Financial markets, international organizations and conditional lending: a long-term perspective

FLORES ZENDEJAS, Juan

Abstract

This paper aims to provide a historical insight into past experiences of conditional lending in sovereign debt contracts. It shows that the history of conditional external lending first emerged in early nineteenth century financial markets.

Reference


DOI: 10.1017/CBO9781316442876

Available at:
http://archive-ouverte.unige.ch/unige:131076

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Contractual practices in the field of sovereign debt management have a long history. The willingness of governments in financial distress to adopt public policies or other measures agreed upon in sovereign debt contracts in exchange for new lines of credit has varied over time. The recent European debt crisis has brought the thorny debate about the infringements upon national sovereignty that are associated with “conditional lending” to the forefront. While this crisis remains unique in that its causes are related to potential loopholes in the monetary union structure, nevertheless raises relevant issues regarding the relationship between national governments, international financial institutions (IFIs), and global financial markets. Indeed, the main institutions involved in the sovereign debt crisis management, located in Brussels (European Commission), Frankfurt (European Central Bank), and Washington (the IMF), have strongly advocated that the provision of financial support be conditioned upon banking sector reforms, debt restructuring and fiscal austerity.

Although still controversial, the incorporation of “conditionality” clauses – defined as the implementation of specific policies in order to obtain financial assistance (Dreher 2009) – into sovereign debt contracts is not new. Throughout the post-World War II period, when states faced limited access to private financial markets, IFIs provided financial support through emergency loans, requiring debtor states to adopt specific economic policies and oversight structures built with the purpose of monitoring the implementation of their commitments. While this had been the case during balance of payments crises, since the
1970s, conditional lending has been primarily associated with sovereign defaults.

This paper aims to provide a historical insight into past experiences of conditional lending in sovereign debt contracts.\footnote{In that regard, I am grateful to archivists at ING Baring, the League of Nations Archive, the Rothschild Archives, Hambro, IMF Archives, the Bank of England Archives and JP Morgan Library and Museum – here is also the place to thank the Swiss National Science Foundation for its financial support.} It shows that the history of conditional external lending first emerged in early nineteenth century financial markets. This practice was related to predominantly primary market access that was strongly controlled by two entities. First, an institutional authority established a set of requirements that borrowers were expected to meet to have access to liquidity. Second, financial intermediaries developed the means and capacity to exclude, de facto, a borrower that would not comply with the conditions set in the contract. The management of sovereign defaults was framed by these two actors who could condition market access to the resumption of debt service. Averting further future defaults could incite financial intermediaries to extend the condition of no-default to economic policies related with fiscal and monetary issues. Governments in creditor countries would occasionally intervene and, in certain cases, conditionality could be further enforced by coercive measures such as external fiscal control. The existing breakthroughs in the twentieth century, in particular, the emergence of multilateral organizations, legitimized and spread these practices without modifying the basic principles that were put in place in the nineteenth century.

This paper has a chronological framework and is structured as follows. In the first section, I present various cases of conditional lending in the nineteenth century. It emphasizes the processes and historical contexts that led to the inclusion of conditions in sovereign debt contracts. I further discuss the case of conditionality in the case of sovereign defaults during the 1890s, a decade that saw a wave of defaults affect the volume of capital flows from London. The main defaults of this decade were settled through final agreements which included conditions related with economic policies and in one case the imposition of an international commission of foreign control.

Section II addresses one of the major institutional innovations in terms of conditional lending, which was the League of Nations’ Economic and Financial organisation. This multilateral public entity mainly dealt with the reconstruction of Central and Eastern Europe...
countries in the 1920s. It attempted to attract external funds to these countries, as it did not have any financial assets that it could loan itself. The League therefore promoted so-called “League Loans,” which were issued in coordination with underwriting banks and, when necessary, with the governments that guaranteed the loan. In doing so, the League also acted as a financial intermediary. The implementation of “stabilization programs,” under a close monitoring system organized by the League, was the major condition sine qua non a borrowing country could maintain the League’s support. Finally, the League also incorporated other non-market roles, which formalized forms of coordination between creditor countries’ governments, by using a contractual practice that was pioneered in the nineteenth century. In the third section, the paper presents contrasts between these historic practices of conditional lending and those that have been developed since 1953 by the IMF. While the latter has only indirectly adopted a certification role that would allow governments to have access to external finance, it has predominantly focused on managing sovereign debt crises, particularly those that have taken place after the onset of the 1982 Mexican crisis. This paper shows that unlike the League, the IMF has switched its focus from conditional lending in primary markets to one in which it has emphasized the need for a lender of last resort when sovereign defaults constitute a real threat.

By tracing the long-term evolution of the practices of financial intermediaries, creditor governments, and IFIs associated with conditional lending, this paper helps us identify these contractual practices that have been put in place in recent decades. While enforcement mechanisms may differ in degree, IFIs today have tools that were absent in historical cases of conditional lending. This paper examines the historical role of the League of Nations in the construction of the world economy and positively assesses these attempts. Previous works have argued that the League failed because it could not halt the slide into the Great Depression and war (Pauly 2003; Schuker 2003), which were associated with a wave of defaults on the League loans in the 1930s. Similarly, the IMF has been criticized for imposing economic regimes that lead to low rates of economic growth and continued dependence on external funds. In fact, most policy evaluations of conditional lending have concentrated on the ex post handling of financial and economic crises by IFIs. This paper claims that focus on ex post effects is too narrow to give an accurate picture of the effects of contractual practices promoted by IFIs such as the League. If the IMF were judged according
to the same criteria as the League, it would be considered a failure, as it has neither prevented the breakdown of the Bretton-Woods system, nor the defaults of the 1980s and the 1990s and the slide into the new Great Recession. In contrast, this paper shifts the focus on IFIs and conditional lending to the ex-ante role of IFIs as a facilitator in the development of financial markets. It shows the important role IFIs played in establishing the formal contractual framework of international cooperation between governments and private agents that ultimately restored international capital flows during both the 1920s and in the post-WWII period.

THE CONSTRUCTION OF CONDITIONALITY:
LIGHTS AND SHADOWS OF THE LONG NINETEENTH CENTURY

Institutions, market actors and early experiences of conditionality
Conditional lending existed in the early nineteenth century and perhaps even before. During this period, the London Stock Exchange (LSE) acquired a new relevance in the sovereign debt market. The LSE held the authority to veto the listing of new securities on the exchange, thereby cutting off access to the capital market. This veto would arise in cases of bonds issued by a defaulting government, where a satisfactory arrangement with bondholders had not been reached. In practice, the LSE emerged as an Arbitration Court and triggered the formation of a system that mirrored today’s collective action clauses, where majority agreements among bondholders are encouraged (Flandreau 2013). This “non-default” clause was therefore a generic, institutional condition that served as a dispute solution mechanism between borrowing governments and bondholders. Nevertheless, other cases occasionally appeared in the sphere of primary capital markets that led to the inclusion of conditions in sovereign debt contracts that corresponded to the interests of certain market actors. The agents in charge of imposing such conditions on international loans were mostly underwriting banks and creditor governments. The reasons for direct intervention of creditor

2 On the listing requirements established by the LSE, see Neal and Davis (2006).
3 While exchanges have ceased to be functional today, they nevertheless have a certain capacity to inflict reputation penalties on sovereign borrowers, acting thus as an additional enforcement device (Weidemaier and Gulati 2014).
4 Yafeh and Sussman (2003: 25) report some cases in which the Corporation of Foreign Bondholders offered advice on economic policies and sought to impose conditions related to fiscal sustainability, though they described this experience as mostly unsuccessful.
governments (Great Britain and France, in particular) in the sovereign debt markets were diverse. Often the type of conditionality that accompanied those historical cases involved imposing foreign control on fiscal and monetary policies, along with a debt restructuring that was favorable to bondholders and without the issuance of new funds. One line of historiography remains skeptical of the role of sovereign debt disputes – whether sovereign defaults or debt repudiation – as the main factor that encouraged the creditor-government activism. Certain scholars explain such activism as evoking geopolitical issues constituted by so-called “gunboat diplomacy” that was part of the colonial expansion that took place in the nineteenth century. In contrast, the conditions negotiated between borrowing sovereign governments and underwriting banks were embedded in a systematic procedure of sovereign debt contracting. These conditions could be included in the debt contracts signed by borrowing governments. In most cases, the enforcement was structured through a monitoring mechanism – often through permanent agents sent by underwriting banks to borrowing countries – that coordinated the gradual release of loan funds upon compliance with the agreed-upon conditions (Liedtke 2008; Flores 2012).

One early instance of this procedure, reported by Flandreau and Flores (2012a), is a 1832 Belgian loan. During the Belgian revolution of 1830, wherein the country emancipated from the Netherlands, the Rothschild Bank succeeded in including a clause in the loan contract signed by the Belgian government that committed Belgium to respect the peace agreement signed at the London conference (an international parlay group) and abandon its claims for further territorial expansion. The enforcement mechanism was market-induced, to the extent that Rothschild was a dominant player in international finance – its market shares during the early nineteenth century were, on an average, around 60 percent – could determine the terms, the amount, and the time when the funds would be available to borrowing governments.

Historical evidence shows that the Belgian government sought alternative

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5 The case where additional funds were envisaged is described below.
7 Precise figures in subperiods of the nineteenth century can be found in Flandreau et al. (2010).
8 On the other hand, Rothschild and other prestigious merchant banks in London developed a business model where reputation was essential. While the system evokes today's originate-to-distribute practice, the willingness to keep market shares and extract the consequential rents related to market power meant that these banks were interested in maintaining a positive record for the loans they issued. See Flandreau and Flores (2009, 2012b).
financial possibilities – the exit option – appealing to two minor, forced internal loans in October 1830, though these were insufficient to meet the needs of the treasury (Gille 1965). 

Rothschild’s successful experience was, nevertheless, exceptional throughout the nineteenth century and no other serious attempt to explicitly require conditions on new loans were included until 1898. Rothschild’s subsequent record as default manager, which often required more proactive reactions from defaulting governments, was rather negative. When the bank attempted to provide solutions for the partial defaults of Austria and Italy – both governments had introduced a tax on coupon payments of their external loans in 1868 (Fenn 1883; Gille 1965) – Rothschild could not convince them to withdraw this new imposition. Austria’s bonds were banned from the LSE after bondholders complained, and remained so until the Hungarian government, having gained autonomy from Austria, reached an agreement in 1871 that allowed it to issue a new loan. Rothschild’s failure as default manager was not unique. Baring had also been very active in the cases of Mexico, Venezuela, and Argentina during the first half of the nineteenth century, but it obtained mixed results partly due to the banks’ reluctance to commit new funds to these countries.

The case of conditional lending by creditor governments was different in forms though not in the outcomes. The British government, for instance, granted explicit guarantees to the loans issued by sovereign governments, as in the cases of Greece (1833, 1896) and Turkey (1855), all of which led to a reduction in the costs associated with these loans. In return, borrowers were expected to provide the necessary insurances and attach pledges to the loans, and even, if necessary, to accept third party control and monitoring of public expenditure. In the case of the 1833 Greek loan, even though there had been no explicit conditions originally requested, Greece’s repayment difficulties and the need for further advances urged the British government (along with the other

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9 I am grateful to Stefano Ugolini for providing details on these domestic loans.

10 This assertion should be qualified, as it is based on the revision of debt contracts from the archives of certain banks in London and Paris and from the prospectuses published in British Newspapers, such as *The Times*. It could have been that banks had attempted but failed to include conditional clauses in their underwriting contracts, though we have not made a thorough revision of debt contract drafts.


12 See Esteves and Coskun Tuncer (2014) on a pricing analysis of the guaranteed loans by the British government during the nineteenth century.
guaranteeing governments, France and Russia), to impose new pledges and controls on public expenditure. None of these measures, however, prompted the Greek government to resume payments.13

A similar episode involved present-day Turkey, whose loan was jointly guaranteed by the governments of Britain and France to support the Ottoman Empire in its joint war against Russia. The original convention between the guaranteeing governments and the Ottoman Empire did not explicitly include any condition clauses, though it was stated that the loan would enable “His Imperial Majesty to prosecute with vigour the war against Russia.”14 The contract signed between the government and Rothschild, who thereafter underwrote the loan did not include any condition clauses either. This can be explained by the limited role Rothschild assumed, as the bank was merely in charge of receiving the subscriptions at the time of the public offering.15 On the other hand, the Bank of England was responsible for administering funds and establishing a commission that monitored the Turkish public finances. A second agreement, signed between Britain and Turkey, determined the terms and conditions of this commission, though the effectiveness of this procedure failed. The state of the Ottoman Empire’s public finances, which had been meandering even before the war, never recovered and the government defaulted in 1876 (Anderson 1964).16

The case of sovereign defaults in the late nineteenth century

Despite the reversals suffered by merchant banks as default managers, some of these banks were obligated to assume this role, particularly when a defaulting country was willing to issue a new loan – for which banks earned underwriting fees – and was obligated to fill the requirement of no-default from the LSE. However, most of these banks were either unable or unwilling to condition the loans that they underwrote.

13 The pledges and monitoring devices were agreed upon in a convention signed between Russia, Britain, France, and Greece on September 1843. A new Greek government refused to ratify the convention (Wynne 1951). The convention is published in De Martens (1898).
14 Bank of England Archives, 13A84/7/4, “Imperial Ottoman Guaranteed Loan 1855.”
15 Rothschild contract with Constantine Musurus Rey, as representative for the government of the Ottoman Empire. (20 August, 1855). A supplementary agreement between that government and the Bank of England determined that the Bank was the payment agent for the loan. The Rothschild Archives, file 000/401B/15.
16 Lengthy negotiations followed the default before settlement in 1881, which resulted in a more active foreign participation in Turkey’s public finances, whereby creditor governments and different bondholders groups participated. Pamuk (1987: 56) suggests that this agreement was part of a longer process of “imperialist penetration short of de jure colonialism.” While there is an abundant literature that analyzes the link between sovereign debt and colonial expansion, this issue goes beyond the scope of this chapter and is not considered in the present analysis.
on economic policies or any other government action that would avert future defaults. Even in the cases where this was attempted, the nineteenth century, for the most part, represented a history of failed enforcements of policy commitments. During the 1890s, three bailouts on behalf of foreign governments were organized solely by financial intermediaries with attached conditions on fiscal and monetary policies. The 1890 Rothschild committee bailout for Argentina was followed by the 1893 Hambro loan for Greece and some years later by the 1898 Funding loan for Brazil, organized by Rothschild (Flores 2012). In all the three cases, the conditions of the loans aimed at improving the solvability position of the borrowers. However, the results of these experiences were rather disappointing, as the financial position of these governments never stabilized, leading to a lack of compliance.

Argentina’s bailout in 1890 entailed a three-year moratoria and a bondholder haircut that had to be renegotiated in 1893, as the country’s public finances had not sufficiently improved to continue to pay the initially agreed upon debt service (Rapoport 2006). Three conditions were laid down in a set of documents (other than the debt contract), once a bankers’ commission had first prepared a report presented to the Bank of England on Argentina’s economic position in general and on the government’s public finances in particular. The General Bond that accompanied the funding loan enumerated the government’s engagements, which were basically the banker recommendations spelled out in the report, among which: pledging the bailout loan to the revenues from import duties, which had to be collected in gold pesos, avoiding thereby the risk from further exchange rate depreciation; the reduction of the monetary supply along with the formation of a Caja de Conversión, which was to lead to the later adoption of the gold standard; and the compromise not to assume any new external debt engagements.

The 1893 Greek loan shared certain common elements with Argentina’s bailout loan. The conditions were mostly related to

17 The main reason behind this was the short-term nature of the relationship between banks and borrowing countries. The turnover ratio, defined as the frequency at which governments switched underwriting banks, was close to 100 percent for recurrent defaulters (Flandreau et al. 2010).

18 In all three cases, the basic idea was to pay interest on the external loans with new bonds (funding loan bonds) equivalent to the amount due during a limited period of time (usually three years). These new bonds offered interest payments in cash. See Flandreau and Flores (2012b) on Brazil’s funding loan of 1898 and Wynne (1951) and Flores (2012) for the funding loans of Argentina and Greece.
public revenues that would be utilized as a guarantee, and the creation of a “Caisse,” made up of bank agents who were tasked with managing the loan. While a first agreement project between the government and Hambros Bank established a set of clauses with the details related to the Caisse modus operandi, the final convention excluded all of these clauses, which were instead embedded in a decree by the Greek executive. After a change in government some months thereafter, this agreement was not ratified, leading to a debt default (Wynne 1951). A final solution was found in 1896, wherein a second bailout, this time organized with the support of creditor governments and the establishment of an international control commission, as we explain below. Finally, Brazil’s loan, which took place two years afterwards, was a relative success in terms of compliance – the sole condition regarding economic policy was reducing the money supply in an attempt to allow the local currency to appreciate. Brazil’s economic conditions remained poor and the government needed a second bailout in 1914, which was again organized by the Rothschild Bank.

Throughout these examples, one common feature can be observed in the type of conditions put into place in each of the bailout loans. Whereas the conditions related to fund management and the monitoring of public revenues pledged as guarantees were essentially contractual in nature, this was not the case of the conditions that sought to reinforce the borrowers’ capacity to repay the loan and, thus, relied solely on the market mechanism for compliance and enforcement. Babb and Carruthers (2008) classify these type of conditions as the narrowest form of conditionality that can be found when private lenders are the sole agents requiring the conditions. As conditions were not legally binding, exit-options were open, realistic alternatives. On the one hand, benefits from conditionality compliance were directly linked to, first, having market access and second, to lower borrowing costs, as defaults generated increased costs on future loans (Flandreau and

19 The agreement project can be found at the Hambros Archives, Greece 1893 # 27 Ms 19103. The final convention and decree were published in Georgiades (1893), pp. 128–134.

20 Whether development targets were considered in conditional lending is an open issue. Accominotti et al. (2009) quotes the British administrator for Egypt (British intervention in that country followed a default by the Egyptian government in 1873) who suggests that the policies applied to that country probably had a development purpose. Jenks’ (1927) history of international finance presents a subsection devoted to “Foreign loans and public policy,” though he basically advocates for the benefits of free trade and free capital flows and the non-intervention of creditor governments.
Zumer 2004; Tomz 2007). On the other hand, costs could lead to a certain degree of loss of sovereignty, through the acceptance of third-party intermingling and intervening into a country’s economic policies. However, extreme cases of gunboat diplomacy, which had previously been evoked as an important factor that restrained countries from defaulting (Mitchener and Weidenmier 2010), were rare events that did not constitute a norm in the functioning of sovereign debt markets (Tomz 2007; Flores 2012).

From this brief examination, we can conclude that only a handful of underwriting banks attempted to place conditions on their loans: three out of at least ninety-three banks participating in the underwriting market for foreign government loans in the nineteenth century. Given the high concentration in the market (the three banks covered 66 percent of the market between 1877 and 1895, see Flandreau et al. 2010), other banks were not in a position to impose any conditions on borrowers because their enforcement possibilities were weak. However, the dominant banks had an incentive to screen the market and avoid more risky borrowers before issuing a loan; governments would be willing to comply according to lender expectations. The main reason why conditional lending was such a rare event was precisely that the majority of defaults that took place were those issued by minor underwriters, who were unwilling to act as default managers. This meant that finally investors were obliged to find other means to defend their interests, which they did through forming bodies of bondholders, which led to the final establishment of Corporation of Foreign Bondholders and analogue bodies in other countries (Flandreau and Flores 2012b). However, even if attempts were made to impose conditions in their agreements, they were largely unsuccessful.

The final attempt to find more efficient enforcement mechanisms – in which national rivalries would also play an important role – occurred in the case of Greece in 1896. The default resolution was framed with the participation of creditor governments, underwriting banks, and bondholders associations. In 1897, after the defeat of Greece in the Greco-Turkish War, an International Control Commission was established. This was a condition accepted by the Greek government to obtain the necessary additional external funds to meet indemnity payments and to resume payments of defaulted bonds. This commission supervised both that the specific revenues assigned as security for the new loan were delivered to meet the debt service and that the government-pursued expenses did not interfere with the interests of the
bondholders (Wynne 1951). The commission also made recommenda-
tions to balance the budget and to reevaluate the drachma, mainly
through monetary contraction. This body would last even after WWI,
where it was utilized by the League of Nations when the League agreed
to provide support to Greece in the 1920s.

In his analysis on how global capital markets operated in the nine-
teenth century, Pauly (1998) argued that domestic British policy was
largely passive, leaving the market to self-regulate itself during the late
nineteenth century. While this may have been the case for the mone-
tary regime – the gold standard – that dominated the period, it was not
the case for financial markets. As we have seen, there had been a lim-
ited, yet effective amount of state intervention, which was occasionally
utilized and that was to be further developed during the interwar period.
Several practices were employed to justify public intervention: loan
guarantees to third countries, the establishment of permanent fiscal
agents, and the capacity to ban foreign government loans from financial
markets (though Britain pursued a laissez-faire policy) (Fishlow 1985).
States also acted as information providers through embassy network and
the communications they occasionally engaged with underwriters and
associations of bondholders (Ferns 1960).

The approach to enforcement mechanisms was unsurprisingly “prag-
matic” and similar to the approach that the League would adopt after
World War I.\(^{21}\) This meant that when third parties assumed the admin-
istration of fiscal revenues, defending the interests of investors was a
primary objective. The external interference in fiscal management –
the recollection of specific public revenues and their use to secure the
payment of external debts – was a cost that a defaulting country was
required to assume both for geopolitical reasons but also, primarily, to
allow it to maintain its access to financial markets. In the nineteenth
century, certain underwriting banks strongly preferred to request public
guarantees as a condition to issue new loans. Overall, while the absence
of international courts complicated the enforcement of these guaran-
tees, their inclusion could serve to justify the intervention of bond-
holders associations, the banning of new loans from the London Stock
Exchange and most drastically, the intervention of creditor govern-
ments.

\(^{21}\) Pauly (2003) describes the League’s approach compared to the approach followed by the IMF
as “interventionist.” This feature was not exclusive to the League but, as I demonstrate, in line
with practices already present during the nineteenth century.
CONDITIONAL LENDING DURING THE INTERWAR PERIOD: THE LEAGUE LOANS EXPERIENCE

At the end of World War I, the poor state of international credit constituted a major hurdle in the struggle for economic recovery in Europe. The institutional innovations that followed during the 1920s—similar to those of the late 1970s—were multilateral responses to immediate financial needs, even if these innovations were ad hoc measures of coordinated international support that successfully met the targets for which they were conceived. In a nutshell, the Economic and Financial Organisation of the League of Nations promoted the establishment of the economic and institutional policies that were necessary to restore the productive basis of countries in economic distress. This planning would have involved some form of external funding, which generally took the shape of an external long-term loan issued on international financial markets. In these cases, the League served as an intermediary, functioning as a monitor and fund manager, as well as coordinating the intervention of creditor governments when necessary.

Comparatively speaking, the League of Nations emerged as a more ambitious money doctor than its predecessors of the nineteenth century. The conditionality that the League requested adopted two forms: adherence to the programs the League had helped set up and government acceptance of external surveillance and external fund management, including the proceeds from loans and revenues that were attached as loan guarantees. To a large extent, these conditions were related to information asymmetries that were rampant in the early interwar period, given the extremely deteriorated macroeconomic position of most European countries. While adverse selection was in principle absent, the League faced an important problem of moral hazard, as countries had a stronger interest in meeting their most urgent needs rather than achieving long-term debt sustainability. In order to avoid opportunistic behavior from potential borrowers, the League adopted an enforcement mechanism, through the nomination of fiscal agents that directly managed the proceeds from the loans and also a

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22 Even if I concentrated on banks as money doctors, other cases existed that worked close to financial intermediaries (Flandreau 2003).
23 The League provided its support to countries that were unable to obtain resources from private capital markets, so that there was a self-selection process of countries obtaining the League’s assistance.
24 For instance, debt overhang may reduce the incentives of countries to comply with policy reform. See Sachs (1989); Diwan and Rodrik (1992), and Dreher (2009) for a literature review.
monitoring procedure based on the establishment of permanent missions that were in charge of obtaining all the necessary information on public expenditures, the state of the economy, and the progress of the agreed reforms.

The procedure followed by the League for issuing new loans was not different from the work that had been pursued by private bankers in London and New York in the nineteenth century. A preliminary phase was initiated via informal contacts with the borrowing government. Once an institutional demand for support was made to the League, a delegation from the Economic and Financial Organisation was sent to the country. The resulting reports were then presented and discussed at the Financial Committee, which then could draft a stabilization program that would frequently include the need for an external loan. If this was the case, these plans – captured in documents called “Protocols,” which were the government promises regarding economic policies to be adopted – were distributed to the banks that were invited to participate as underwriters.

The similitudes between the League and the banks’ modus operandi can be best illustrated once we analyse the process that led to the loan on behalf of Austria in 1923. Prior to the League’s intervention, the Austrian government had attempted to issue a foreign loan, with Baring and Rothschild acting as underwriters. While the conclusion reached by the banks regarding mainly Austria’s economic condition was not different from the one delivered afterwards by the League – particularly in regards to the possible assets that could be pledged as collateral for the new loan – banks initially refused the deal, only accepting once the League had set up a long-term plan. The League’s participation added value because it provided missing elements, such as support from creditor governments and an enforcement mechanism that went beyond banks’ capabilities, which ultimately allowed Austria access to foreign funds.

In short, the practice of foreign control that the League was soon to implement was no novelty in the 1920s, though it would become democratized as the countries that participated in the League were not limited to those emanating from creditor governments. This implied an enlargement of stakeholders’ participation to allow for increased legitimacy, an argument raised by borrowing governments. Moreover, governments in creditor countries were already actively involved in sovereign debt markets through the imposition of capital controls used during the war. Even as these controls were gradually relaxed during
the 1920s, they remained relevant as a potential voice for governments to intervene in their financial markets. In Britain, the British Foreign Office, along with the Bank of England later on, was in permanent communication with underwriting banks and could encourage or refuse any loan to foreign governments (Ziegler 1988). A similar process was taking place in the United States, in which banks were in permanent communication with the US State department (Rosenberg & Rosenberg, 1987; Chernow 1990).

**League involvement in the 1923 Czechoslovakian loan**

How the League came to adopt such a prominent role in the financial markets of the interwar period is not a settled issue. One way to respond to this question is to identify the needs of market actors that would have required some form of public intervention that were specific to the new conditions of the interwar period. This new environment, however, could also have helped to consolidate a growing trend toward the more active intervention of creditor governments in private financial markets that had already been present since the late nineteenth century. This could be seen, for instance, by the introduction of compromissory clauses in sovereign debt contracts (on this point, see Sgard in this volume). In fact, it was a fortuitous event that would trigger a debate within the League that would lead it to increase its participation in the contracting process of sovereign lending during the 1920s. It was the League involvement in the 1923 Czechoslovakian loan that was responsible for the now-famous arbitration clause in the contract negotiated between the Czechoslovakian government and Baring. Although arbitration clauses were still rare in the sovereign debt contracts issued in London, they had been present since the mid nineteenth century (Weidenmier, 2010).

There are two major points that would determine the League’s role in the market for sovereign debt. One is related with the reason for the appearance of arbitration clauses; the other is the choice of the arbitrator. According to Weidenmaier (2010), the original motive for the emergence of arbitration clauses in the United States was to involve states from creditor governments in the resolution of potential

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25 To some scholars, the League was set up as a means to defend national interests, in particular those from Britain and the United States. See for instance, Hogan (1977); Orde (1990) and Berger (2003). For a different view, mostly related with the necessities of the world economy, see Eichengreen (1989), and for a case study (Austria) see Beyersdorf (2011).
conflicts with borrowers. This would also explain the choices of arbitra-
tors, which were mostly, though not always, US politicians. Arbitration
clauses became common in many loans issued in New York on behalf
of Latin American countries in the early twentieth century.

The inclusion of arbitration clauses also became a widespread
practice in London during the interwar years. For Pauly (1998:52),
Czechoslovakia can be described as the first country that the League
assisted: the League Council acted as arbitrator in the contract signed
with Baring. The need for an arbitrator surged when Baring and
the Czechoslovakian government initially disagreed about the bank’s
request to administer customs and tariffs receipts pledged as security
for the loan, a request that the government refused to concede (Pauly
1998:53). But this statement should be qualified, as the League’s role
was limited – loan negotiations certainly did not hinge on the inclu-
sion of this clause. Furthermore, the League did not serve as an arbitra-
tor. The Council of the League was invited to nominate the Financial
Committee, or any other committee or representative, who would be
empowered to make the best arrangement to protect bondholders.26
This subtlety was considered relevant because the Council sought to
avoid any involvement in actual financial activities and responsibili-
ties. In fact, archival evidence further demonstrates that the League
did not perceive itself as being in a position to settle disputes arising
from debt contracts, though the Council was empowered to nominate
arbitrators.27

The parties also disputed the amounts of the loans and the legal guar-
antees on the securities offered by the Czechoslovakian government. In
regards to the first issue, Baring would only agree to underwrite the loan
once it was clear that a major part of the loan would be issued on the
New York market.28 As for the second issue, the Czechoslovakian gov-
ernment agreed to provide as security for the loan the receipts from
the Tobacco Monopoly and on Customs duties, though it refused to
pass a law to formalize this part of the agreement. This was a condition
that Baring required, as it doubted that the Prime Minister could legally

26 Letter by the Secretary General of the League of Nations to Dr. Vilem Pospisil dated the 12th
September 1922. The League of Nations Archives, Box R 376, file 20068. This was essentially
the resolution adopted by the League on July 21, 1922.
27 Comments to the Draft resolution of the Council by Jost Van Hamel, Director of the Legal
Section of the League. 4 July 1922, The League of Nations Archives, Box R 376, file 20068.
28 Negotiating details between the Czechoslovakian government and Baring can be found in ING
Baring Archives, Folder 2011882.1.
provide these securities. In the end, the government agreed to vote on a law that would authorize the government to contract the loan and provide the previously agreed upon securities.

The League could not intervene in any of these disputes. The mediation role was provided by the British chargé d’affaires in Prague, as he was in contact with both Czechoslovakia’s government and with Baring. He provided background information to the bank and gave his personal impression and advice on specific matters. On the contrary, the banks cast serious doubts about the convenience of having the League as an arbitrator and pushed for a London-based arbitrator instead. The banks had been similarly displeased with the second potential candidate, the Hague Tribunal. As in the case of the League, the banks contemplated the possibility that the Tribunal would cease to exist before the loan was completely reimbursed. These fears were not unfounded regarding the Financial Section of the League. In fact, at the moment where the Council had finally accepted the arbitration clause, the Financial Section’s usefulness was being called into doubt and faced the risk of definitive closure (Jacobsson, 1979:48). As we shall see, it was rather a problem related with the economic need of a country in financial distress which was determinant for the League’s own future as a main actor in international financial markets.

**League involvement in the 1923 Austrian loan**

The proposals advanced by banks and different governments to support Austria, on the other hand, counted on the active participation of the League. Among these proposals, Austria was the only country in which the “Ter Meulen scheme” could be implemented (Myers 1951:493–494; Eichengreen 1995:156–157; Schuker 2003:58–59). This program aimed to support international trade through obtaining government guarantees and other securities that would be administered by the League. Its financial committee was also actively making proposals to facilitate the reconstruction of Austria, both at a diplomatic and at a more internal, technical level. While none of these proposals were actually implemented, the degradation of the situation only emphasized the need for international cooperation. Though not providing any

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29 This is reflected by the correspondence between the bank, Czechoslovakia’s government and the British chargé d’affaires in Prague. ING Baring Archives, file 201882.1.

30 Draft proposals for the inclusion of indemnity and arbitration clauses in agreement sent by Baring to Dr. Pospisil. 21 January 1922. ING Baring Archives, file 201882.1.

31 Named in reference to the Dutch banker who designed it.
definitive solution, bilateral short-term loans were provided by several
countries. (Williams 1929). Austria’s government had also been unable
to obtain a long-term private loan, though a reversal of this situation
was envisaged through a third-government guarantee. This was initially
refused by the Allied Ministers. However, this guarantee was obtained
some months later and was considered a major diplomatic success in
the history of the League.

The contrast between the Czech Republic and Austrian cases is
emblematic. Both states approached Baring (along with other New
York banks in both cases) to request that it underwrite their new loans.
In both cases, informal contacts were followed up on by the bank, which
sent agents to analyze the economic situation of the country and the fis-
cal position of the governments. While the bank ultimately decided to
underwrite the loan on behalf of the government of Czechoslovakia, it
refused to do so for Austria.

In fact, the role of Baring in Austria was complementary to the
League’s activities in that country. The Financial Section prepared
a program before the enquiry and the procedure foresaw meetings
with the Chancellor and leaders from the main political parties to dis-
cuss the nature of the enquiry, and with different commissions to dis-
cuss the fiscal budget, the state of public enterprises, and that of the
agriculture and the industrial sectors. Each of these commissions was
composed of members of the government along with representatives of
other social groups, such as industrialists, trade union officials, and other
non-official representatives from particular sectors. The aim of these
commissions was to provide a general overview of the problems faced
by each particular sector, along with proposals and policy measures to
address them. The reports of each commission were to be delivered in
two months, and were to be accompanied by an additional report that
was to be prepared by Austria’s statistical bureau and Baring’s own rep-
resentatives. Finally, the program foresaw that additional work was to
be pursued in order to take control of the Austrian Bank of Issue and of
the customs revenues. The League, then, appeared as one of the agents
whose agreement was necessary, along with that of other governments
and the Reparations Commission, to accept a scheme that would fore-
see this kind of control.

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32 This enquiry was to be based on a plan advanced by Dr. Rosenberg, who was advisor to Alfred
Gürtler, Austria’s Finance Minister. See Marcus (2011:33).
33 The Program was originally prepared by G.M. Young, director of the Anglo-Austrian Bank,
and then distributed to the banks interested in the loan (J.P. Morgan, Schroeder, Rothschild,
The Baring case is one example that can be extrapolated to other banks in London or New York. J.P. Morgan also actively selected countries to collaborate with Latin American countries were typical examples. In the early 1920s, the bank received requests for either short- or long-term loans from Brazil, Colombia, Peru, Paraguay, and Argentina. J.P. Morgan was equally active in debt negotiations with Mexico, a country that, although it was in default, was important for the bank given its commercial and financial activities. US government representatives also served as an intermediary between the bank and the local borrowing country. As in the case of Britain, once the bank assumed a favorable position on these requests, it sent a letter to the US Secretary of State to confirm that the Department posed no objection to the operation. The replies specified that this did not imply any responsibility regarding the transaction or whether the approval should be advertised in the loan’s prospectus.34

The economic information required was not different from the Baring case, which was related to the gold reserves at the central banks, floating and consolidated debt levels, current external and internal loans, and the state of public finances and of the current account. The correspondence with their agents and American diplomats also concerned the political situation and the evolution of major sectors of each economy. These were the kind of tasks evoked by the EFO of the League, which continued with these practices and formalized the coordination efforts with creditor governments.

League involvement in defaults caused by the Great Depression
After the eruption of the economic crisis that hit Central Europe in the early 1930s, the Economic and Financial Organisation had to deal with the problem of sovereign defaults. Before those critical years, the League was only indirectly obliged to act on behalf of the countries it supported that were in default. This was the case of Bulgaria, whose default consisted of some loans the government had issued before the war. The government had been expected to reach a permanent agreement with the bondholders before issuing a new loan, as this was an

Baring, on the 28th May 1922). ING Baring Archives file 203202, pp. 6–8. Baring also sent an additional questionnaire to be answered by Austria’s government regarding the particulars of the loan requested, such as purpose of the issue, amount, securities, other debts, current account, and information regarding the efforts by the government to reduce the budget deficit.

34 Some examples on loans to Latin American countries can be found in ARC 1214 (15), Vincent P. Carrosso Papers. The Morgan Library & Museum.
implicit condition that the League required to grant its support. However, the League did not directly intervene in the negotiations.

The focus of the League in regards to sovereign defaults can be described as preemptive. The design of each debt contract reflected this approach, as the League drafted a set of clauses that attempted to preemptively discourage debt service disruptions. That was the main motivation behind the existence of trustees, figures that were systematically included in all contracts, who could also act as payment agent, but whose main motivation was to defend the interest of bondholders (Borchard 1951). Trustees were in charge of managing of the proceeds of the loans and on ensuring that sufficient revenues would be provided to service the loan. In the event of default, nevertheless, the trustee could only “make it good out of the entire assigned revenues” (Tyler 1945:53), but was excluded from undertaking any other actions, such as a foreclosure, and appeals were limited to the League Council.

Nonetheless, the Council could only act as arbitrator between trustees and governments in the case of disagreements or differences in the interpretation of protocols. Moreover, an implicit fragility stemmed from the conception of the stabilization programs and the debt service requirements from the external loans. The type of intervention planned by the League corresponded to the League’s overall economic policy principles, which were centered on the promotion of liberal trade, balanced budgets, the adoption of the gold standard, and the establishment of autonomous central banks (League of Nations 1930). While these objectives could be attained in a brief period of time, the time span needed to achieve a sustainable position as a borrower was far more uncertain. In most of the League’s stabilization programs, the League promoted loans that had a long-term maturity (typically twenty years), as this focus was most in line with the objectives of the League (Polak 1991). Comparatively speaking, this was in blatant contrast with the practice that the IMF would develop in the post-1945 period, and whose programs, along with the necessary attached funds, have

35 This recommendation was established by the Financial Committee and expressed in a Council meeting on June 1926 (Tyler, 1945, p. 102; League of Nations Archives, Box R 434, file 52081). The “encouragement” by the League for such an agreement was also provoked by the recurrent petition for League involvement made by national bodies of bondholders and underwriters from defaulted bonds (League of Nations Archives, Box R 434, file 51919).

36 The loans were issued in tranches, and were denominated in the currencies of each financial market. In the last loans the currency utilized were limited to British pounds and US dollars.
focused primarily on the short term (see section “Discussion: The IMF practice of conditional lending in historical perspective”). Even with a long-term focus, the Commissioner-General, who was the permanent agent responsible for carrying out the program, was expected to leave once the objectives set out in the protocols were achieved. For the first loans (Austria and Hungary), this took place after three and four years, respectively. The consequent maturity mismatch resulted from the fact that while the proceeds from the loans were utilized during the first years of the programs, often to deal with emergencies resulting from the reconstruction needs of the war or the destabilization from unexpected internal or external shocks (such as the resurgence of inflation in Central European countries in 1924), the contracted loan had to be repaid over a much longer time span. This implied that the immediate enforcement mechanism stemming from market-related incentives vanished. The indirect incentives to commit to the League’s imposed conditions, which League support was contingent upon, were thus limited in several regards. Once the Great Depression affected financial markets in creditor countries, the League could not offer alternative tools to impede a financial meltdown. As the enforcement mechanisms failed, defaults became the natural outcome.

In fact, in the 1930s, the majority of League loans were in default. At the onset of the crisis, a default by Austria had been adverted under exceptional circumstances. A severe banking crisis erupted in 1931 (the famous Credit Anstalt crisis) that could only be faced through public support and a short-term advance by the newly established Bank for International Settlements (Toniolo 2005). As the government position weakened with the economic crisis and debt default threatened, the League coordinated actions from the governments that had guaranteed Austria’s 1923 League loan to issue a new loan in 1933 and then a second conversion loan in 1934 (Marcus 2011). The conditionality requested by the guaranteeing governments in exchange for their support was embedded in the Austrian Protocol (also known as the Protocol of Lausanne, signed on the 15 July 1932), which had to be ratified by each government afterwards. The new protocol included many of the same provisions as the protocols agreed upon in 1922, including monetary and fiscal policy and the need for a permanent advisor for

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37 In the case of the IMF, the incentives to adopt recommended policies depended on previous relationships with the organization.

38 The protocol and its annexes are published in Hudson and Bacon (1937:84).
the central bank and a General-Commissioner. Historians have further emphasized the commitment adopted by Austria to ratify one particular condition, which was already included in the first protocol of 1922, in which Austria refused to form a customs union with Germany. The non-compliance would later create a legal controversy with the Anschluss in 1938, 39 though the payments for the Austrian guaranteed loans continued to be temporarily paid by Germany under the terms of Anglo-German transfer agreement (Borchard 1951).

Nevertheless, for other defaulting countries whose loans were backed by the League, no support from third governments was available. Even the League itself, lacking its own funds, could not provide additional funds. That being said, as The Economist echoed in the first meeting by the League loan committee – formed in 1932 to act as a negotiating agency between bondholders and defaulters – that even if the League held no legal obligation toward bondholders, the moral responsibility was “clearly a heavy one.” 40 However, the experience of the League loan committee was short and unsuccessful, as no permanent agreement could be reached before World War II.

Unsurprisingly, modern scholars have evaluated the League’s focus and reaction to sovereign defaults as that of plain failure. These criticisms join other more macroeconomic arguments, such as Fior (2008), who blames the League for the poor economic performance of the countries in which it had intervened. For him, the League – as any other global institution interacting with financial markets – served to diffuse specific economic policies, related to the dominant liberal traditions of the time, and that later contributed to amplify the effects of the Great Depression. Another set of criticisms refer to the League’s failure in terms of monitoring. Pauly (1997, 2003) has emphasized that the League failed to implement multilateral monitoring schemes and that this failure foreshadowed a similar failure by the IMF. Highlighting the tension between free capital markets and democratic governments’ sovereignty (or freedom of action), two features that were already present during the interwar period, Pauly believes that the League’s inability to develop a system of multilateral surveillance centered on international institutions, suggests that the IMF will similarly

39 Hendrik Willem Verzijl (1968:362) has argued that Austria’s government never fully ratified the protocol as the Bundesrat rejected it. One year after the loan’s issuance, the League agreed to deviate part of the loan proceeds for finance public investment schemes to alleviate the unemployment problem. (Bischoff et al. 2003).
40 The Economist, 24 September 1932.
fail if a recession is substantial enough that debtor nations can no longer reimburse their debts.

The literature, nonetheless, is not completely in agreement with this pessimistic vision of the League Loans. Some scholars, such as Sargent (1983) or Santaella (1993) see a relative success in the League’s experience securing sovereign debt contracts. These authors cite the fact that inflation rates strongly diminished in the countries where the League intervened (Sargent 1983) or that debtor countries gained credibility when announcing economic policies promoted by the League (Santaella 1993). The League’s own critiques, while recognizing the negative performance of the countries after the Great Depression, attributed the lack of expected results to external factors, such as the rise of protectionism that prevented implemented programs from obtaining better results (League of Nations, 1945). However, there was perhaps less confidence within the League regarding the appropriateness of its stabilization plans. Clavin and Wessels (2004) have shown that the League’s Gold Delegation had already raised questions around the convenience of the policies it promoted in relation to the adoption of the gold standard. This self-criticism may sound familiar to contemporary scholars, as they do not strongly differ from those occasionally raised by the IMF.41

A general agreement can be extracted regarding the effectiveness of the League in enforcing and monitoring the programs it implemented. The debate about compliance, now recurrent in IMF programs, did not emerge in the case of the League – at least in the short-term – as countries were prevented from adopting policies other than those agreed upon in the protocols.42 These documents, that enumerated all the conditions that the country had to fulfill to secure the League’s support, do not differ strongly from the Technical Memorandum of Understanding later utilized by the IMF. While the protocols as such had no legal validity, governments were expected to ratify them in parliament and thus become national acts, along with any other measures that may have been necessary for the implementation of the stabilization programs, regarding particularly the League’s permanent agents. The League’s ex post analysis, speculated on what would have happened in the absence of any multilateral organization in the 1920s. Their view suggests that

41 On these criticisms raised in the aftermath of the Argentinean crisis of 2001 see Sgard (2005).
42 On the contrary, certain authors have criticized the character of the League as too intrusive (Pauly 1996; James 2003). For Myers (1945) this may have been a reason why many countries refrained from requesting the League’s support.
the market would have intended to impose the same kind of conditions, though countries would have had more facilities to repudiate its engagements (given the lack of “safeguards” granted to the League by borrowing governments), thereby making their loans more expensive (League of Nations, 1945:59). Flores and Decorzant (2015) have further demonstrated that this assertion should be qualified. While the conditions regarding economic policies were similar for other countries that issued new loans with third-party intervention, the monitoring setting was not different from that implemented by the League. These authors show, however, that negotiating times and loan costs were higher in comparison to the League loans.

DISCUSSION: THE IMF PRACTICE OF CONDITIONAL LENDING IN HISTORICAL PERSPECTIVE

Previous literature has placed considerable attention on the continuity, contrasts, and parallels between the League’s Economic and Financial Organisation and the IMF. Legal, economic, and political science scholars have drawn parallels between our contemporary period and the interwar years; historians have provided detailed descriptions of the evolution of our monetary and financial regimes during the twentieth century (Santaella 1993; Sargent 1983; Eichengreen 1989; James 1996; Gulati and Weidemaier 2014). Money doctors, as they became to be known, were in vogue during the 1920s as much as they were in the 1990s, when scholars debated the costs and benefits of their intervention in financially distressed countries. Disagreements in the literature cover a wide range of issues, such as economic performance, social costs of the programs implemented, positive and negative effects on financial markets, and the impact on internal political issues.

Nevertheless, while the existence of historical parallels between the League and the IMF has been emphasized in the literature, there is also a need to recognize the contrasts between these two experiences. First, the League and the IMF were conceived under far different initial conditions. Accordingly, the objectives faced by the League and by the IMF differed in their scope, methods, and perhaps even by the willingness of member countries to succeed. If anything, near to the 1982 debt

43 I have argued in a previous article that the literature on the League’s loans coincided with the first years of the Bretton Woods institutions (Decorzant and Flores 2012).

44 On the history of the IMF see Horsefield (1965) and Boughton (2001).
crisis, the IMF’s targets approached some of those noted by the League (Pauly 1996; Bordo and James 2000; Sgard 2004), as explained below. In fact, while the League’s ultimate target was reconstructing the productive basis of the countries where it intervened, the IMF initially concentrated on the balance of payments’ position of borrowing countries, in order to guarantee that the payment system functioned smoothly, as had been agreed upon in the Bretton Woods meetings. With the emergence of Euromarkets in the 1960s and the increasing liberalization of international capital flows, the IMF also evolved to meet the necessities of the world’s financial system. Default, debt management, and the need to have access to external funds – from both the IMF and private financial markets – appeared to become the novel targets that were to be attained in the late 1970s, a field that, to a certain extent, the League had pioneered.

Conditional lending practices, moreover, differed in origin. In the case of the League, the main enforcement mechanism was linked to the primary access to private financial markets. The IMF, on the other hand, would provide its own external support for a very short-term (six months for its first stand-by agreements, in the particular case of macro-economic imbalances). From this perspective, the IMF introduced certain innovative aspects in an attempt to avoid fragilities introduced into sovereign debt contracts of the 1920s, in particular, the short-term nature of the loans made available to governments. Private financial markets were an alternative exit-option that limited IMF’s conditional lending during the 1960s, a natural effect from the IMF’s countercyclical nature.

Once the crises of the 1970s erupted and international liquidity eroded, the IMF provided a “certification effect” similar to the one offered by its League antecessor. In both cases, the League and the IMF tried to support the economic and financial sustainability of countries that were willing to access capital markets.\(^45\) In both cases, these institutions based economic policy plans on the credibility of their programs, in other words, the \textit{ex-ante} perception that countries would comply with the conditions by reducing the exit-options, providing enforcement mechanisms, and minimizing transaction costs. In both cases, the institutional innovations succeeded, to a certain extent, in attracting capital to borrowing countries. Portugal is a typical example of this,

\(^{45}\) Khan and Sharma (2001) argue that the IMF needs to obtain assurances that it will be repaid and links this to the necessity of conditionality.
as the country was only able to borrow from international commercial banks once it entered into a stand-by agreement with the IMF, a condition which was requested by lenders.\footnote{IMF Archives, EBM/78/81 and EBS/78/228.}

In the years leading up the 1982 debt crisis, however, this information provision role played by the IMF would prove to be problematic. In fact, the evolution of the IMF as crisis manager and active participant of international debt markets raised challenges that the League did not face. For instance, the IMF may face potential problems of adverse selection from the population of potential borrowers, but also moral hazard, both from borrowers and lenders. Sgard (2016) has furthermore remarked that, given its recurrent and long-term relationship with borrowing countries, the IMF has developed privileged access to soft information, although the basis of this continued information flow is confidentiality. While the IMF has sought market efficiency through the provision of hard information, Sgard identifies a trade-off between both. On the contrary, this distinction did not exist in the 1920s. The League’s commitment to transparency obliged this body to make the discussions of the Council public, its resolutions and the reports of the Financial Committee’s missions to borrowing countries. Nevertheless, a salient similarity in both cases is the fact that conditionality emerged as a distinctive element that was unavailable to other private intermediaries during the 1970s or to creditor governments, as it had been during the 1920s.\footnote{Sgard (2016) evokes the failed attempts by commercial banks to condition their loans. A comparison between bilateral and multilateral support to countries in Central and Eastern Europe in the 1920s is provided in Decorzant and Flores (2015).}

Finally, the experience of the IMF as crisis manager and promoter of financial integration presents new problems (or issues) that surpass those experienced by the League. In the debt negotiations that followed the 1982 Mexican crisis, the IMF conditioned its own support on commercial banks continued participation in Mexico and later, also in other defaulting countries. In contrast to the League, the IMF was not an external agent or pure mediator between lender and borrowers, but could have an impact on negotiation outcomes: this was reinforced by the active intervention of creditor governments. Alvarez and Flores (2013) have, for instance, demonstrated that the availability of trade finance to countries that defaulted but adopted an IMF program did not diminish in the wake of the crisis. This was made possible by the intervention of national export credit agencies, whose support had
been firstly conditioned by the countries’ entering into an IMF program. Nevertheless, subsequent actions by the IMF have been controversial in terms of their effect on private capital markets. 

In conclusion, an ex post perspective of the long evolution of international finance demonstrates that IFIs made conditional lending possible and conditionality allowed for the development of a sovereign debt market. The nineteenth century offered partial solutions to the problem of default management and prevention. The interwar period saw the first attempt to provide a more comprehensive solution through the cooperation of creditor governments and underwriting banks, while providing long-term development plans to borrowing countries. These innovations led the way for a more ambitious effort that took place in the post-World War period. The conception of the IMF followed the logic evolution of previous IFIs – the first stabilization plans in the 1950s were not radically different from the League’s reconstruction loans – though adapted to a new economic and monetary regime. Furthermore, the IMF’s disposal of its own resources has allowed it to act in a counter-cyclical manner. This feature has furthermore isolated the IMF from the market mechanism logic of the nineteenth century and interwar period and given it the capacity to act as a lender of last resort, a major advantage over the tools the League had at its disposal.

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48 The debate on the signaling effects of IMF interventions, see Saravia and Mody (2003).


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