, CO: Westview Press, 1980), especially pp. 35-37. Note that, although procrastination is a likely response in the absence of a deadline, this procrastination may or may not be a useful response for the decisionmaker. George distinguishes, for example, between “the general *strategy* of ‘calculated procrastination’” and “the *tactic* of [defensive] procrastination” (italics in original), pp. 35-36. The former refers to a rational decision to postpone a decision in order to use the extra time to gather more information; the latter refers to the simple postponement of a decision when there is no deadline facing the policymaker. According to George, the primary difference is that the strategy of calculated procrastination is aimed at devising ways to *reduce* the uncertainty that surrounds the decision, while the tactic of defensive procrastination is aimed at *escaping* the unpleasantness of the uncertainty surrounding the decision (p. 36).

deadline, decisionmakers must act.⁸⁸ One common response is to resort to incremental decisionmaking, or, as Lindblom has termed it, a “muddling through” approach to decisionmaking.⁸⁹ This approach to decisionmaking is not necessarily a negative thing; indeed, several organizational theorists have suggested that it can be a way of getting to optimal outcomes.⁹⁰ Yet incrementalism may have serious negative consequences, especially if it ignores broad strategic concerns in the attempt to deal with small problems as they occur.⁹¹ Done consciously, decisionmakers can use incrementalism to take minor steps toward a goal, consider the impact of those minor steps -- and, if need be, make corrections when mistakes are made. Done poorly (or subconsciously) decisionmakers run the risk of making policy in short-term segments with no overall “vision” of their ultimate goal.

In the case of the debt crisis, incrementalism occurred on two levels. “Muddling through” was the term given to the banks’ overall strategy during the early part of the crisis. The idea was that the rescheduling process would give banks some room for maneuver, which they could use to implement policies that would insulate themselves from a large-scale default.⁹² Making short-term concessions (in the form of lower interest rates and longer repayment periods in rescheduling agreements) averted a longer-term financial crisis. At the same time, many banks were taking measures to protect themselves by selling their exposure in secondary markets, conducting debt-equity swaps, and gradually increasing their loan-loss reserves. This incrementalist strategy allowed banks, for example, to take measures to protect themselves against the potential negative consequences of widespread default. This broad “muddling through” approach worked: banks avoided their worst-case scenario of widespread default.

Yet incrementalist decisionmaking by the banks applied also to the dynamics of individual debt agreements. In the case of Argentina, for example, when negotiations appeared on the verge of breaking down, creditors agreed to unpalatable measures in order to keep Buenos Aires at the bargaining table. These concessions were small (for example, a loan made without an IMF agreement, a slightly better

⁸⁸As noted in the discussion of Argentina’s negotiations, bankers were extremely conscious of the implicit deadlines created by the U.S banking regulations that required the reclassification of loans that had not been serviced for more than 90 days as non-performing.

⁸⁹See Charles E. Lindblom, “The Science of Muddling Through,” *Public Administration Review*, 1959, Vol. 19, pp. 79-99. Incremental decisionmaking, or “muddling through” is a form of satisficing behavior -- that is, the tendency to accept a decision that meets some minimum set of criteria rather than to insist on finding the single best solution. For more on satisficing, see Herbert A. Simon, *Administrative Behavior: A Study of Decision-making Processes in Administrative Organizations* (New York: Free Press, 1976) and Herbert A. Simon, *Models of Bounded Rationality* (Cambridge, MA: MIT Press, 1982).

⁹⁰See the discussion by Irving L. Janis and Leon Mann, *Decisionmaking: A Psychological Analysis of Conflict, Choice and Commitment* (New York: The Free Press, 1977), pp. 33-35.

⁹¹Some theorists, for example, have attributed U.S. involvement in Vietnam at least partly to the pitfalls of incremental decisionmaking. The increase in U.S. troops in Asia came gradually, without a grand strategy or well thought-out U.S. commitment. George recognizes this danger in his warning that “[i]ncrementalism is *not* a substitute for *policy analysis* that encompasses longer-range considerations and generates a *planning context* within which, then, incremental decisions are made.” George, op. cit., p. 41, italics in original.

⁹²See Karin Lissakers, *Banks, Borrowers, and the Establishment*, op. cit. In personal interviews with bankers, several acknowledged that the value of the broad “muddling through” approach was that it bought time. Consequently, that approach is considered a central

interest rate than most other debtors received), but were nonetheless very real attempts to forestall the possibility of LDC non-repayment. This outcome was less attractive for banks, for it translated into a situation where cooperative debtors received fewer concessions than did intransigent debtors -- an outcome that creditors certainly did not intend.

element of the banking community's ability to avoid a financial collapse during the early 1980s. The extension of the "muddling through" logic to individual negotiations is my own.