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Laura Rama Iglesias
Alison Schultz

**What Kinds of Challenges
Does a Debtors' Cartel Face?**

An Analysis of the Latin American
Debt Crisis

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No. 02/2015

Department of Social
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Abstract

This paper explores the challenges that debtor countries face while trying to cooperate in debt negotiations to strengthen their position vis-à-vis the creditors. With that purpose in mind, we study the Latin American debt crisis of the 1980s. The *lost decade* of the region is remembered for the devastating economic and social impact of the crisis and the neoliberal measures undertaken. These measures imposed on the Latin American countries in debt have set standards for today's approach of multilateral organizations when dealing with similar situations. The nature of the Latin American debt crisis was different from previous crises because for the first time the international community considered it a political issue requiring the attention of multilateral organizations. Thanks to the support of the international community alongside the mechanism of syndicated loans, creditors were able to act in unison to push the debtors to accept uneven adjustments.

A thorough analysis of the Latin American debt crisis and its negotiation processes reveals several insights. To the countries in debt, a debtors' club is a crucial instrument to improve the bargaining position and retain autonomy in debt negotiations. However, our analysis shows that, in spite of being in the interest of most debtor countries, the forming and maintenance of a debtors' cartel comes along with serious challenges. Firstly, despite the fact that they are all highly indebted, countries in crisis often differ regarding the political and economic situation and their ties to the creditors. Secondly, internal struggles and particular interests can prevent a country from fostering its "real" interest of joining a debtor's club. Thirdly, given the power of the creditors, the serious threat of sanctions and the offering of concessions, debtor nations face a collective action problem. Although every country would benefit from the alliance, each individual debtor has an incentive to defect, leave the union and accept the concessions. In the case of the Latin American crisis, each of these obstacles were particularly challenging as debtors found themselves in an unstable political situation and were confronted with a strong alliance of creditors enjoying the support of "their" governments as well as of the international financial institutions.

Our analysis further illustrates that the framing of the crisis is crucial. Finance in general and debt in particular, are no material reality. Both the financial system and debt obligations appear as a material reality only as long as existing structures are defended and repayment is enforced by the repressive force of the state. Political action can change, but this will only be possible with a change in the framing of whom to blame for the crisis, to whom a democratic government should listen and to what extent governments in creditor countries must care about "their" banks as opposed to the interest of humanity.

1. Introduction

This paper explores the obstacles that debtor countries face in acting in a coordinated manner to strengthen their position in negotiations with creditors. The study of the Latin American debt crisis of the 1980s provides a very illustrative case showing that despite the fact that the countries involved had some common similarities and problems, the significant gains that could have been achieved by the formation of a debtors' cartel or debtors' club were not realized. Because of the devastating impact of the crisis, the 1980s are known as the *lost decade* for the region. Some further factors make its study relevant for the field of Global Political Economy. The negotiations of the Latin American crisis can be seen as an important shift, as for the first time debt negotiations were considered a political issue requiring the attention of multilateral organizations such as the World Bank and the International Monetary Fund (IMF). The neoliberal measures undertaken in the region have established the current approach of these institutions. We believe it is important to study previous cases, as the problem of debt crises is far from resolved and the current strategy resembles the one used in our study case. For the first time in the Latin American debt crisis, creditors were able to achieve unified action backed by governments and multilateral institutions, pushing debtors to accept uneven and often counterproductive adjustments and conditions that hid the mixed causes of the crisis and its social consequences.

With the purpose of understanding the Latin American case and the attempts and challenges to create a cartel or club of debtors, the paper first presents the historical and economic context of the Latin American debt crisis. Following, attempts at joint action by the debtor nations will be explained alongside the reactions of the creditors, their governments and multilateral organizations. In particular, we will explore the Cartagena Consensus alongside the pronouncements and petitions made by the group. The fourth section will address the main challenges for coordinated action in the context of the debt crisis and the reasons why, despite the significant potential gains, the members of the Cartagena Consensus were not successful in unifying to defend their common interests.

Before going into detail, it is worth clarifying what we understand as a debtors' cartel and its possible connotation. Generally speaking, a *cartel* is an agreement between competing firms to control prices and quantity, or prevent new competitors from entering the market. In our case, the literature has used the term to refer to an organization created from a formal agreement between countries with similar problems and interests that could benefit from joint action. As will be explained, in the Latin American debt crisis a formal agreement was

reached by the Cartagena Group. The agreement was eventually only successful to the extent that Latin American countries established a permanent forum on debt issues. However, the political pronouncements and proposals of the group did not lead to collective action.

An alternative concept used in academia is *debtors' club*. Although on some occasions both terms were also used to refer to creditors, it is our belief that the frequent negative connotation of the word *cartel* could have been used to delegitimize the steps of the debtors towards coordination to reinforce their position. Thus, creditors and their governments could have chosen the term to frame the debt problem as one exclusively generated by the debtors. Following this, debtors would be morally obliged to pay the debt back, and consequently judged for not fulfilling their responsibility. Therefore, we would like to emphasize that our position does not encompass attempts to discredit the actions of debtor nations. As in the literature, both terms will be used here in reference to the agreement between debtor countries to act in a coordinated manner.

2. Context: The Latin American Debt Crisis

The Latin American debt crisis of the 1980s – or the *lost decade* – implied that many countries in the region became unable to service their foreign debt, which eventually led to debt rescheduling of sixteen Latin American countries. As Sims and Romero (1982) point out, '[t]he spark for the crisis occurred in August 1982, when the Mexican Finance Minister Jesús Silva Herzog informed the Federal Reserve chairman, the US Treasury secretary, and the International Monetary Fund (IMF) managing director, that Mexico would no longer be able to service its debt, which at that point totaled \$80 billion'.

The large oil price shocks of the 1970s created account surpluses among oil-exporting countries, which with the encouragement of the US government pushed many large American banks to invest in several Latin American countries with account deficits. These private banks acted as intermediaries between the two groups of countries, providing the exporting countries with a safe liquid place for their funds and significant flows of money to the Latin American countries (FDIC 1997, cited in Sims and Romero, 1982). As Ocampo (n.d.) has explained, the recycling of petrodollars provided abundant financing for the region in the second half of the 1970s. High levels of liquidity in the Eurodollar market combined with high commodity prices generated significant incentives for heavy external borrowing.

As reported by the Federal Deposit Insurance Corporation (FDIC), '[a]t the end of 1970, total outstanding debt from all sources totaled only \$29 billion, but by the end of 1978, that number had skyrocketed to \$159 billion. By 1982, the debt level reached \$327 billion' (FDIC 1997, cited in Sims and Romero, 1982). Similarly, Ocampo (n.d.) mentions that in the period from 1973 to 1981, Latin America accounted for over half of all private debt flows to the developing world.

One of the new characteristics of this crisis was the fact that 'private banks played a much more active role in this phase of rapid indebtedness' (Palma, 1984: 93). According to Palma (1984), they served as main providers of the credits demanded by the developing countries recycling the petrodollars. However, the credit policy they practiced frequently violated basic rules of banking prudence and can be judged as careless. The boom in external financing in the region was part of a broader movement to rebuild the international capital market that had grown through the Eurodollar market in the 1960s and which has been prominently described by Helleiner as the 'reemergence of global finance' (Helleiner, 1994). This process was characterized by strong competition among a growing number of banks providing funds in the international market and guiding the entrance into this market

of smaller banks through the use of syndicated loans. Syndicates mean that loans were granted by a large number of banks that included small and medium sized institutions led by a few large banks. Indeed, according to Palma, 'the nine largest United States banks had a very high degree of exposure and risk in Latin America, having granted, on the average, loans for 1.5 times their capital and seven percent of their assets to only five countries in the area' (Palma, 1984: 93).

The low interest rates of the 1970s were not possible to sustain when, in the 1980s, the industrialized world prioritized reducing inflation. As a consequence of the monetary policies of the United States and Europe, nominal interest rates rose globally in 1981 and the world economy entered a recession. Latin American countries experienced abrupt rises in the interests of their loans and the situation became unsustainable. As Sims and Romero (1982) explain, many commercial banks stopped lending money and tried to collect and restructure existing loan portfolios.

As Ocampo (n.d.) indicates, financial crises in their various dimensions have been a recurrent phenomenon in Latin America's economic history. However, Devlin and French-Davis (1995) claim that the crisis of the 1980s has one element in common with previous crises in the region, namely the excessive enthusiasm on the part of the creditors to extend finance and on the part of the countries to go into debt, but the similarities end there. Several authors have remarked on the different nature of the events of the 1980s, not because of their causes, but because of the international response to the crisis and the contractionary macroeconomic policies undertaken. The policies and international pressure were 'associated to the management of the domestic banking crisis which the U.S. simultaneously faced' (Ocampo n.d.:2). The author believes that the policies pursued to avert a default in Latin America helped the US avoid a banking crisis and clearly benefited its banking system, but did so at the cost of a lost decade of development in Latin America. Indeed, as Ocampo stresses, between 1980 and 1990, the poverty rate climbed from 40.5 percent to 48.3 percent and the deterioration of income distribution increased inequality in the region.

Historically speaking, 'the 1980 crisis is unique because of the tremendous coordination creditors achieved among themselves (...) during the 1980 crisis, some of the financial rescue mechanisms that governments typically used to deal with systemic financial problems in their national markets were employed at the international level' (Devlin and French-Davis, 1995: 128).

As Sims and Romero (1982) point out, ‘as the crisis spread beyond Mexico, the United States took the lead in organizing an “international lender of last resort”, a cooperative rescue effort among commercial banks, central banks, and the IMF that pushed private banks to restructure the countries’ debt’. In addition, the Latin American countries received some financial support from the IMF and other official agencies to pay part of the interest. Meanwhile, as mentioned above, strict structural adjustments were required for the debtor countries.

The enormous body of creditors was predominantly located in rich countries with voting power to control the IMF. This situation led to an unbalanced system in which the powerful actors designed a program capable of averting an immediate crisis and saving the commercial banks, but at the cost of heavy social and political problems in Latin America. Many countries in the region cut spending on infrastructure, health, and education, and froze public wages (Sims and Romero, 1982). According to the authors ‘the result [of these measures] was high unemployment, steep declines in per capita income, and stagnation or negative growth’ (Carrasco 1999, cited in Sims and Romero, 1982).

Following Durán (1986), this type of adjustment program is grounded in the (early) idea that the problem faced by the debtor countries was one of liquidity and not one of insolvency. Therefore, it was supposed that short term assistance would restore internal equilibrium in the countries by putting them back on a sound economic base. As the author indicates, ‘the expectation was that the implementation of this program would lead to the eventual restoration of the debtors’ creditworthiness which would, in turn, lead to the resumption of voluntary lending. However, the theory did not match the practice’ (Durán, 1986: 84).

3. Attempts at Joint Action and the Cartagena Consensus

As mentioned before, large-scale macroeconomic adjustments were made on the assumption that the crisis would be mainly a problem of liquidity, and therefore short lived. Supported by the governments of developed countries and especially by the United States, creditors conducted negotiations on the assumption that the short-term liquidity problem required case-by-case treatment.

Thus, as explained in the previous section, the strategy followed from the beginning of the crisis in 1982 to 1985 was mainly one of austerity in which conditions were established by the creditors and the international lender of last resort.

However, during this time debtors started to acknowledge and focus on the political and collective nature of the situation alongside the fact that both debtors and creditors were responsible for the crisis. In this sense, it has been said that in the years of crisis 'Latin American officials started voicing their belief that it was not only internal factors that had created the debt crisis. External circumstances and policies in the industrial countries were also to be apportioned part of the blame. Therefore, they argued, it was logical to expect that the burden of responsibility should be more evenly shared' (Durán, 1986:85). According to Durán (1986), leaders stressed that despite the high social and political costs, Latin American countries had fulfilled their financial obligations and the major adjustments and efforts should have been accompanied by a parallel reaction from the banks and creditor countries.

After the Mexican financial collapse in 1982, the United Nations Economic Commission for Latin America (ECLA) and the Latin American Economic System (SELA) prepared a document to develop a strategy to deal with the economic difficulties in the region. Meanwhile, several meetings between representatives of the governments were held to discuss possible coordinated action. In January 1984, an important conference in Quito (Ecuador) involved numerous presidents and high-ranking officials from various Latin American countries. The *Quito Declaration* set a Plan for Action and pointed out that the responsibility for the crisis lay both with the debtors and the creditors. The Declaration had no practical impact, but some would argue that it created an atmosphere of regional solidarity and provided a common platform for future generations (Durán, 1986).

The Cartagena Consensus of Ibero-American Nations was agreed in Colombia in June 1984 to reiterate the *Quito Declaration* and, more importantly, to institutionalize the eleven-nation Cartagena Group as a permanent forum for consultation on debt issues. In the Consensus, the debtor countries expressed their concerns regarding development, the

situation of democracy¹ and the economy in the region. As reported by Navarrete (1985), the countries stated that they could not continue to accept those risks indefinitely, that they had affirmed their resolve to rectify imbalances, and that they would not allow themselves to be pushed headlong into forced insolvency. According to the author, '[t]he reactions came immediately' (Navarrete, 1985: 11): Both the European and United States media 'conjured up the spectrum of a "debtors' club"' (ibid.) which has since 'made the rounds of international financial circles and has given rise to all sorts of misinformed speculation' (ibid.). The debtors' initiatives and courses of action were interpreted as a sign of their strong commitment to 'collective decisions with the intention of imposing them unilaterally upon the banking system and multilateral financial bodies' (ibid.).

In the same vein, Durán claims that '[w]hat worried commercial bankers and their governments after the Latin American governments started consultations among themselves about debt renegotiation was the possibility of a polarization in the debtor-creditor relationship and the eventual formation of a debtor club' (Durán, 1986: 85). The danger seen by the creditors was that such a club could reinforce the debtors' bargaining power and even lead to the adoption of a radical posture towards common financial obligations. However, the truth is that the pronouncements and actions of the Cartagena Group remained within the bounds of moderation.

As indicated by Palma (1984), the main proposals made by the Cartagena Group were: 1) Adopting measures to reduce international interest rates, or implementing mechanisms to cushion the impact of high rates on the debtor countries; 2) Taking into account the capacity of each country for recovery and payment in the renegotiation of debt; 3) Setting a reasonable limit on the commitment of debtors' export earnings in debt restructuring agreements; 4) Reinforcing the credit capacity of the international financial institutions; 5) Revising the criteria with which the International Monetary Fund conditions its loans to make them more bearable for the debtor countries; 6) Establishing longer repayment periods and more favorable interest rates in debt renegotiation agreements, and 7) Eliminating tariff barriers and other protectionist measures in industrialized countries to increase Latin America's export capacity. These proposals were grounded and backed by the political pronouncements of the Group, associated with the co-responsibility of debtors and creditors, and included: the resolve to fulfill external payment commitments, a political

¹ Most of the Latin American countries were democracies at the time of the Cartagena Consensus. The two countries still under military rule, Paraguay and Chile, were not main drivers of the process. In the case of Brazil, the system was only partly democratized. Broadly speaking, we can say that although some countries were under non-democratic systems, the democratic concern was of vital importance for many countries in the Consensus.

dialogue on the debt problem, the concept of dealing with the situation on a case-by-case basis (as established by the creditors), the necessity and fairness of an even-handed adjustment, and the relatedness of the issues of debt, financing and trade (Navarrete, 1985). After the Cartagena Group came into being in 1984, six meetings were held between 1984 and 1986. Nevertheless, it cannot be said that a debtors' cartel emerged. The Group soon faced obstacles and their interests were divided. Despite the fact that common action was not achieved, the dialogue between the debtor countries and their political pronouncements were relevant to the extent that they made the international community aware of the possibility of a common position or some kind of coordinated movement.

In 1985, the debt situation moved in the right direction for several countries. Some interpreted the moderate position in the following meetings of the group as a result of the fact that Mexico, Venezuela and Argentina achieved major successes in their official debt negotiation (Durán, 1986). At the same time, the international economic, trade and financial situation moved in a way that complicated the pursuit of the debtors' goals.

The years 1985-1987 were marked by the Baker Plans that 'provided for a structural adjustment headed up by the World Bank, better lending terms and a modest amount of fresh credit' (Ocampo, n.d., 22). At the beginning of 1986, the decline in oil prices and its tremendous effect in Mexico and Venezuela further alarmed the international community about the uncertain ability of these countries to continue servicing their foreign debt. Together with other concerns, this fueled the idea that the debt crisis was not merely a problem of short term liquidity, which led to the adoption of the second Baker Plan. The plan added debt buybacks, low interest exit bonds and debt swaps. The Cartagena members described the plans as positive and useful but insufficient (Durán, 1986).

The final measure, the Brady Plan, was adopted in 1989. Almost seven years after the beginning of the crisis, this plan was 'the only one to directly address the debtor countries' demands for real debt relief and economic reactivation' (Devlin and French-Davis, 1995: 139). The plan corrected to some extent the asymmetry of the adjustments and helped to create a market for Latin American bonds. This strategy supposed a reduction 'between 7 and 12% of the total Latin American debt at the end of December 1989, and between 8 and 15% for the ten countries that signed Brady deals' (Ocampo, n.d., 23). The plan was followed by a turnaround from negative to positive resource transfers in the early 1990s, with the bond market becoming the major new source of financing.

The involvement of the United States in the crisis and the so-called compromise of stimulating growth in the last Baker Plan as well as in the Brady Plan differed from its

position in the early 1980s. The crisis was, in this final phase, clearly seen as a solvency crisis. However, the concessions made by the creditors after the second and third round of rescheduling were ‘rather “reactions” to difficult moments in the negotiations’ (Devlin and French-Davis, 1995: 133) in which the creditors perceived a growing discontent in Latin American circles. ‘Indeed, the creditors and their governments were frequently concerned about the formation of a debtors’ club, which could have neutralized the negotiating power of the creditors’ (Devlin and French-Davis, 1995: 133). It has been commonly stressed that the role of governments in the development of the negotiations and, in particular, the international lender of last resort had a “pro-creditor” bias.

Despite attempts at joint action by the Cartagena Group, there was never an effective move towards the formation of a debtors’ cartel or club acting in a coordinated manner. Due to the overexposure of the international banking system in the region, especially United States commercial banks, common action was always a great concern for creditors and could have brought them into a severe crisis, or at least reinforced the bargaining position of the debtors and framed the crisis according to their interests. As indicated, ‘[t]heoretically, the debtor countries had strong incentives to form a debtors’ club, since that was the only way to offset the negotiating power of the creditor cartel’ (Devlin and French-Davis, 1995: 134). Following Fernandez and Glazer (1989), the formation of a cartel had implied that the banks, which were not vulnerable to default by one debtor, may have faced bankruptcy if the larger group of countries had threatened to default. In addition, the penalties imposed by banks or institutions on the debtors would have been less credible for a whole region. Finally, the cartel could have led to the provision of a mechanism by which private investors would have had to take partial responsibility for the crisis and shifted the cost of the sovereign debt crisis to the market (Macmillan, 1995-1996). In summary, collective action would have allowed the debtor countries to correct the imbalances of a system in which the creditors, backed by governments and multilateral organizations, established almost unilaterally the conditions of adjustments without recognizing (particularly in the early moments) that they also were partly responsible for its generation. Ultimately, Latin American citizens could have avoided suffering the restrictive measures and consequent social impacts which the “nationalization” of large portions of private external debt assigned to them.

4. What Kinds of Challenges Does a Debtors' Club Face?

If the formation of a debtors' club would have brought so many advantages to the countries in crisis, why have the Latin American countries in debt failed to build one?

The following section analyzes the main challenges hindering the creation of a debtors' club in general and in the case of the Latin American debt crisis in particular. Firstly, the characteristics of the debtors as well as the potential coalition members are analyzed arguing that diverging interests, both between and within countries, made cooperation difficult. Secondly, the creditors' properties and their implications for the success or failure of a debtors' club are investigated. Thirdly, a focus is put on the relationship between the former and the latter. The three different perspectives all provide evidence why, under the specific circumstances present during the Latin American debt crisis, a debtors' club was unlikely to emerge.

4.1 Characteristics of the Debtor Countries

As Keohane (1984: 72 ff.) points out, cooperation between countries can emerge if interests are perceived as common or complementary by political actors and if states consider themselves better off as a member of the coalition rather than outside it. As outlined above, there is good reason to believe in shared interests and individual gains from cooperation for each of the Latin American debtor countries. However, the countries were not exactly in the same situation, and their interests therefore differed at least slightly. Secondly, to speak of the "interests of countries" is too simplistic, as different in-state actors may follow different goals. Both of these limitations play an important role in the failure of cooperation and are elaborated in the following.

4.2 Diverging Interests between Countries

Debtor countries in every crisis differ regarding the extent to which they are hit by the crisis, their balance of trade as well as their balance of payments, and the closeness of their relationships with creditor countries. In turn, though all in the debtor position, they develop diverging interests which are hard to combine. Hojman (1987) shows how these diverging interests were apparent in the Latin American debt crisis by analyzing the specific situation of the nine largest Latin American countries, making up more than 90 percent of the debt (see also Fernandez and Glazer, 1989). For all the countries except Colombia, the amount paid to service debt in the early 1980s was higher than the amount received through new

loans. Intuitively, one would infer that a default would be in the interest of all these countries (O'Brien, 1986: 59). However, as Hojman shows with the use of quadratic and semi-logarithmic regression models, a positive non-linear relationship between the trade balance and the balance of payments can be found for the Latin American countries at the time. This means that the better the trade surplus, the proportionally larger rewards will be. A large trade surplus will induce a proportionally larger positive balance of payments than a moderate trade surplus because it provokes capital inflows (Hojman, 1987: 204 ff.; see also Quirk, 1983). For countries with a trade surplus, this means that by promoting exports through borrowing even more, they can bring themselves into a situation in which they can finally serve their debt. These countries would not have any incentive to default and would hence see no sense in joining a debtors' cartel. Following Hojman, in the case of the Latin American debt crisis, this consideration made sense for the three countries with the largest trade surpluses², namely Argentina, Brazil and Ecuador, which were therefore better off not confronting the creditors (ibid.: 214). Hojman further argues that Colombia and Venezuela were not affected by the crisis like the others. Colombia received more financial inflows than debt service and never had difficulties in accessing finance in international money markets. Venezuela, on the other hand, with its substantial trade surpluses was even able to reduce its debt in 1984 and 1985 (ibid.: 209). Chile has been relatively successful with its IMF program and Mexico received special conditions from the US, making the cooperation of both countries less likely. Uruguay's cooperation would have been of limited relevance due to its small economy and debt, so Peru stayed as the only member with a high commitment for cooperation (ibid.).

As convincing as Hojman's explanation for the region's lack of cooperation seems, it raises several contradictions, especially the fact that the three countries exhibiting the largest trade surpluses, which according to Hojman should not have been willing to confront the creditors, were the ones fostering cooperative action most intensively. This does not fit into his overall interpretation, as it was the president of Ecuador who initiated the first meetings in Quito (La Nación, 1984a, as cited in Instituto Iberoamérica y el Mundo, 2000). Both Argentina and Brazil put relatively high effort into supporting joint action, and together with Colombia and Mexico submitted a declaration for concerted action even before the Cartagena Consensus was negotiated (which, in turn, was strongly supported by the Ecuadorian government) (La Nación, 1984b, as cited in Instituto Iberoamérica y el Mundo, 2000).

² All the other analyzed countries except Colombia also showed positive trade balances. However, they were not likely to reach trade balances positive enough to serve the debt.

The after-the-fact assessment that “it made sense for the countries” to make certain considerations does not mean that the decision makers in power actually made them. In contrast, Kaufmann assessed the Argentinian, Mexican and Brazilian governments’ decisions during the crisis, and argues that the governments’ positions were mainly determined by the form of the regime, as well as by the elites’ economic ideologies, the organization of the public bureaucracy and by the resources available to the various groups operating within the political system (Kaufmann, 1985: 476).

4.3 Diverging Interests within Countries

Many researchers still perceive the formation of a debtors’ cartel as in the interest of most debtors in crisis (see for example Fernandez and Glazer, 1989; O’Donnell, 1987; Quirk, 1983). However, being in the interest of a majority of the citizens in a country does not mean that the policy is pursued by the country’s government.

Until this point, a “country’s interest” was assumed as “objectively” defined for its general society or economy. This is quite narrowly considered. Despite the fact that it is nearly impossible to “objectively” say what creates the most benefits (especially as the political and economic consequences of confronting the creditors, both internally and externally, are hard to foresee), the diverse societal groups within a country have diverging interests and are not equally represented by their (democratic or non- democratic) governments. During the Latin American crisis, two countries were still under military rule and therefore not representative at all (Paraguay and Chile), while for democratic countries in debt, there is a specific incentive to behave well in relation to the creditors. Confronting the creditors, though providing benefits in the long terms, is likely to be costly in the short term due to presumed sanctions and associated instability. Democratic governments are more “impatient” than society because of the relatively short legislative period and fear of being overthrown. They might therefore be less willing to accept short term costs for the benefit of the long run (Fernandez and Glazer, 1989: 25). Further, governments often protect the interests of a particular group. In the early 1980s in the Central Andean countries, the ties between specific business communities, technocrats and governments were very close. The economic advisory groups for Ecuador, Peru and Bolivia were composed of individuals with interests in domestic fixed investment, who had close connections to finance capital and were involved in commercial, financial and agro export activities (Conaghan et al., 1990: 12 ff.). Further, most of them had passed through US neoliberal university education, which led them to hardcore neoliberal policy suggestions that Conaghan et al. (1990: 15)

describe as 'an amalgam of ideology and interests'. In Peru, this ended with the election of the leftist president García, who experienced a strong wave of protest from Peruvian entrepreneurs and middle class against his nationalization of the financial system (Cotler, 2000: 112). In Venezuela, the amount of foreign assets held by domestic citizens was even larger than the state's debt (Hojman, 1987: 209), meaning that some Venezuelan citizens had a huge interest in preventing their government from confronting the creditors so as not to lose their foreign capital through the expected sanctions.

IMF measures, mainly criticized for their disastrous social consequences, were welcomed by some elites who had argued for this kind of politics for years and were finally able to pursue them without the complications of democratic processes. Peru's president in the early 1980s had a particular interest in not confronting the institution, as this gave him the opportunity to continue with programs of housing and road construction started in his first legislative term before the crisis (Conaghan et al., 1990: 16).

Actors that could have been expected to fight and lobby for the creation of a cartel, like trade unions, socialist parties or other civil society organizations, were nearly absent. In some countries such as Bolivia, Peru and Ecuador, popular opposition movements showed internal weaknesses and were partly repressed (Conaghan, 1990: 24 f.). In other countries such as Venezuela, they were incorporated and subordinated to party networks (Levine, 2006: 169). Trade union power in particular was undercut through the growing economic marginalization of the traditional working class and an expanding informal sector (Conaghan, 1990: 25).

4.4 Specific Situations in Domestic Politics

In many Latin American countries, the debt crisis coincided with a shift from military dictatorships to democratic rule³. These emerging democracies had many other issues than just the question of how to deal with debt. The newly elected leaders were afraid that a dispute with the creditors and concomitant sanctions of associated social and economic negative short-term consequences could lead to instability and upheaval. Further, they considered themselves in need of future access to finance to advance the restructuring of the country. In particular, the risk of losing their main export market was a serious economic threat (Fernandez and Glazer, 1989: 25; Roett, 1984; Roett, 1988: 437).

All these potential negative consequences would have been especially serious in the case of unilateral default *without* the pressure exerted by a cartel of debtors. The case of Brazil

³ Argentina became a democracy in 1983, Ecuador in 1979, Uruguay in 1984, Peru in 1980, Bolivia in 1982 and Brazil in 1985 with some democratization already happening in the years before.

declaring a partial moratorium in 1987 served as a deterrent in this regard. Creditor reaction caused Brazil to lose access to trade financing and related support, which exacerbated the economic crisis and in turn provoked a political crisis (O'Donnell, 1987: 1158, Roett, 1988: 437).

Broadening the view to global power relations and taking into consideration the background of the Cold War, some further hypotheses about debtor fears can be drawn: the risk of losing alignment with the US and Western forces and its security promises might have seemed a dangerous threat to militarily weak countries. Hence, although research concentrates on the US geopolitical interest in the crisis (see for example in Schoultz, 1998), debtor nations might have made geopolitical consideration equally⁴. Unfortunately, not much research has focused on this issue so far.

4.5 Characteristics of the Creditors

While debtor coordination was not very successful, the 1980s crisis turned out to be unique in terms of highly effective and unprecedented coordination of creditors (Devlin and French-Davis, 1995: 129).

Banks formed advisory committees to manage the crisis and the common behavior towards the debtors was agreeing on syndicate lending and sanctions to be implemented if a debtor country broke "the rules" (Roett, 1988: 440). Unlike the debtors, the creditors could easily make fast and "efficient" decisions as they did not have to pass democratic processes or justify decisions, which strengthened their negotiation power. Cooperation through syndicate lending prohibited all possible competition that could have played them against each other (Macmillan, 1995: 64; Palma, 1984: 93).

Another issue that strengthened the creditor position was their tight connection to governments in the creditor countries and the international financial institutions. The creditors in general and the advisory committees in particular were supported by the IMF, the World Bank and industrialized governments, especially by the United States (Devlin and French-Davis, 1995: 118).

Besides fostering the interests of "their banks", the framing of the crisis and the particular political composition of Western governments were reasons for their strong support of creditors.

⁴ In general, the geopolitical interests of the different countries might have varied a lot due to country-specific factors. Argentina's relationship towards Britain and the US was, for example, particularly tense at the time due to the Falkland War in 1982. In Chile, Pinochet's pro-American regime was only in place thanks to the US military. A detailed assessment of the geopolitical interests of the various countries and potential impacts on the countries' negotiation strategies, however, goes beyond the scope of this work.

As already mentioned, in 1982, industrialized countries framed the crisis in terms of short-term liquidity rather than insolvency. Debt, therefore, was seen as merely a business matter that had to be worked out between debtor countries and creditor banks, and not an issue to be negotiated between governments (Roett, 1988: 432). The industrial countries stood united with a conservative, market-oriented approach, led and dominated by the US Reagan administration. Reagan's position was supported by the European countries, firstly because they considered Latin America to be in the "US sphere of influence". Secondly, the leaders of two of the most powerful European countries at the time, Chancellor Kohl in Germany and Prime Minister Thatcher in the UK, shared the market-oriented approach and supported Reagan's crisis policies. The three of them were in office for almost the entirety of the 1980s. The leading position of the US was comfortable for European leaders to the extent that they were by no means willing to open their markets to Latin American products, which could have been a reasonable approach to alleviate the crisis. The US financial minister was thereby in a position to determine the Western political response to the crisis (with his Wall Street background) and was unable to see the political implications of the crisis, so emphasized that a solution had to be found through market forces. He was supported by the Federal Reserve chairman who frequently stated that the aim was to prevent dangerous debtors from contaminating others (*ibid.* : 432 ff.).

The strong connection between the governments of industrialized countries stood in huge contrast to their weak ties and lack of willingness to cooperate with debtor governments. Western countries were still used to dealing with military rulers in the region and considered stability in the "Third World" to be more important than democratic transition, especially taking into consideration their strategic nature in a bipolar world order. Further, the newly elected leaders were seen as inexperienced and therefore easy to marginalize (*ibid.* : 434 f.).

The creditor countries, with their general political and economic dominance, had voting power to control the IMF, which was therefore acting as another representative of the creditors (Macmillan 1995: 78). Hence, the "international lender of last resort" did not minimize social costs and consider public welfare as a national institution would have done in this situation. In contrast, the IMF tried to prevent losses to the international and domestic financial system by all means. It thereby further strengthened the bargaining position of the creditors, making a debtors' cartel even harder to achieve (ECLAC 1990; Devlin and French-Davis 1995: 132 f.).

As already mentioned, the creditor side framed the crisis as a matter of short-term liquidity problems (Roett, 1988: 432). Besides classifying the negotiations as a business matter between the banks and the debtors, the act of paying back was construed as a moral commitment to be fulfilled at any cost. Objectively, this is not the only possible interpretation of the situation. The act of forcing repayment in a desperate situation could equally be interpreted as morally reprehensible, which can be traced back to long embedded cultural traditions rooted in religion and philosophy⁵. Other debt negotiations such as the struggle for debt relief of highly indebted “Least Developed Countries” in the 1990s, during which civil society actors managed to reframe the debt and achieve debt relief (Friesen, 2012), provide stark contrast. During the Latin American debt crisis, the power of telling the story remained with the creditors. This was also the result of a weak interest from Western civil society in the debt crisis, accompanied by a lack of support for the debtor countries from the political left in industrial countries, as well as their environmental and social civil society actors.

4.6 Relationship between the Debtors and the Creditors: Collective Action Problem

Looking separately at each actor only provides us with part of the picture. Keohane (1984: 69) speaks of the ‘fallacy of composition which in world politics would lead us to belief that the sources of discord must lie in the nature of the actor rather than in their patterns of interaction’ (Keohane 1984: 69). Following Waltz, causality has to be searched for in the nature of systems rather than in the nature of states (Waltz 1959: 76).

To analyze the interaction and the strategic behavior between debtors and creditors, several scholars have drawn on coalition theory and game-theoretic approaches (Fernandez and Glazer, 1989; O’Donnell, 1985). In game theory, firstly the interest of the “players” is described, and in a second step their options to act on pursuing their goals are outlined. In a third step, the “best answer” for each player is derived, taking into account the strategic behavior of the other player.

The general idea of analyzing negotiations about debt in this framework is that the debtor, in the interest of paying as little as possible, and the creditor, in the interest of getting as much money back as possible, impose “threats” during the negotiations to make the other player behave in the most desirable way (O’Donnell, 1985: 28).

⁵ The three Abrahamic religions promote a rather negative image of creditors, especially in terms of impatience, and prohibit the charging of interest in general (e.g. Bible, Ezekiel 18, 5-17 and Luke 7, 41-43; Koran, Sura 3, 130). Philosophers such as Aristotle pronounced against charging interest, claiming that ‘there is nothing more contrary to nature than this kind of earning’ (Aristotle 1259a).

The debtors in the Latin American debt crisis (as in most debt crises) could “threaten” not to pay the credit back. Actually, this could have been a powerful instrument as it would have imposed huge losses on the creditors, especially on the powerful US-American banks which had lent more than their actual capital to Latin American countries without diversifying their assets (Palma, 1984: 94). With the lack of a global enforcement of contracts, no one could have stopped the debtors from doing this. The creditors, on the other hand, could threaten to impose sanctions on the debtors in case of default, like excluding the debtor from the international community, cutting off import credit, banning exports or confiscating debtor citizen property in other countries⁶. Imposing sanctions would have been costly for the creditors too, however. Loss of the money lent would have meant bearing the costs of non-cooperation, as the creditors (for example, the banks) would have lost their possibility to work in the debtor country and would have faced the risk of confiscation of their own property in the country. Therefore the creditors wanted to eliminate the possibility of non-payment and the associated sanctions beforehand and hence used dissuasive power on the debtors.

The “threats” of both actors differed regarding their credibility. Though the creditors would have liked to avoid imposing sanctions, in the case of unilateral non-payment sanctioning would have made sense to them as it was the only way to avoid other countries following the non-paying debtor. Hence, the implementation of sanctions in the case of unilateral nonpayment was a credible threat. The debtors’ threat of unilateral non-payment, on the other hand, was highly incredible as the country in debt would have been confronted with all the economic and political problems that were likely to arise in the case of default, as well as the implementation of sanctions. In this situation of power imbalance in favor of the creditors, the debtors’ cartel steps in. If the debtors had succeeded in proclaiming default together, the creditors would not have gotten back their money, and applying costly sanctions would have been useless for them as no one would have been left to deter. This would have resulted in a best case scenario for the debtors and a worst case scenario for the creditors.

Creditors knew that, in general, a coalition was possible. Therefore they tried to prevent debtors from uniting by all means. They did so by making concessions to single debtor countries by accepting postponement of loans (that most probably could not have been paid

⁶ It should be noted that all these sanctions are only possible due to the fact that governments in industrialized countries and international institutions supported the creditors. Here, it becomes obvious that the frame imposed on the crisis was inconsistent to some extent. The conflict was framed as held under private law, but in the negotiations about the repayment the Western states stepped in to support one of the “private” actors, supporting the banks with sanctioning policy.

back anyway) or improving repayment conditions. These strategic “side payments”, rather than real concessions “achieved from negotiation”, were often described as creditor reactions to tricky moments in negotiations (Devlin and French-Davis, 1995: 129; Tussie, 1988: 69-70) and were meant to prevent the debtors from gaining the joint negotiation power that the creditors had already achieved. Each debtor country had to decide if it wanted to accept the offered concessions and take the short-term benefits, or reject concessions and foster the alliance of the debtors. As mentioned above, a successful cartel would bring the country huge medium term benefits. However, pursuing the cartel puts a single country in danger of breakdown. With a break in the alliance, the debtor would again find itself in unilateral default with tremendous short and long term consequences. Depending on the size of the side payments, both the benefit from accepting and the probability of alliance breakdown changed. Knowing that the creditors were willing to offer ever higher payments to countries most useful for the union, each debtor was aware that breakdown was quite probable. Each payment rejected would have been offered to another (potential) member, who then could potentially quit the union and leave the member alone in the worst situation. Even if the alliance had formed, the creditors would still have been able (and were willing) to give incentives to specific countries to leave it. Hence, for each debtor, even though the overall best situation could only be achieved through an alliance, it made sense to take the concessions if they were high enough. The threat of forming a union therefore served well to obtain concessions. However, it was not able to change the power structure as the creditors were able to keep the debtors in the ‘logic of the debt trap’ (O’Donnell, 1985: 27 ff., see also Fernandez and Glazer, 1989). Durán concludes that ‘regional cooperation ends when bilateral negotiation begins’ (Durán, 1986: 88).

Similar collective action problems are found frequently in issues of international cooperation. Hence, much research has been done in the field and found some ways to escape the logic, even when incentives indicate otherwise: collective action is found to be possible if extremely reliable communication between the (potential) members of an alliance can take place (O’Donnell, 1985: 30). This, in turn, is mostly only feasible if the group is small (Olson, 1965: 53) and multiple confidence has been already created through positive experience with former joint action (Keohane, 1984: 79). Further, actors should have the opportunity to commit themselves credibly to their word, which is mainly possible if the potential members have strong political and economic ties giving them means to sanction members who defect (Keohane, 1984: 79; Ostrom, 1990: 94 ff.). Related to this, in

a “dense policy space”, collective action is more likely to arise (Keohane, 1984: 79). To create cooperation independent from current events and to avoid the centrifugal forces that the alliance is exposed to, in the best case the cooperating parties should give up some power to an institution (Ostrom, 1990: 101 ff.) which would then speak for the group.

Regarding the Latin American debtors, most of these patterns were not present. Although the group was relatively small, there was no common recent history in which they would have been able to create confidence and develop a joint communication structure. As mentioned above, most of the countries had just changed their political system. They had not evolved strong structures to negotiate and cooperate with their neighbors, nor had they experienced common projects. The leaders of the various countries often did not even know each other. Despite the fact that some of the countries were economically bound together through the Latin American Free Trade Association and the Central American Common Market created in the 1960s, economic ties were still weak and there was no proper possibility to sanction defect behavior. With all the existing internal struggles, there was also no way that governments would have been able to install and agree on a common institution to represent them during the years of the crisis. In addition, negotiating the cartel without the intervention of creditors would have required confidential agreements, which were nearly impossible due to democratic structures and Western secret services (O’Donnell, 1985: 31).

All in all, the analysis reveals that in general it is always difficult to form a debtors’ cartel as well as to maintain it. This is especially true if the creditors are well coordinated and supported by political actors. In the specific case of the Latin American debt crisis, the potential for an alliance was even lower. Due to different interests and the political instability of recently emerged democracies, debtors were in a particularly weak position.

5. Conclusions

This paper has explored the challenges that debtor countries face when trying to coordinate in debt negotiations to strengthen their position vis-à-vis the creditors (i.e. to form a debtor's cartel or club). With that purpose in mind, we have studied the Latin American debt crisis of the 1980s. The *lost decade* of the region is remembered for the devastating economic and social impact of the crisis and the neoliberal measures undertaken, which has set a standard for today's approach of multilateral organizations when dealing deal with similar situations. The nature of the Latin American debt crisis can be seen as differing from previous crises because for the first time the international community considered it a political issue requiring the attention of multilateral organizations. Thanks to the support of the international community and in particular of the United States alongside the mechanism of syndicated loans, creditors were able to act in unison to push the debtors to accept uneven adjustments.

Leading up to the crisis, commercial banks played a main role as intermediaries between oil-exporting countries with surpluses and Latin American countries receiving significant flows of money. However, benefitting from the immense credit volume, banks were neither concerned with the borrowing capacities of governments and private debtors nor did they try to promote responsible lending. The countries in debt struggled with the debt and interest burden and, following the pressure of creditors and international organizations, imposed contractionary macroeconomic policies to fulfil repayment obligations. Large-scale adjustments were made on the assumption that the crisis was mainly a problem of liquidity. Austerity measures dominated the scene from the beginning of the crisis to 1985, when debtors started to acknowledge and focus on the political and collective nature of the situation alongside the fact that both debtors *and* creditors were responsible for the crisis. In this spirit, the Cartagena Consensus was reached in 1984. However, the agreement was only successful to the extent that Latin American countries established a permanent forum on debt issues; their political pronouncements and proposals did not lead to collective action. By 1989, the crisis turned to be seen as a solvency problem. Alongside the creditors' concerns for joint action of the debtors this led to the adoption of the Brady Plan. The Brady Plan corrected the asymmetry of the adjustments to some extent and helped to create a market for Latin American bonds.

A thorough analysis of the Latin American debt crisis and its negotiation processes reveals several insights: To the countries in debt, a debtors' club is a crucial instrument to improve their bargaining position and retain autonomy in debt negotiations. However, our analysis

shows that, in spite of being in the interest of most debtor countries, the forming and maintenance of a debtors' cartel comes along with serious challenges. Firstly, despite the fact that they are all highly indebted, countries in crisis often differ regarding their political and economic situation and their ties to the creditors. Secondly, internal struggles and problems alongside the existence of strong particular interests can prevent a country from fostering its "real" interest of supporting the cartel. Thirdly, given the power of the creditors, the serious threat of sanctions and the offering of concessions, debtor nations face a collective action problem. Although all of them would benefit from the alliance, each individual member has incentive to defect, leave the union and accept the concessions.

In the case of the Latin American crisis, these obstacles were particularly challenging as debtors found themselves in an unstable political situation and were confronted by a strong alliance of creditors enjoying the support of "their" governments as well as of the international financial institutions controlled by the former.

There are two more lessons to be drawn from the Latin American case. Firstly, the 'logic of the debt trap' (O'Donnell, 1985: 27 ff.) can only be maintained if private creditors as banks are backed by "their" governments. Without political support, banks could not impose or threaten sanctions like export bans, the confiscation of property or exclusion from the international community. This would take away the debtor's fear of the consequences of defaulting, and hence could make cooperation possible. Secondly, the framing of the crisis matters. Finance in general and debt in particular, are no material reality. Both the financial system and debt obligations appear as a material reality only as long as existing structures of the former are defended and repayment of the latter is enforced by the repressive force of the state. Debt has to be repaid only as long as all actors perceive it to be so and as long as some actors are willing to enforce repayment. Political action can change, but this will only be possible with a change in the framing about who blame for the crisis, to whom a democratic government should listen and to what extent governments in creditor countries need to care for "their" banks as opposed to interest of human beings. Particularly, a change in the political action of countries in which credit institutes are located could give those in debt the ability to unite and stand up for their interests.

It remains to be seen if highly indebted countries these days will follow the rules imposed by credit institutes and "their" governments, or if they will be able to tell a convincing alternative story about debt and relief.

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