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On the Origins of Moral Hazard: 
Politics, International Finance and the Latin American Debt Crisis of 1982

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February 2016

Abstract
A consensus has not been reached in the ongoing debate on the effects of lender of last resort functions by the IMF, given the contradictory results from macroeconomic analyses that depend upon samples and periods. This paper sheds new light on the relationship between international banks and their home governments, the IMF and international regulators during the years that preceded the debt crisis of 1982. Based on new archival evidence, we find that commercial banks’ decisions to lend were largely based on home governments’ preferences, competition, and the assumption that home governments and international organizations would provide lending of last resort functions to support borrowing governments. These factors also influenced loan pricing. While previous works suggest that the 1982 debt crisis was unexpected, we show that banks reacted to the deteriorating macroeconomic situation in many emerging economies once the role of international organizations as lenders of last resort became uncertain.

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I. Introduction

One proposal that has repeatedly generated debate among academics and policymakers is the need for an international lender of last resort (ILOR). Those who argue in favor of an ILOR assert that such an institution would provide support to solvent countries facing liquidity crises. This would improve the present financial “architecture,” where problems of collective action impede investors from furnishing such support, as has been argued since the 1990s financial crises (Radelet and Sachs, 1998). Those who argue against the establishment of an ILOR reference the potential problem of moral hazard, a point which has been raised as a main criticism to the IMF. A departing point for this debate in the history of financial crises is the 1982 debt crisis—an event which took place over 30 years ago. Strikingly, the literature has not provided a definitive answer on whether moral hazard was the main problem that led to the crisis. This paper provides new evidence, based on rich archival material from a variety of sources, which demonstrates that commercial banks’ lending volumes and their pricing to governments in developing countries were affected by moral hazard and other market failures, such as information unavailability and distortions from international competition for export markets.

Mexico’s moratorium announcement in August 1982 marked a turning point in the assessment of credit risk. The default by the Mexican government and the consequent rescheduling of its debt represented the abrupt end of the lending boom to developing countries that had begun after the oil shock of 1973. Looking for the causes behind the wave of defaults during the 1980s, a wide belief emerged among scholars and policy makers that international banks, then the main financial intermediaries, had miscalculated the risk associated with the loans granted to developing countries. Scrutinizing the state of country risk analysis during the 1970s, it has been argued that banks’ assessment of country risk was flawed, underdeveloped, and limited by a lack of proper information on debt and other variables on the borrowing countries. The combination of these factors has been held as a major cause that led to the wave of defaults in the late 1970s and early 1980s.

There is an abundant amount of literature that aims to explain the banks’ overlending to high risk countries in the 1970s. These works assume that perverse incentives existed that deterred banks from properly assessing the risk of these loans. Among the explanations provided by this literature, factors such as competition, excess liquidity, and poor regulation have been favored. Political scientists and economists have also cited the banks’ decision to lend on political grounds. Following this literature, home governments encouraged banks to increase loans to developing countries. Risk analysis remained

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2 On the problem of the ILOR and its role in a new design of crisis resolution, see the recent paper by Panizza (2013), which draws from Fernández-Arias (2011).
3 On a literature review and the conceptual and empirical controversies on the studies of moral hazard and the IMS, see Dreher (2004) and IMF (2007).
4 Devlin (1989) provides a comprehensive analysis on the structure and performance of international banking previous to the debt crisis.
5 Wellons (1985), which we review below.
at a secondary stage, as banks expected that in case of trouble, either their governments or the IMF would intervene to support both them and the borrowing countries, thereby avoiding any potential losses.

Nevertheless, this argument—overlending due to market failures—was never truly demonstrated, and contradicted another body of literature. There are also a substantial number of works that analyze the how the late 1970s Euromarkets functioned. Some of them have sought to identify the factors that justified the interest rates charged by the banks for their loans. However, a main flaw in this literature is that it did not include political variables, which have been taken into account in the more recent literature on moral hazard in IMF lending. Furthermore, their conclusions suggested that such variables were irrelevant. Most these works argue that macroeconomic fundamentals drove the risk premia charged by banks in their loans to sovereign borrowers in the 1970s and 1980s. They also found that, overall, there was no change in this phenomenon after the 1982 crisis. There was thus no scope for moral hazard or governmental interests, as was argued by political scientists. Following this literature, the 1982 crisis arose due to the sudden deterioration of macroeconomic fundamentals, the tight monetary policies in creditor countries, and the deterioration in the terms of trade of borrowing countries.\(^6\)

In this paper, we provide new empirical evidence that demonstrates how banks included political factors in their decision to lend. Contrary to previous works in political science, we provide a comprehensive analysis on the role of all the main agents participating in the Euroloans market based on archival material: commercial banks, their home governments, borrowing governments, regulators, and international organizations (IMF and BIS). Keeping in mind that while we proceed as historians, we address our results to social scientists. Today’s scholars working on international finance may easily identify certain, persistent elements that we highlight as central to the emergence of moral hazard in the 1970s Euromarkets. Particularly, these include the close relationship between home governments and international banks, and the alignment of incentives that fed the lending boom, which ended with the wave of defaults in the 1980s.

We begin in Section II with a review of the literature on international finance and the reasons that led to the 1982 crisis. In Section III, we establish the “puzzle”, as implied by the literature, in which banks’ loan volumes and prices did not behave in accordance with increased macroeconomic imbalances in developing countries, as observed in the years that preceded the crisis. We then analyze in Section IV whether information flaws could have distorted banks’ risk analysis. We find that this was not the case, though the improvement of risk analysis and information production by the banks was a main concern among national and international regulators. Interestingly, the commercial banks that were seemingly more active in the Euro market were also those that most strongly opposed international

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\(^6\) Sachs et al. (1988) have shown that these factors do not allow differentiating between defaulting and non-defaulting countries. For this author, the performance of exports and the destination of the external loans were the main variables that explain why certain, mainly East Asian countries did not default despite its increased indebtedness during the 1970s.
regulation, independent of their nationality. In Section V, we show through a set of case studies that commercial banks in Great Britain and France maintained a close relationship with their governments prior to granting a loan. The price was determined by other factors, such as exports’ contracts, national foreign policy, and competition. Section VI concludes.

II. Literature Review: The Supply-Side Factors of the 1982 Crisis

Moral hazard is a frequent issue in international finance. Most of the literature has concentrated on the empirical evidence from the 1990s and early 2000s, and far less on the 1980s. This is certainly related to the increased relevance of the bond market, as opposed to the syndicated bank loan market predominant in the 1980s. Nevertheless, bank lending to developing countries has remained important for private and public entities long after, as shown by Eichengreen and Mody (2000). These authors looked for the factors behind the pricing of syndicate banking loans in the 1990s. They demonstrated that contrary to those who argued that banks did not properly price the risk of their loans due to insurance contracts—deposit insurance, lender of last resort services and guarantees—interest rates varied according to the risk involved based upon macroeconomic and financial variables.

This kind of analysis was commonplace in the literature on international bank lending during the late 1970s and early 1980s, the period of the Euromarkets lending boom. Rockerbie (1993) examined whether the determinants of risk premia (measured as the spreads over LIBOR) of sovereign-guaranteed private Eurodollar loans in the 1970s varied between less-developed and developed countries, and whether this changed after 1982. He confirmed that differences between both groups of countries existed, but he rejected any differences in the spread determinants before and after the 1982 Mexican crisis.

Rockerbie’s paper was one of the last studies on the determinants of bank loan interest rates for that period. It followed a long list of works pioneered by Feder and Just (1977). One contended conceptual issue was how to interpret the spreads used in these analyses. For instance, Edwards (1984, 1986) treated the spreads as the perceived probability of default by the lenders. Edwards (1984) found that between 1976 and 1980, banks charged different levels of spreads, which depended on fiscal and monetary variables. He concluded that banks had no reason to expect the wave of defaults in 1980, as spreads had been in line with macroeconomic fundamentals since 1976.

On the other hand, Folkerts-Landau (1985), defined these spreads as the expected loss that banks would incur if rescheduling the loan repayment became necessary. The authors concluded that the borrowing countries’ cost of default increased considerably in the 1970s, and this assured banks that defaults had a very low probability of occurring. An environment of confidence was also based upon
other factors, such as deposit insurance from public authorities, lender of last resort services from national central banks, and some legal modifications that helped lenders protect their assets, such as the introduction cross-default clauses or the Foreign Sovereign Immunities act of 1976, which restricted the interpretation of sovereign immunity.

Edwards (1986) rejected Folkerts-Landau findings. He compared the determinants and sensitivity of spread behavior in both the loan and the bond markets, and concluded that although differences existed, spreads in both markets reacted similarly to most macroeconomic fundamentals in the same manner. Though the significance and sensitiveness could differ slightly, they were both equally sensitive to many basic variables (reserve’ levels and debt ratios). Moreover, the author concludes based on evidence from the Mexican bond market that investors only reacted to the Mexican default a few weeks before it was officially announced. He concludes that investors in bond markets and banks did not differ in their risk assessment of borrowing countries.

None of these papers, however, dealt with related issues on information availability or political factors. Still, a general overview of contemporary publications, regulators’ reports and bankers themselves argue that the risk analysis was full of flaws and that information on borrowing countries was lacking. Even worse, bankers active in the Euromarkets recognized ex post that country analysis was not really taken into consideration on pricing or the decision to lend (Lissakers, 1991). Moreover, whereas bankers denied that other political factors were considered in their risk calculations, some works have precisely demonstrated the opposite. Kahler (1985) suggests that the easing of IMF conditionality beginning 1979 and the increase of IMF resources through quota enlargements and borrowing also encouraged moral hazard on both the debtor and lender sides. The author argued that lenders assumed that a lender—or lenders—of last resort existed in the system of bank lending to developing countries, though no party had explicitly adopted such functions. For Eastern European countries, it would have been a "Soviet Umbrella," humorously described as the first Communist lender of last resort, whereas governments in creditor governments would act on behalf of troubled borrowers due to strategic interests. This is why West German banks led the lending boom to Eastern Europe, whereas American banks assumed this role in Latin America.

Wellons (1985, 1987) also emphasized the importance of the links between banks and their national governments. Based on interviews and contemporary publications, banks lent to developing countries with the support of their home governments, which were interested in increasing the markets for their exports after the oil shock of 1973 (Spindler, 1984 argued similarly). Devlin (1989) included

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7 Other methodological issues by this literature included endogeneity issues in the regressions that had the loans’ spreads as dependent variable, as the cost of the debt would also affect the fiscal position of borrowing governments. Econometric tests in Edwards (1986) rejected this claim. An additional issue raised was the relative significance of each macroeconomic variable and whether bond prices were more appropriated to capture sovereign risk.
the structure of bank lending in his analysis and agrees with the importance of concentration—in both the lenders and the borrowers—that made more the probability of intervention more likely should a problem arise.

Contemporary observers also stressed the role of the IMF as an institution whose presence was supposed to “underpin confidence, just as a steady local central bank strengthens the domestic monetary system” (De Vries, 1986, p.180). This banker also emphasized the importance of the IMF’s support of countries in financial distress including Turkey, Zaire, Peru and Jamaica during the 1970s. In fact, the IMF slowly transformed dealing with balance of payment problems related to exchange rate stability to becoming a crisis manager. In fact, in 1976, the Mexican government had called upon the IMF to obtain its support to redress a balance of payments position and obtain financial support to solve the consequent currency crisis. Until 1979, the country was under an Extended Fund Facility program. IMF missions to Mexico were thus conducted at a regular basis. This monitoring certainly contributed to the confidence demonstrated by bankers in regards to Mexico.

Folkerts-Landau (1985) and Gutentag and Herring (1985) also evoked the possibility of moral hazard among lenders through a herd behavior pattern. Banks would have had the incentive to keep country exposure in line with other banks, as this would have increased the probability of government intervention in case of trouble, since the entire banking system would have been in jeopardy (Gutentag and Herring, 1985:3). Previously, Vaubel (1983) also expressed concerns regarding moral hazard on both the debtor and lender side, due to IMF lending practices. This institution, he argued, gave incentives to the countries not to remain solvent, but instead to resort to both continuously rescheduling their debts while also subsidizing the errors that banks had committed in the past. The author concluded that there were no economic reasons for IMF lending and that it did more harm than good to international finance. However, he proposed transforming the institution into an "International Monetary Information Agency" (Vaubel, 1983:301).

In fact, the role of information limitations has been at the core of discussions between banks and the IMF. In a recent paper by Sgard (2016), the author describes how the IMF conducted continuous exchanges on the economic situation of member countries, but governments shared this information because they believed it would remain confidential. Though the IMF prematurely recognized that information on borrowing countries needed to be improved, the IMF firmly rejected the idea that it would ever become a rating agency. The IMF decided to disseminate statistics without publicizing its judgment, though differences within this organism remained, due in part to the continuous pressure by commercial banks to receive “policy signals” from the Fund. Thus the question of the proper role of the IMF emerges. Was it expected to provide financial support, or rather, improve market efficiency?
III. Absence of Bank Reaction to Macroeconomic Imbalances in Borrowing Countries

Did the lack of information in any way distort the function of the Euromarkets? It has been widely recognized that in the late 1970s, many borrowing countries experienced a rapid deterioration in their macroeconomic fundamentals. Puzzlingly, most of them continued to borrow in international markets on relatively good terms. In fact, despite Mexico’s EFF program, IMF missions continuously expressed their concerns regarding the generally high levels of inflation and the high levels of public deficits in 1979. Yet, the economic growth boom also influenced by favorable oil prices—Mexico was exporting an increasing volume of oil—and by an expansionary fiscal policy. In 1982, Mexico’s fate depended on a combination of external and internal factors. Starting in 1979, adverse conditions in the world economy affected the country through higher interest rates and lower economic growth. As a result, the public finances of Mexico’s central government deteriorated, as most of the external debt was public (government, public firms and private firms with public guarantees). Internal conditions were related to the overvaluation of the peso and the high budget deficits, which had existed since the late 1970s (Cline, 1984). Mexico's balance of payments, along with its public finances, suffered from a drop in the oil prices in 1981.

A main question concerns the precise moment that capital markets reacted to Mexico's increased debt service problems. Comparing the reactions of both the bond and bank loan markets is enlightening, given the different institutional settings and the nature of each market in terms of the possibility of concerted action and the relative weight of a renegotiation position in case of default. As we show below, banks were accused of failing to react to Mexico’s debt problems. Previous works that looked at the bond market have only found mixed evidence on an earlier reaction, in comparison to the Euroloan markets. Gutentag and Herring (1985) for instance, examined the weekly behavior of spreads over LIBOR of the Nacional Financiera (a credit institution owned by the Mexican Government) floating rate notes. They demonstrated that while some investors began to react to an increased risk of a default in May 1981, this risk was not fully appreciated until November 1981. However, Folkerts-Landau (1985) shows that foreign bonds—denominated in either deutschmark or dollars—had no particular behavior until August 1982, the month when Mexican authorities publically announced on their debt service difficulties.

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8 IMF Archives, Western Hemisphere Department (WHDAI – Country Files), Box 129. Official memorandum, 24 September 1980.
9 A report of the first meetings between Mexican government representatives and the IMF observed that “The Mexicans, who, I must say, proved their skills as stage managers (…) blamed to external conditions…”. IMF Archives, Western Hemisphere Department (WHDAI – Country Files), Box 129. August 1982. On the Mexican external debt rescheduling, see Kraft (1984).
10 Edwards (1986) provides a detailed discussion on the differences between the bonds and the banks’ loans markets.
The bond markets’ late and sudden reaction is consistent with Edwards (1986) findings. On the contrary, banks seemed to have reacted more rapidly to Mexican public entities’ increased need for liquidity, as confirmed by a brief review of the press. For instance, The Wall Street Journal published several articles on the bankers’ concerns about Mexico’s external debt as early as August 1981 (WSJ, “Mexico’s heavy debt load doesn’t hurt credit rating,” 11 August 1981). The terms of the loans also became less favorable—a loan on behalf of Pemex, Mexico’s state oil company, in August 1981 reported a spread of 0.5, compared to the 0.375 spread of previous loans.\(^{11}\) The deteriorating situation of the Mexican economy—the fall in oil revenues due to both a drop in the price of oil and tightening of interest rates worldwide—reflected the "wider margins" that Mexican public entities had to pay for their borrowing, as reported in the Financial Times.\(^{12}\)

It is thus striking that most of the discussions that followed the crisis were linked to the limited of information on developing countries. In fact, the BIS was heavily criticized for their delay in publishing statistics on the total amount lent to borrowing countries (Mentré, 1983). Nevertheless, the BIS rejected this argument. In its annual 1982 report, this organism provided a general description on the evolution of the world economy that led to the crisis, along with the banks’ reactions. It showed that a substantial increase in borrowing by developing countries began in 1974, and largely accelerated after 1976. The main risk of this lending boom was the nature of this borrowing, which consisted of loans with floating interest rates that had much shorter maturity than loans granted in 1974 and earlier. The macroeconomic situation of most borrowing countries weakened beginning in 1979, with an increase in oil prices and anti-inflationary policies taken by industrialized countries. Economic growth in developing countries came to a sudden halt in 1980. At the same time, their account deficits increased because of a drop in price of raw materials prices and an increase in protectionist tendencies by industrialized countries.

Despite this macroeconomic evolution, the BIS described the banks’ behavior as having “not strongly reacted” to the international payments situation (BIS, 1982:124). It also referenced that central banks from the G-10 countries and Switzerland expressed their concerns about the risks of international lending and the need to maintain adequate capital levels as early as 1979. The BIS reported that while banks did become more selective regarding individual borrowers, and charged higher spreads to countries with high debt levels, other countries, which the BIS called “prime,” such as Mexico, continued to obtain credit on better terms. In the case of Mexico, this was partially due to its oil resources.

Finally, for the BIS, one of the most important indicators of increased debt service problems was the banks’ undisbursed international credit commitments, which started to decline in the second

\(^{11}\) See Dow Jones Newswires, "Pemex arranges a $200 million Euroloan" 21 August 1981.
\(^{12}\) 11 January 1982, "Companies and markets: Mexican credit margins rise."
half of 1979 and then most rapidly beginning in 1982, particularly for major Latin-American borrowers. From the BIS analysis, it seemed unlikely that the problem was poor information. It is therefore puzzling that banks maintained such high exposure to high-risk developing countries in the years that preceded defaults by Mexico, Argentina, and Brazil. The only visible proof that banks were aware of the increased risk was the evolution of loan maturity. The BIS quarterly publications on the maturity distribution of reporting banks’ lending showed that lending accelerated to developed countries outside the reporting area as early as June 1980 (BIS, December 1980). This can be interpreted as a flight to quality movement, although the most important shift came much later.

Alexandre Lamfalussy, who worked as Economic Adviser and Head of the Monetary and Economic Department and then as Assistant General Manager at the BIS during that period (see Maes, 2011), wrote that governments in borrowing countries were aware of the unsustainable pace of external borrowing well ahead of foreign lenders (banks and investors). In Lamfalussy (2000), he argued that the Falklands War (April and May 1982) had been the external shock, whereby investors reacted to the true situation of developing countries’ debt problems, even if the maturity of their lending had already begun to shorten by 1980. Table 1 confirms his statement regarding the maturity composition of bank loans. It shows the maturity distribution of the foreign assets from BIS reporting countries in Mexico between December 1977 and December 1982. In 1980, the short-term assets (up to one year) increased, while the rest, longer-maturity assets, move in the opposite direction. This is mostly striking for the long-term assets (over two years), which peak in December 1978 at almost 50% and then drop to 38.2% on the eve of the crisis in June 1982. On the other hand, a downward trend in the proportion of short-term loans to Mexico can be observed, as these loans first stagnate and then rebound beginning in 1980, when these kinds of loans again became the dominant type of loans. This observation is consistent with absolute pricing figures. Table 2 shows that the distribution of loan spreads of syndicated loans (adjusted for differences in maturities) to governments, as reported in Rockerbie (1993). While the average spread fell continuously until 1981, the differences between minimum and maximum spreads were amplified beginning in 1980. While this argument is expanded upon in the following sections, we conclude that banks reacted to the difficulties in borrowing countries before the outset of the crisis, thereby relativizing potential problems with information availability.

IV. Regulatory Failure?

While the banks reactions were qualified as “mild,” they could have been explained through a number of factors. A first possibility is the nature of the information itself. If information was lacking, banks and investors would have reacted to “noises,” which could have been contradictory pieces of information, with “negative” events being offset by other “positive.” A second possibility is that even if
information was available and consistent, it was not properly processed due to market distortions such as competition, lack of regulation, or moral hazard. While the previous section relativized the problem of information unavailability, we now analyze how information sources were utilized and whether market distortions could have affected banks’ risk management.

A first market distortion is competition. In a highly competitive market, such as the international banking sector in the 1970s, competitors could have been unwilling to engage in more restrictive lending policies that would have led to market share losses. Competition from creditors would have impeded them from developing long-term relationships with borrowers. According to banking theory, a bank’s continuous transactions with a borrower involve economies of scale in information production. Those banks acquire additional incentives to engage in information production, as their initial investment becomes profitable through a long-term perspective of profitability. This capacity lies at the core of the concept of relationship banking (Boot, 2000).

a) Information sources and market structure

The relationship banking argument can be further used to explain the information production that took place in commercial banks in the U.S. and elsewhere. On one hand, the structure of international banking remained concentrated among the major banks in main creditor countries. On the other hand, competition increased and long-term relationships were not always the main reason behind the choice of lead-managers by borrowers (Goodman, 1978). Examining the state of country risk analysis, however, a report by the U.S. regulatory authority recognized that country exposure management systems were adequate for banks with "larger exposures" (GAO, 1983; iii), though this was not the case for banks with smaller exposures. Bogdanowicz-Bindert and Sacks (1984) described the sovereign risk analysis of the 1970s as "soft," but insisted that the problem was not a lack of information, but rather the use of available information (Bogdanowicz-Bindert and Sacks, 1984:70). Following these authors, some regional banks relied on the information included in the documents elaborated by the money-center banks (mainly the “placement” memoranda), as international lending was a new activity for them. These documents included statistics on the political and economic situation of the country; the primary sources were mainly publications elaborated by the IMF, the World Bank, and the BIS.

Mentré (1983) provides a detailed description of all the available sources of information on developing countries. Besides the publications mentioned above, other publications existed on the markets and on the economic and political situation of borrowing countries. A noteworthy contrast — as compared to today— was the minor importance placed on ratings awarded by rating agencies. Ratings on sovereign borrowers from these institutions were practically non-existent. This fact had historical roots. After World War II, many countries faced default and repayment problems, and the general increase in loans from multilateral organizations (mainly the World Bank and IMF) had deterred
countries from looking for access in private capital markets. Once their general solvability improved, the default problem evaporated, along with the demand for a rating system (Gaillard, 2012). Less than 10% of countries actively being financed through the Euromarkets were rated. In 1980 for instance, Moody noted only Panama, Australia, New Zealand, Denmark, Canada, Venezuela, Austria, Finland, Sweden, Norway, and the United Kingdom. They add a total of 11 countries (Moody’s, 2003:3), whereas Standard & Poor’s rated 7 countries in 1974 and Fitch did not rate any (Gaillard, 2012:48).

Along those lines, rating agencies did not provide other useful analysis on borrowing countries’ economic prospects, or on the fiscal position of their governments. Moody's International Manual of 1981 listed and summarized the information on the bonds issued by the Mexican government. It also included a detailed map of the country and the most significant figures on public finances, exchange rates and other macroeconomic indicators, along with their historical trends. Rather than an analysis, this was an annual summary of economic facts without comments or judgments on the short-term perspective of the country.

Other ratings were thus used, though they were directly dependent upon the conditions under which the market and the banks rated the borrowers. One of these was a ranking published by Euromoney, which created a rating system based on the conditions under which each borrower contracted a loan in dollars or deutsche marks, using the Libor as reference rate. This rating had seven categories based on the values of the “Euromoney index,” defined as the ratio of the spreads of the loans issued to their maturities (all concerning only the public sector). One major drawback was that this system did not add new information into the market; it simply reflected the conditions under which other banks were lending.

How did the Euromoney ranking perform in regards to the probability of default? Table 3 plots the rankings of 1979, 1980, and 1981 of those countries that defaulted between 1981 and 1986. In 1979, the best-ranked “future defaulter” was Mexico who placed 34 out of 67. Remarkably, Mexico was upgraded after the following year, and appeared in 13th place out of 67 countries. Its ranking was better than countries such as Norway (15th), Iceland (19th) or Spain (21st). It was then downgraded in 1981, following a general trend of countries that later defaulted. Mexico was one of the first and largest defaulters of the 1980s, even if the country ranked higher than all other defaulting countries (22nd). The relative borrowing terms of countries that would go on default in comparison with non-defaulting countries further confirms that banks reacted at least one year before the onset of the crisis. From 1980 to 1981, average defaulter ranking was downgraded from 40.5 to 45.5.

The increased concerns by banks on the macroeconomic state of borrowing countries was reflected in the set of requests for reliable and timely information, as mentioned in the previous section.

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13 The other publication that also created a similar index was Institutional Investor (See Gaillard, 2012).
In April 1982, Morgan Guaranty proposed that the IMF could provide this function not only through a reasonably timely release of economic information, but also through policy analysis (IMF, 1983:36). In an analysis of the sources of information that banks had at their disposal in the years prior to the crisis, the IMF remarked that the BIS was strongly criticized for delays in both their publications and their coverage. However, as we detail below, the BIS rejected the accusation on the grounds that this would not have affected the perception of looming problems (IMF, 1983:39). The banks claimed that the BIS data on bank lending to individual countries was relevant for defining their own exposure to borrowers, and for obtaining information on the debt position of borrowers.

b) Failed regulatory efforts

Following the IMF, increased competition also contributed to the banks’ refusal to collaborate with regulatory authorities (IMF, 1983:25). In countries such as the U.S. or Great Britain, banks could not be forced to reduce their exposures or to alter their practices—though regulation did impact the lending activities of banks in countries such as Germany or Japan. In 1980, the U.S. General Accounting Office reported that its recommendations (which they called “special comments”) had limited impact on restraining the increase of country exposures, which had grown problematic over time.14

In fact, the banks’ requests for better information in the early 1980s blatant contrasted their initial position regarding regulation in the 1970s. The Burns questionnaire is illustrative, as it was an early attempt to improve the general state of information. In 1977, the BIS, along with the G-10 group of central banks, developed a questionnaire that established a list of questions that commercial banks were recommended or even obligated, in some cases, to ask to potential borrowers before granting loans.15 This questionnaire was supplied to the main banks in G-10 countries, and was also intended to capture the receptiveness of the bank to this initiative. As expected, most banks rejected the idea on various grounds, and in general, they felt that they “did not need central bankers to teach them how to assess sovereign credit risks” (Lamfalussy, 2000:12). The BIS archives provide precise reports on the visits their staff conducted in some of the main creditor countries. They describe the attitudes of bankers as a national group or, as in the case of the U.S., attitudes at the individual bank level. We have coded

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14 An internal IMF report (Official Memorandum written by David Finch for the Managing Director and the Deputy Manager Director, 5 November 1979) explained in 1978 that the GAO classified countries according to their credit standing. This rating was based on historical quantitative indicators and the country reports prepared by the New York Fed. There were three categories of countries, and although this rating was not supposed to guide the market, it served the supervisory authorities to issue “special comments” to banks if the ratio of exposure to capital to an individual country was above 25% for high standing countries, but for the other two groups it would be 5% or 10%. The writer of the report was skeptical about the information used and the utility of the practice as comments arose when the exposure limit was already reached. IMF Archives, Central Files, S150.1, Central Files Collection, Box 13.

15 See Lamfalussy (2000) and Maes (2011). A proposition to obligate banks to obtain this information was directly rejected.
their relative attitude from less to more favorable attitudes for each bank (from 1, being completely in favor, to 4 being completely against).

Figure 1 shows the results at national levels. Swiss banks were the most openly hostile to any type of regulatory intervention. They are followed by British and Belgian banks, with U.S. banks coming in fourth. Overall, there are important variations between the national groups of banks. Nevertheless, we suspect that the same type of heterogeneity can be observed within each group. A closer look at U.S. banks demonstrates that the attitudes were different between small and large banks. Figure 2 shows that Bank of America, Citibank, and Chase Manhattan, three of the most active banks in the Euromarkets, were the most adverse to the Burns questionnaire. In 1975, they had ranked first, second and fourth in the League Tables of banking assets at a world level (Devlin, 1989). In other words, size mattered. While this evidence would be noteworthy during the debt renegotiations of the 1980s, it was already relevant in the pre-crisis period in terms of information production, market share, and regulatory interests.

c) Banks exposure and home biases

How could regulation and information distortions affect the market? While banks could define their own individual strategies, it did not necessarily imply that they were unattached from the “natural” regions they operated in according to their national origin. As advanced by Wellons (1985) and others, the volumes of banks’ assets in individual countries may have carried a “home bias.” However, this also implied that the resulting regional heterogeneity should have had an effect on the risk exposure for each group of banks classified by country of origin. After all, each region had its own borrowing performance (Africa and Latin America on one side, and East Asia on the other) and, to a certain extent, major macroeconomic differences (Sachs et al., 1988). This means that the defaults of the 1980s should have had an asymmetric effect on groups of banks. The “Latin American” penalty, observed in 1981 (Euromoney, February 1981), should have been reflected in a riskier position in U.S. bank portfolios.

A general overview of the data allows us to refute this apparent intuition. On one hand, the “home bias” can be illustrated through contemporary sources. We have gathered aggregated data from reporting banks, mainly from developed countries, that shared this information with the BIS, and then subtracted the part for the U.S. banks that was provided by the Federal Reserve Statistical releases.16 In Table 1, we show the differences in the relative exposure to banks to sample countries in Latin America, Eastern Europe, Asia, and Africa. As expectedly, U.S. banks were comparatively active in Latin America and East Asia, whereas other BIS banks, such as those with German, French or British origins, were more involved in Eastern Europe.

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16 This disaggregation can probably also be obtained for British and Japanese banks.
However, in terms of risk exposure, we do not observe major differences between US and other, BIS-reporting banks before 1982. Based on the data mentioned above, we compared the exposure of U.S. banks and other BIS reporting banks to different levels of country risk, approximated by an average measure of spreads to government loans. For each year between 1979 and 1984, we looked at the distribution of the spreads of the loans granted, dividing them into quintiles, from the 20% lowest spreads to the 20% highest. Figures 3a and 3b show the results. Figure 3a illustrates the evolution of U.S. banks’ exposure utilizing histograms. In 1979, U.S. banks had an exposure of 33.4% to countries with the 20% lowest risk level. This rather conservative picture did not change until 1983, one year after the Mexican default. The portfolio’s composition is similar to other BIS-banks until 1982 (Figure 3b), though it differs to some extent in 1983 and substantially by 1984. Even if the bailout arrangements that followed contemplated some forced lending, this suggests that a risk reevaluation took place after 1982, when the expected heterogeneity emerged.

This wakeup call can be explained by a risk reassessment or from a change in perceived support from lenders of last resort. As mentioned above, contemporary observers and scholars have argued that banks relied on the IMF to bailout countries in financial distress. It would therefore be reasonably accurate to assert that banks were hostile to the manner employed by the IMF to deal with Mexico’s default, and regarded the bail-in strategy as an unpleasant surprise. So for instance, on 19 November 1982, an article published in the *Financial Times* reported bankers’ complaints. According to the article, the banks perceived the IMF to be largely unaware about the considerable amounts of debt held in bank portfolios. Moreover, the IMF was further criticized by the banks over its request to make further loans to the Mexican government, and that IMF support hinged on bank participation in the loan. Archival evidence shows that the IMF staff discussed and dismissed the criticism raised.17

The IMF was aware of the banks’ position towards high risk countries. This body had been working with the most important lenders to Mexico for several months beforehand, when the Mexican problems first came to light. This relationship, however, had even been developed before that, as Mentré (1984) reported. Apart from the request for information from the IMF, banks favored the proposal for an increased amount of resources available to the IMF, not only in the form of increased general quotas, but also by allowing the IMF to borrow in private capital markets. The IMF’s perspective encompassed nevertheless a broader issue. One year before Mexico’s default, an IMF internal document dated 4 August 1981 severely criticized the banks’ optimistic position on the future of further lending to developing countries, partly nourished by their low levels of loan-loss record. However, the document provided an acute observation that probably laid the foundation for the position the IMF would adopt one year later “[t]he banks have so far managed to place virtually all the costs of their mistakes on others,

17 IMF Archives, Western Hemisphere Department Funds, Country Files Mexico, Box 205.
particularly on the debtor country forced to adopt a painful adjustment path. In my view, banks will have to assume some of the financial responsibility for their mistakes.\textsuperscript{18}

V. The Historical Context: the Origins of ILORs

This section provides background and archival evidence that highlights why the perception of an active lender of last resort encouraged governments to enter into the Euroloans market in the early 1970s, despite information shortcomings and lower profits margins that became commonplace at the end of the decade. This period witnessed one of the largest expansions of international banking in history: the role of international institutions and the support of national governments, generally through the central banks, were essential. Eichengreen (2003) notes that lending booms had taken place within favorable political conditions during the last 200 years. The 1970s were no exception. The political context, to a large extent, explains the paradox identified in Sachs (1989:9), whereby “few banks, apparently, were concerned with the question of whether the debtor countries would be willing and able to service their debts.”

The origins of this lending boom can be traced back to 1973, where in the aftermath of the oil shocks, the current account balances of developed countries were affected and the international liquidity of stock increased. The debate turned on the question of how to avoid a global slump and avoid a return to the beggar-thy-neighbor policies of the interwar years. This quest for an innovative policy response is best illustrated by the words of IMF Managing Director H. J. Witteveen. He justified a more liberal economic policy, given the extent of the new deficits and surpluses, which were peculiar because they had come about suddenly and could not be eliminated “by any of the traditional policy responses which the Fund and its members have come to regard as normal over the past twenty-five years” [emphasis added].\textsuperscript{19} In order to keep the world economy going and avoid a recession, Witteveen stressed the importance of private markets such as the Euromarket. He claimed they would be the ‘main channel,’ as they offered the flexibility and anonymity that lenders in oil-producing countries desired.\textsuperscript{20} As we now know, in the following years leading up the 1982 debt crisis, capital flowed from surplus countries to developing countries through the unregulated Euromarkets.\textsuperscript{21}

In fact, the IMF had not been alone in its diagnosis of the type of responses to the oil shocks. The same types of recommendations were released by other international institutions, such as the Working Party 3

\textsuperscript{18} “Letter by David Finch to the Manager Director”, 4 August 1981. IMF Archives, S150.1, Central File Collection, Box 13.
\textsuperscript{19} IMFA, European Department-EURAI Subject Files Box 145, ‘Speech by H. Johannes Witteveen at the Economic Club of Detroit,’ 6 May 1974.
\textsuperscript{20} IMFA, European Department-EURAI Subject Files Box 145, ‘Speech by H. Johannes Witteveen at the Economic Club of Detroit,’ 6 May 1974.
\textsuperscript{21} On the recycling of Petrodollars and the banking expansion in the developing world see Altamura (2016).
(WP3) of the OECD. The resulting policy consisted in privatizing credit through the recycling of Petrodollars, which were then spread to national institutions, mainly central banks. The evidence from discussions held at the Balance of Payment Department of the Bank of France shows that the Bank favored an increase in capital exports to developing countries to alleviate the deficit position of developed countries. Essentially, LDCs were expected to incur debt to boost international trade and avoid a new recession. Borrowing by LDCs not only reflected the growing trust of international organizations (IMF, BIS and OECD) in private markets or the need to shore up earnings by commercial banks. It also reflected a demand from developing countries’ regimes, which were generally ‘one-party democracies’ or military juntas, to finance productive investments in industrial sectors that were deemed strategic.

The position of commercial banks within this new political context was more complex than previously assumed. New archival evidence allows us to examine the popular belief that banks were eager to enter into the recycling process. Evidence shows that at least in the beginning, they were fairly hesitant. After the meeting of the Trilateral Commission in Brussels in 1974, Sir Philip de Zulueta, one of the two British delegates, wrote to the Governor of the Bank of England that the bankers present, including David Rockefeller of Chase Manhattan, ‘expressed considerable worry about the capacity of the private banking system to recycle extra Arab oil money into medium term credits.’

Rockefeller was particularly worried about four possible impediments to recycling Petrodollars: first, the maturity mismatch between assets and liabilities; second, a potential credit exposure problem; third, the ‘fact that Arab investors would ultimately seek alternative investments to their short-term deposits in low-yielding accounts;’ and finally, ‘the simple fact that most developing countries were not credit-worthy.’ Banks were well aware of the potential for profits, but were likewise equally informed of the risks involved. Ultimately, commercial banks needed explicit guarantees that they would be bailed out, if necessary.

The Bank of England reacted favorably to these concerns. In 1974, the Bank released a memo stating that ‘it is the job of central banks to ensure the effective operation of a highly leveraged banking system and above all to prevent its collapse. The prospect of back-stopping, even without any direct action, will go a long way toward providing such assurance [emphasis added].’

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22 Archival evidence suggests that the debates did not differ from those taking place at the IMF. For instance, in a document written in January 1974, just a few months after the oil shock it is clearly stated that ‘from the global point of view it would seem very desirable for at least part of the increased savings of the oil producers to be passed on to the non-oil developing countries. This would also help to reduce both the external and internal imbalance created in the OECD area [emphasis added].’ OECDA, WP3 Documents 1974, ‘The Increase in Oil Price,’ CPE/WP3/74(1), 12 January 1974.
Herstatt crisis of 1974, the debate between the Bank of England, which was more inclined to serve the needs of the financial community, and the central banks of Germany, Switzerland, and the Netherlands on whether there would be a lender of last resort became even more harsh. Karl Klasen, the President of the Bundesbank, remarked that a bank should not be saved, as it should serve as an example to the financial community, and that any intervention by central banks would be self-defeating because it would “hang a security net under the banks whose position is shaky.”

Ultimately the German position would not prevail; in September 1974, the G-10 issued a communiqué of crucial importance for the rest of the decade. The communiqué stated that “the Governors had also an exchange of views on the problem of the lender of last resort in the Euro-markets. They recognized that it would not be practical to lay down in advance detailed rules and procedures for the provision of temporary liquidity. But they were satisfied that means are available for that purpose and will be used if and when necessary”[emphasis added]. The communiqué reassured the banking community that global credit intermediation on a global scale would continue and international organizations would stand behind them. The safety net provided by the G-10 inaugurated a phase of unprecedented banking and financial expansion, but also led to heightened global risks. This kind of safety net could only be justified in a case of increased controls on cross-border lending but, the controls remained limited or non-existent.

Thus, it is not surprising that when staff from the European Department of the IMF visited several commercial banks in Europe, the mood was upbeat and they reported that “bankers did not seem overly concerned with the immediate dangers of defaults or debt rescheduling.” Some bankers were adamant, indicating that “they would look to the Fund to provide the debtor countries with the resources to meet their obligations if serious difficulties were to arrive”[emphasis added].

The activities of commercial banks in developing countries continued to expand unabatedly. A report entitled ‘The Fund and the Commercial Banks’ explicitly remarked that “the scope of their activities could be reduced by changes in national official policies, but governments are reluctant to consider curbs” because they recognized that, given the size and difficulty of the recycling process, “it is considered unwise to seek any sharp reduction in the scale of commercial bank operations.” The Euromarkets was praised for its apparent efficiency in transferring capital from surplus to deficit countries on a large scale. The Governor of the Federal Reserve proudly stated that ‘the Euromarkets

26 IMFA European Department-EURAl Subject Files Box 70, ‘Confidential Note of the European Office of the IMF in Paris to the Managing Director Witteveen’, 11 July 1974.
28 IMFA European Department-EURAl Subject Files Box 70, ‘International Banking Staff Visit to Europe,’ 9 April 1976.
are one of the *success stories* of our day, which needs a few successes. In difficult times, they have helped to keep trade flowing, they have financed investment and development, they have enabled countries to deal with their balance of payments problems. *The Euromarkets serve as a reminder of what a market system can achieve when it is allowed to operate freely* [emphasis added].”

IMF Managing Director, Jacques de Larosière was equally optimistic, even when the clouds were gathering on the horizon. In March 1982, he remarked that “on the whole the global financing and debt situation, difficult as it is, is not in my view unmanageable.”

VI. Case Studies: Boosting Exports and Foreign Lending

As anticipated, banks became a crucial element in the re-equilibration of global payment imbalances, by providing credit to borrowing countries, especially those in the developing world. The banking and financial community would benefit both from the support of international organizations, such as the IMF, and also from individual governments caught in a frantic scramble for markets. Thus, the competition that emerged in the market for Euroloans was just one, perhaps secondary aspect of a wider market for acquiring export markets, as the following case studies demonstrate.

*a) The Brazilian government and the electrification of the Belo Horizonte-Icutinga-Volta Redonda railway*

In April 1974, in a Barclays internal memo, industrial adviser Sir Peter Tennant reported after a lunch at the Bank of England that the new Governor, Gordon Richardson, “[was] especially interested in Latin America” and “would like to see much more activity” in the region. Of the many examples that could be presented, the case of financing for the electrification of the Belo Horizonte-Icutinga-Volta Redonda railway, the so-called ‘Steel Line,’ is particularly illustrative.

In 1976, the military ruler of Brazil, General Ernesto Beckmann Geisel, paid a state visit to the United Kingdom. The electrification of the steel line was one of the main topics of discussion between the Brazilian Railway Company (RFFSA), General Electric (GEC), and NM Rothschild. NM Rothschild, a British export credit agency, had already agreed to guarantee a loan of £115 million, but the Brazilians had made it clear that they wanted dollars on a 1-to-1 ratio to complement the loan. This meant that the contract “[would] only become effective to the extent that the euro-dollars are

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30 IMFA, Exchange and Trade Relations Department-ETRAI Subject Files Box 4, ‘Speech of Henry C. Wallich at the 1978 Euromarkets Conference,’ London, 8–9 May 1978.
31 IMFA, European Department-Subject Files Box 146, ‘Remarks by J. de Larosière to the Meeting of the International Financial Group,’ Ditchley Park, 8 May 1982.
32 Barclays Bank Archives (BBA), 80/5852, Note for the Chairman by Sir Peter Tennant, 25 April 1974.
forthcoming and, in turn, the first drawing on the euro-dollar loan [would] be made to pay the down-payment under the contract between RFFSA and GEC.”

In the post-1973 world, marked by an increasing scramble for markets, Euroloans became a crucial element to obtain export contracts for domestic industries that faced increasing competition in the West. Borrowing countries were quick to adapt to the new scenario. When the British argued that such a loan was difficult to put in place, the Brazilians responded that they were not willing to enter into discussion with countries “whose banks were not prepared to support their industries.” In fact, Brazilian officials remarked that German banks had agreed to provide US$ 700 million in Euroloans in support of nuclear power plants, the French had promised substantial Eurodollar loans to complement insured financing while Italian, French and German banks had agreed to loan US$ 900 million to support a consortium of leading electrical companies. Both the French and the Germans had accepted, albeit with reluctance, to the respective contracts being tied to forthcoming Euroloans.

Midland was doubtful, felt that the conditions imposed by the Brazilians felt like ‘blackmail,’ and that the amounts involved “presented serious ‘country limit’ problems.” In this context, Midland thought that if the whole operation was “for the public good,” the British Treasury “should do more.” The Rothschild proposal, which involved the four clearing banks putting up US$ 50 million, was ‘not acceptable judged on normal commercial criteria’ [emphasis added].’ As we have already pointed out, normal commercial criteria were not the norm in the years preceding the debt crisis, as political and strategic considerations played a crucial role in determining where money flowed. Midland recognized that “a number of very important ‘political’ considerations were involved,” and the loan was ultimately granted.

The archives of the major banking establishments show that the influence of politics on lending decisions was omnipresent. For example, in October 1981, less than a year before the Mexican default, Lloyds Bank International acted as lead-manager and coordinator of a syndicate of British banks that had committed to financially support five major development projects, which Brazil allocated to U.K. industries as a “sign of gratitude.” The agreement was backed by a previous government-to-government memorandum of understanding, signed by Minister Antonio Delfim Netto and Secretary of State for Trade, John Biffen. The memorandum concerned the suburban railway system for the city of Recife (£43 million in guaranteed credits and £102 million in Euroloans), a thermoelectric plan in the state of Rio Grande do Sul, and a credit line to finance the Brazilian Navy’s purchase U.K. equipment (£105 million in guaranteed credit and £121 million in Euroloans).

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34 Idem.
35 Idem.
36 Lloyds Bank Archives (LBA), HO/Ch/Mor/104, ‘Brief Notes of Interest,’ 29 June 1982.
b) French foreign policy, Euroloans, and the “Soviet Umbrella”

Official pressures had detrimental consequences on the soundness of the investments that were already influenced by the competitiveness of the financial sector. Of course, this pervasiveness was not limited to the British. All major French banks listed the state as a shareholder and often saw their lending decisions imposed directly by the Ministry of Finance. For instance, in December 1980, the President of Crédit Lyonnais, Claude Pierre-Brossolette, wrote angrily to René Monory, the Finance Minister, because the major French banks had been compelled to lend US$150 million for seven years to the Yugoslavian Central Bank “without having been previously informed.” Since all the large commercial banks were influenced by political power, the loan to finance balance of payments disequilibria was ultimately granted. Nonetheless, the pressure exerted on the reluctant commercial banks had been enormous. Philippe Lagayette of the Ministry of Finance said that “the Minister would not forget the banks who had refused to participate in the loan.” It is worth remembering that Yugoslavia defaulted in 1982 and that an IMF program was negotiated.

French banks played a pivotal role deploying French foreign policy: loans were often the outcome of political decisions. The special relationship between French banks and the Saddam Hussein regime is particularly illustrative. Hussein was invited by Prime Minister Jacques Chirac (later nicknamed Jacque Iraq) to Versailles in September 1975, for discussions that were centered around nuclear energy and financing thereof. Ultimately a nuclear cooperation agreement was signed and construction of the Osiraq reactor began. Israel was particularly disturbed at the idea of having a nuclear reactor in the hands of a hostile power. In June 1981, operation Babylon was launched, resulting in the destruction of the reactor and the killing of one French technician. The special relationship between France and Iraq continued despite this setback. In January 1983, at the height of the war with Iran, Vice-President Tarek Aziz visited Paris again, where he met with President Mitterrand and several key ministers. As the war cost an estimated US$1 billion per month, Aziz desperately needed money, along with more sophisticated arms to strike the Iranian oil facilities in the Gulf. The links with the Saddam regime were so strong that Aziz argued that “you cannot abandon us, if we sink you will sink with us too.” Ultimately, the French government agreed to settle FF2.5 billion of outstanding debt and to triple its purchase of Iraqi oil. The French support also involved military equipment: in 1983 five Super Etendard carrier-borne strike fighter jets built by Dassault-Breguet, were sold to Iraq, with the assistance of the nationalized banks.

Along with the guarantee of the G-10 and the support of domestic governments, one final element that justified the scale of moral hazard during the 1970s should be mentioned. Since the creation of the Council for Mutual Economic Assistance in 1949 to the beginning of the borrowing bonanza in the early 1970s, there was a tacit truth accepted by international financial circles: in the event of a default by a Comecon member, the Soviet Union would step in and bail out the country. This perceived doctrine was known as the ‘Soviet Umbrella.’ In July 1978, during one of the weekly meetings with the banking community, Governor Richardson, despite warning the clearing banks to be wary of “relying on the so-called “umbrella theory” and that they should “take into account the size of Poland’s present debt before granting new loans” was ultimately sure that “in the very end, which was not very likely to be reached, the Soviet Union might help [Poland].”

The inability of Poland to repay its debt in the second quarter of 1981 and the subsequent regionalization syndrome that affected other Socialist countries, including Romania and Hungary, shattered the belief in the Soviet Umbrella and caught the major European banks by surprise. In December 1981, while analyzing the position of its bank in Eastern Europe, Société Générale clearly remarked that “the crisis in Poland started in August 1980 … lead to the realization by the Western financial community that the theory of the Soviet ‘umbrella’ was not based on anything else than its own conviction artfully, although informally, supported by the Soviets themselves.”

Ultimately, the pervasiveness of political considerations in lending to developing countries was acknowledged by the BIS once the crisis had erupted, ultimately weakening its regulatory efforts. In its 1983 Annual Report, the BIS adamantly remarked that “while supervisory authorities were tending to encourage a moderation in the pace of new lending, governments were not always averse to soliciting the participation of banks in export-related project financing [emphasis added].”

**VII. Conclusions**

This paper provides new evidence on bank behavior prior to the Mexican crisis. Banks decided prices and loan volume, not necessarily upon macroeconomic indicators, as previously argued, but seem to have considered competition, market liquidity and to a large extent, political factors. As we have demonstrated, although banks reacted to the deteriorated macroeconomic situation in the years immediately prior to the crisis, this reaction was more related to a general deceleration in lending, rather related to the home country’s macroeconomic conditions. The banks’ lending volumes appear to be

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42 BIS Annual Report 1983, 125.
more related to the conjuncture of high liquidity and strong competition. Even if the banks were concerned about the lack of information, the demand to improve information sources only took off in the year previous to the crisis. While banks reacted to this failure too late to have an effect on loan pricing, they were able to respond by becoming more selective regarding the identity of the borrowers. On the other hand, the drop in loan maturity demonstrates that banks were aware of potential problems in borrowing countries in the near future. Banks reacted promptly, however, following the realization that no supposed international lender of last resort, such as the IMF or the Soviet Union in the Soviet Umbrella case, would automatically intervene to support countries with repayment problems.

The results of this paper suggest that bank lending patterns were related to commercial interests. The problem of moral hazard arose as a byproduct from the encouragement by governments and international organizations. The primary goal of these parties was to boost exports and weather the effects of the oil shocks and decreased economic growth that took place in the early 1970s. This does not mean, however, that policymakers were not concerned about the issue of over-lending. Their concern is reflected in the regulatory attempts at both national and international levels, and later, in the efforts to involve the banks and bank funds in the debt rescheduling arrangements that followed the Mexican default. Nonetheless, official institutions continued to prefer the svelte intermediation of surplus funds from oil-producing to developing countries to any coherent regulation scheme. As a result, banks grew to become the crucial element in world finance after the ‘financially repressed’ Bretton Woods period. While the link between international finance, politics, and commercial links may have evolved since those years, certain elements may have persisted until today.

Sources

References


Tables and Figures

Figure 1. Banks’ reactions to the Burns’ questionnaire. *Source:* See text.

Figure 2. US Banks reactions to Burns questionnaire. *Source:* See text.
Figure 3a and 3b. US and other BIS-reporting banks. Banks' distribution of Euroloans according to spreads' levels. Source: See text.
### Table 1. Asset amounts outstanding (in percentages) by reporting banks classified by maturity as reported by the BIS, “Maturity distribution statistics”, 1977-1982.

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### Table 2. Descriptive statistics of maturity-adjusted spreads. Sources: Own computations from Rockerbie (1993).

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Table 4. Banks’ claims on individual countries, in percentages of total external assets. Sources: See text.