Northwestern Journal of International Law & Business

Volume 16
Issue 1 *Fall*

Fall 1995

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New York

[*Author's Note*: This article is based upon the author's lecture entitled "The Next Wave of Cross-Border Lending" delivered in connection with the Meredith Lectures at McGill University in April 1994.* The subject of that lecture, and of this article, is how cross-border lending to less developed countries (*LDCs*) in the 1990s differs from the last major period of such lending in the late 1970s. It is surely a testament to the accelerated obsolescence of modern financial commentary that the author's April 1994 lecture — delivered in the middle of a boom in cross-border lending — has already been followed by a bust starting in late December 1994 when Mexico devalued its currency, and by tentative signs of yet another resurgence in cross-border capital flows in the second half of 1995.]

INTRODUCTION

When financial historians come to explain the behavior of cross-border investors in the last decade of this millennium, they will have to begin with the statistics. Aggregate net long-term resource flows to developing countries from private sources exceeded $159 billion in 1993 and $170 billion in 1994; roughly a fourfold increase over the five-year period since 1989.[1] Portfolio equity flows increased more

* That lecture was subsequently published by *Les Éditions Yvon Blais* (Cowansville, Quebec, Canada 1994) in *Les Transactions Transfrontalières/Cross Border Transactions. Les Éditions Yvon Blais* have kindly consented to the use of the text in preparing this article.

1 1 WORLD BANK, WORLD DEBT TABLES 1994-95 7, Table 1.1 (1994) [hereinafter DEBT TABLES 1994-95].

than thirteenfold from $3.5 billion in 1989 to $47 billion in 1993.[2] Bond placements by developing country borrowers aggregated approximately $59 billion in 1993.[3] The comparable figure for 1989 was about $5.5 billion.[4]

One London-based securities firm calculated that $160 billion of emerging market equity shares were held by international investors in 1994. Seven years earlier, that number was $2.4 billion.[5]

Anyone who tried to book a business class seat on an airplane to Mexico City, Buenos Aires, Manila or dozens of other LDC capitals in 1993 or 1994 could supply anecdotal evidence supporting these statistics. For the prior ten years, those seats were occupied mostly by melancholy country debt negotiators, visibly licking wounds received at the hands of creditor committees in New York or London. In the 1990s, those same seats have been booked by eager young investment and commercial bankers clutching mandates for new Eurobonds, global depositary receipt issues, Euroconvertibles and so forth, or by mutual fund managers checking on the performance of their LDC investments.

THE CYCLES OF CROSS-BORDER LENDING

The history of cross-border lending teaches caution. At irregular intervals over the last two centuries, public and private sector borrowers in developing countries have been received with enthusiasm by the international capital markets. The 1820s, the 1880s, the years before the First World War, the 1920s and, most recently, the 1970s, were all periods of massive international lending to developing economies. Each lending boom, however, was usually followed by a period of painful retrenchment, disillusionment and recrimination. Some of the creditors saw their loans rescheduled on concessionary terms; others saw them repudiated or treated with malign neglect.[6] After the passage of a few decades, however, memories would fade, optimism

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2 *Id.* at 14.

3 INT'L MONETARY FUND, PRIVATE MARKET FINANCING FOR DEVELOPING COUNTRIES 13 (1995) [hereinafter 1995 PRIVATE MARKET FINANCING].

4 INT'L MONETARY FUND, PRIVATE MARKET FINANCING FOR DEVELOPING COUNTRIES 18, Table 8 (1993) [hereinafter 1993 PRIVATE MARKET FINANCING].

5 Stephen Fidler, *A Bubble Borne Along on a Wave of Money*, FIN. TIMES, Feb. 3, 1994, at 15.

6 There is considerable literature on the boom and bust cycles of cross-border lending. *See, e.g.*, EDWIN BORCHARD & WILLIAM H. WYNNE, STATE INSOLVENCY AND FOREIGN BONDHOLDERS (1951) [hereinafter STATE INSOLVENCY]; THE INTERNATIONAL DEBT CRISIS IN HISTORICAL PERSPECTIVE (Barry Eichengreen & William H. Wynne eds., 1989) [hereinafter INTERNATIONAL DEBT CRISIS]; FRANK GRIFFITH DAWSON, THE FIRST LATIN AMERICAN DEBT CRISIS (1990).

would again triumph over experience and a new cycle of cross-border lending would begin.

The last major financial hangover started in August of 1982 when Mexico declared a moratorium on the repayment of certain categories of its external debt. In the following decade, $400 billion or so of debt obligations incurred by dozens of countries were repeatedly rescheduled and, in the end, partially written off under the auspices of the so-called Brady Initiative.[7] This process is still not complete in some countries.[8] As the figures quoted above show, however, a new wave of cross-border capital flows to developing countries has come crashing ashore in the 1990s onto beaches not yet fully cleared of the jetsam of the last inundation.

WHAT'S DIFFERENT THIS TIME?

The cynic might say that the desire for higher yields always has, and always will, unseat prudence and caution in international lending. It is an appealing explanation. The fascination of investors with the so-called emerging markets in 1992 and 1993 can be attributed in large part to the investors' dissatisfaction with the available yields on domestic investments.[9] The marked slowdown in cross-border capital flows in late 1994 (in comparison with the prior two years), even before the Mexican devaluation in December 1994, was a direct result of the significant interest rate increases in the United States starting in February of that year.[10] But this cannot be the complete story. Memories, after all, are not *that* short and the spreads on new developing market issues are not *that* high.[11]

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7 Lee C. Buchheit, *The Background to Brady's Initiative*, INT'L FIN. L. REV., April 1990, at 29.

8 Panama, Peru and Russia, among others, have not yet finalized comprehensive commercial bank debt rescheduling packages.

9 *See* Steven Greenhouse, *Third World Markets Gain Favor*, N.Y. TIMES, Dec. 17, 1993, at D1; *Junk Bonds Emerging, Converging*, ECONOMIST, Jan. 29-Feb. 4, 1994, at 79; Jacqueline Doherty and Candace Cumberbatch, *Colombia to Sell Yankee Bonds, With Investors Ready to Buy Amid a Shortage of New Issues*, WALL ST. J., Feb. 15, 1994, at C20 (quoting a portfolio manager as saying "You're getting 50% more yield spread [with Colombia Yankee bonds] than similarly rated U.S. corporate bonds."); *High Yield, Not Love of Mexico, Drove Country's Yen Duel*, LDC DEBT REPT., July 31, 1995, at 1.

10 Michael R. Sesit, *Foreign Stocks, Bonds Are Losing Their Appeal for American Buyers*, WALL ST. J., Feb. 23, 1995, at C1.

11 *See Yield Spread at Launch for Unenhanced Bond Issues By Developing Countries and Regions*, 1995 PRIVATE MARKET FINANCING, *supra* note 3, at 62, Table A6 (showing that average yield spread for LDC bonds, expressed as the basis point difference between the bond yield at issue and the prevailing yield for industrial country government bonds in the same currency, declined from 346 basis points in 1991 to 187 basis points in the first quarter of 1994).

The broader explanation is that the historical cycles of cross-border lending have not all been alike. New investors quite naturally focus on the changes that have occurred since the last cycle as the basis for their hope that this time things will turn out better. The international lending activity of the first half of this decade, for example, is significantly different in a number of respects from its counterpart in the 1970s. Have these changes removed the risks of cross-border lending? No. Have they diluted or significantly attenuated those risks? Perhaps. Have they altered the nature of the risks? Almost certainly they have.

International investors, like old generals, suffer from the temptation to fight the last war over again. Those who are prepared in the 1990s to commit their capital to the developing world have carefully studied the history of their immediate predecessors. They have extrapolated from the dolorous history of the 1980s certain lessons as to when cross-border credits are likely to be repaid and when they are not. Much of the cross-border lending in this decade will bear the stamp of these perceived lessons.

What has changed? How is the current pattern of cross-border lending different from that of the 1970s?

Nature of Investors. Most of the lending to lesser developed countries during the 1970s took the form of syndicated commercial bank loans. The banks were happy to intermediate between Euromarket depositors (particularly petrodollar depositors after the oil shocks in 1976 and 1979) and the ultimate LDC borrowers. One consequence of this credit intermediation, of course, was to place the stability of the commercial banking systems of the creditor countries uncomfortably at risk when the debtors' moratorium telexes came cascading across telex machines in 1982 and 1983. The resulting debt renegotiations were therefore matters of intense concern to the governments of the creditor countries and these governments did not hesitate to intervene in the negotiation process when they felt it appropriate to do so.[12]

In contrast, cross-border lending in this decade will take place principally through the medium of the international bond markets.[13] Apart from those few hours in each transaction when the underwriters actually own the bonds, the credit risk of the borrower is nowadays passed through to the ultimate investor (the bondholder) with all pos-

12 Lee C. Buchheit, *A Change of Hat*, INT'L FIN. L. REV., June 1990, at 12.

13 1 WORLD BANK, WORLD DEBT TABLES 1993-94 20-22 (1993) [hereinafter 1993-94 DEBT TABLES].

sible speed. If future events were to force issuers to default on these bonds *en masse*, a great many investors might lose their money but the full weight of the problem would not fall again on commercial banks, their regulators and their government-sponsored deposit insurance agencies.

The shift away from commercial bank lending, however, raises a different set of worries. However ill-advised some of their lending decisions may have turned out, international commercial banks were presumed to understand the special risks that attend cross-border lending. Some of these banks had branches or representative offices in the debtor countries and they were thus in a position to assess first-hand the local political and economic scene. A similar presumption cannot be made about bondholders. Even sophisticated institutional investors may lack the background and resources needed to assess all of the elements of cross-border risk.[14] These risks may take the form of exchange controls, exchange rate movements, wars, rebellions, *coups d'etat*, shifts in commodity prices, political instability, expropriations, nationalizations, trade imbalances, corruption, inefficiency, discrimination against foreign investors and a host of other nasty circumstances that can separate the unwary international investor from his money. Even the shrewdest domestic investor may be unprepared for everything that can go wrong in a cross-border context.

Nature of the Instruments. Unsecured, medium-term, commercial bank syndicated loans are out of vogue, at least in the context of LDC financing.[15] Syndicated loans showed themselves to be uncomfortably susceptible to rescheduling during the 1980s. The lenders were easily identifiable, could be contacted at the end of a telex line and were expected to behave with maturity and forbearance in the face of disappointing news from the borrowers. Publicly-issued debt instruments, on the other hand, were almost never rescheduled during the last debt crisis. The Eurobonds and floating rate note issues of most countries were consciously excluded from the restructuring exercises and were paid on time in full.[16]

14 Kenneth N. Gilpin, *New Third World Fear: Investors Could Walk Away*, N.Y. TIMES, Apr. 24, 1994, at 4 [hereinafter GILPIN].

15 *See* 1993-94 DEBT TABLES, *supra* note 13, at 25 ("As in previous years, access to syndicated bank credit was severely restricted for developing countries that had experienced, or are experiencing, debt-servicing difficulties").

16 A notable exception was Costa Rica whose commercial bank Steering Committee in 1982 pressured the country into rescheduling its bonds. *See Costa Rica: A Case History*, DEFAULT AND RESCHEDULING 141, 149-50 (D. Suratgar ed. 1984). *See also*, S.M. Yassukovich, *Eurobonds and Debt Rescheduling*, EUROMONEY, Jan. 1982, at 61. Notwithstanding this history, a Costa

Investors in the 1990s take comfort from this recent practice of excluding bonds from the unpleasantries of debt restructurings. This is one important reason why investors are prepared to buy emerging market bonds, even if they might recoil at the idea of buying interests in syndicated bank loans to the same borrowers.[17] If these investors believe, however, that the nature of the instrument (a bond versus a loan) is sufficient, by itself, to insulate the holder from the thousand shocks to which the international lending flesh is heir, they are mistaken. The main reason why bonds were not rescheduled in the 1980s was that there were not very many of them. LDC borrowers had been able to satisfy most of their financing needs during the 1970s from the commercial bank loan market. Publicly-issued bonds were the exception and, frankly, it was not generally thought worth the effort to try to reschedule them in light of the limited debt relief that could be achieved from such an exercise.[18]

Many sovereign borrowers also recognized that commercial banks could not be counted on as a reliable source of financing during the first few years following the end of the debt crisis. By maintaining punctual debt servicing of outstanding bonds, these countries hoped to keep the international bond markets sweet for an eventual re-entry by the sovereign borrowers following the crisis. It was a sound strategy and has been amply rewarded by the bond markets.

The situation has largely reversed itself in this decade. Bank loans are now the exception and bonds are the lending instrument of choice in LDC financing. A borrower that experiences financial difficulties in the future may find that its aggregate stock of bond indebtedness is simply too large to be ignored or excluded from a request for debt relief. An attempt to reschedule such instruments may therefore be inevitable for some countries, however formidable may be the practical difficulties of rescheduling bearer instruments.[19] In a perverse way it is the popularity of bonds with today's investors — a

Rican public sector issuer was well-received by the Eurobond market in early 1994. *See CR Makes a Comeback*, INT'L FINANCING REV., Jan. 22, 1994, at 46.

17 An example of this sentiment may be found in a paper published by Morgan Stanley in February 1991 entitled *Mexican Brady Bonds* (at 17): "Mexico is unlikely to default on its bonds given that it did not do so during its worst economic times." A paper published by Salomon Brothers dated March 16, 1993, entitled *Evaluating Sovereign Credit Risk* (at 22) reached a similar conclusion: "[I]n the sovereign markets, bond debt is de facto senior to bank loans. . . . By this we mean that since World War II, sovereigns that have rescheduled bank loans have not rescheduled bonds."

18 *See* Lee C. Buchheit, *Of Creditors, Preferred and Otherwise*, INT'L FIN. L. REV., June 1991, at 12-13.

19 *See* Watkins, *How to Reschedule a Bond Issue*, EUROMONEY, Jan. 1983, at 103.

popularity reflecting the recent history of not rescheduling bonds — that may force these instruments to be rescheduled if countries run into financial difficulties in the future.

Nature of the Borrowers. Investors in the 1990s have a preference for private sector borrowers.[20] The naked balance of payments financings for sovereign borrowers that characterized the late 1970s are now distinctly out of favor.[21]

This preference for private sector borrowers makes obvious sense in cases where the borrower has assets or receivables outside the debtor country that could be seized by the creditors in the event of a default, or in cases where the borrower has a foreign parent to whom the lenders may look for repayment should the borrower/subsidiary fail (or be unable as a result of exchange controls) to repay the debt.[22] Apart from these situations, however, investors who study the 1980s will learn that private sector borrowers, however solvent, were usually swept up in the debt problems of their governments. Most sovereign borrowers refused to sell foreign exchange to private sector borrowers to permit those entities to service their foreign loans except on terms equivalent to the treatment accorded to the government's own creditors. Thus, a *bad* credit decision in respect of a private sector borrower (that is, a loan to a borrower that subsequently went bankrupt) usually resulted in a loss to the lender, but a *good* credit decision (that is, a loan to a financially healthy private sector borrower) typically earned for the lender only the same treatment as he would have received had he originally lent to the government itself or to a public sector borrower.

Interest Rate Bases. One benefit of the LDCs' return to the bond markets is the preference of those markets for fixed rate instruments. Commercial bank lending during the 1970s, on the other hand, was almost exclusively based on floating interest rate bases such as the

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20 *See 1993 Private Market Financing*; *supra* note 4, at 19, "Private sector issuers accounted for an increasing share of developing country bond issues in 1992, representing 42 percent of total issuance activity, compared with 31 percent in 1991 and 8 percent in 1989." Int'l Monetary Fund, *International Capital Markets, Part II. Systemic Issues in International Finance* 50 (1993).

21 Wolf, *Private Flows After Mexico*, FIN. TIMES, Jan. 21, 1995, at 15, col. 5. ("In 1993, 95 per cent of net private finance flowed to the private sector, while 70 per cent of net long-term flows to developing countries were from private sources to private users, up from 45 per cent in 1990.")

22 The rating agencies, however, still generally recognize a "sovereign ceiling" on credit ratings for private sector borrowers. That is, a private sector borrower, however solvent, will not be given a credit rating higher than that of its host country absent off-shore assets or a solicitous parent. *See* Fitch Investors Services, "Sovereign Risk Ceiling," Special Report dated Dec. 7, 1992.

London Interbank Offered Rate ("*LIBOR*"). When LIBOR rose to about 20% p.a. in the early 1980s, this vastly increased the debt service burdens of LDC borrowers and was a proximate cause of the last debt crisis.[23]

Use of Proceeds. If one looks at the reasons why some LDC borrowers have sought to disavow their international debt obligations over the last two centuries, perhaps the most common explanation is that the proceeds of the disputed financings did not contribute to the common weal in the debtor countries. It is one thing to contemplate repudiating a loan that found its way into the Swiss bank accounts of the government officials who approved the borrowing, or which financed the construction of a wholly decorative monument to the previous dictator.[24] It is quite another thing for a sovereign to question its moral obligation to repay a debt that clearly benefited the recipient country and its people. With this history in mind, today's investors prefer to see the proceeds of their credits used for productive (*i.e.* morally defensible) purposes.[25]

Economic Reforms. The debt restructuring programs of the 1980s were usually carried out in conjunction with IMF-sponsored economic stabilization and adjustment programs. Most of the countries that have come through the restructuring process, therefore, have done so with economies that have benefited from major structural reforms.

In the years immediately following the end of the debt crisis for many of these countries (1991-94), economic policy in the countries was guided by foreign-trained technocrats who openly embraced the objectives of free trade, sound money, low inflation and a reduced level of state involvement in the economy. These policies are precisely what foreign investors want to see in developing economies and the international capital markets readily (too readily as it turned out) interpreted them as a sign that the risk of economic mismanagement had receded to a point that was no longer worrisome.[26]

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23 *See generally*, Lindert, *Response to Debt Crisis: What Is Different About the 1980s? in* INTERNATIONAL DEBT CRISIS, *supra* note 6, at 229-234.

24 *See generally*, Thomas Wälde, *The Sanctity of Debt and Insolvent Countries: Defenses of Debtors in International Loan Agreements*, *in* JUDICIAL ENFORCEMENT OF INTERNATIONAL DEBT OBLIGATIONS 119, 124-29 (David M. Sassoon & Daniel D. Bradlow, eds., 1987).

25 *See* Moffett, *Latin Nations Open Up to Long-Term Foreign Capital*, WALL ST. J., June 23, 1995, at A10, col. 1.

26 *See* Krugman, *Dutch Tulips and Emerging Markets*, FOREIGN AFFAIRS, July/Aug. 1995, at 28. Krugman describes the so-called "Washington consensus" regarding LDC economic policies that developed in the early 1990s as: "Liberalize trade, privatize state enterprises, balance the budget, peg the exchange rate, and one will have laid the foundations for an economic takeoff;

Available Information. One explanation for why commercial banks overlent to the developing world during the 1970s is that the banks had remarkably little information about the economies of the debtor countries, their balance of payments positions, investment inflows, aggregate external debt, international reserves and so forth. When the crisis broke in 1982, some banks proclaimed that they would never have lent so much money to LDCs had they known that everybody else was lending so much money to LDCs.

High on the banks' list of priorities during the ensuing debt restructurings, therefore, was a requirement that the sovereign borrowers provide to the creditors exceptionally detailed economic information on a regular basis. The format for this reporting closely (and deliberately) tracked the reports that are submitted to the International Monetary Fund by its member countries. Most countries that have gone through a generalized debt restructuring over the past decade prepare and distribute booklets to their creditors on a quarterly basis containing these economic and financial statistics.[27]

A new organization, the Institute of International Finance (IIF), was established in 1983 for the purpose of analyzing and reporting to its members on economic and financial developments in borrowing countries.[28] The IIF now has more than 170 banks and financial institutions as members, as well as investment banks, trading houses and export credit agencies as associate members.

Remedies. Until the middle of the 20th century, a lender extending credit to a foreign sovereign did so with no expectation that he could compel repayment of the debt by legal means. Most countries recognized an "absolute" theory of sovereign immunity under which a foreign sovereign could not be sued in the national courts of another country without its express consent. Unless the debtor government could be sued in its own courts (an unlikely scenario), the only remedies available to disappointed lenders in the past were

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find a country that has done these things, and there one may confidently expect to realize high returns on investments." *Id.* at 29.

27 *See* Gilpin, *supra* note 14, quoting a senior Mexican official as saying that "The explosion of information is the biggest change that has happened" since the debt crisis started. *But see*, Michael Gonzalez, *Mexico's Mysteries Frustrate Wall Street*, WALL ST. J., June 19, 1995, at A6, col. 1. ("Analysts complain that, after a brief period of supplying better economic and financial data, Mexican bureaucrats are backsliding, either dragging their feet on requests for information or refusing outright to supply it."), and for a response from the Mexican Ministry of France, *see No More Mysteries about Mexico Economy – a letter of Alejandro Valenzuela*, WALL ST. J., July 28, 1995, at A15, col. 1.

28 Walter Sterling Surrey & Peri N. Nash, *Bankers Look Beyond the Debt Crisis: The Institute of International Finance, Inc.*, 23 COLUM. J. TRANSNAT'L L. 111 (1984).

moral suasion, diplomatic pressure (if the lenders' own governments were prepared to get involved) and threats to shut off additional credit unless outstanding obligations were honored.[29] In cases where the creditors' plight coincided with their governments' geopolitical interests, an occasional resort to the gunboat or to military intervention might be possible.

Most creditor countries now recognize a restrictive theory of sovereign immunity under which foreign sovereigns engaged in commercial activity abroad may be sued in the national courts of other countries.[30] Borrowing money in the international capital markets is considered a commercial activity for this purpose. In the United States, the restrictive theory of sovereign immunity was codified in the Foreign Sovereign Immunities Act of 1976 and in the United Kingdom in the State Immunity Act 1978. Drafters of credit agreements and bond indentures for sovereign borrowers and government-owned enterprises also routinely include express waivers of any immunities to which the borrowers may be entitled.

The cross-border lenders of the late 1970s thus had every reason to expect that their contracts with foreign borrowers could be enforced in courts of their own choosing. In practice, however, litigation was not attempted, except in rare instances, as a means for resolving the debt crisis. Several reasons have been advanced to explain this forbearance: the brotherhood of bankers, the fear of prompting a raised eyebrow of disapproval by one's regulator, and a recognition that any widespread resort to lawsuits would jeopardize the renegotiation process and force borrowers into a bunker mentality. Whatever the explanation, however, the creditors caught up in the last debt crisis did not try to sue their way out of it.[31]

Will the lenders of the 1990s be as tolerant? Those who believe that publicly-issued bonds will always be treated as a preferred category of debt and will be serviced faithfully even if other obligations go into default would presumably answer this question by saying that today's lenders will never be given any provocation to sue. If this faith proves misplaced, however, the conventional wisdom is that bondholders are a less tractable lot than commercial banks. Public bondholders are not regulated entities like banks. They are less susceptible to government pressure. They cannot be expected to agonize over the

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[29] *See* STATE INSOLVENCY, *supra* note 6, at Part IV.

[30] JOSEPH W. DELLAPENNA, SUING FOREIGN GOVERNMENTS AND THEIR CORPORATIONS 3-8 (1988).

[31] *See Avoiding the Nightmare Scenario*, INT'L FINANCIAL L. REV., Aug. 1992, at 19.

geopolitical consequences of their actions in the same way as the international banking community, and, bluntly put, there are thousands upon thousands of them out there who could potentially cause trouble. If debt problems were to recur in some of the developing countries, it is not at all clear that negotiated solutions could be pursued without the threat of harassing litigation by some creditors.

Disclosure. One important difference between borrowing money through a bond issue rather than a loan agreement is that the former will trigger the application of the securities laws in the countries in which the investors reside. Even if the transaction is structured to take advantage of an exemption from registration of the offering because the securities are sold privately to a limited number of sophisticated investors, the issuer will nevertheless be obliged to prepare and distribute a disclosure document of some kind. These disclosure documents, whether they are styled as prospectuses, offering circulars or information memoranda, are a significant feature distinguishing the cross-border lending activity of the 1990s from that of the 1970s.

CONCLUSION

Taking all these factors together, does today's cross-border lender stand a better chance of getting repaid, in full and on time, than did his predecessor in less enlightened times like the 1970s? Perhaps so. One thing seems certain however: the extrapolation of simple lessons from the last wave of cross-border lending is hazardous. The circumstances under which cross-border lending takes place today are significantly different from cross-border lending twenty years ago. One consequence of this, of course, is that the resolution of future LDC debt problems, if such problems recur, may also be very different from the methods used to resolve the debt crisis of the 1980s.[32]

The integration of the world's financial markets over the last twenty years is perhaps the single most important change in cross-border lending. Money can flow into and out of economies with astonishing speed.[33] The markets reassess a country's investment climate — interest rates, exchange rates, political factors, domestic economic policies, trade flows and commodity prices — on a daily or even hourly basis. The period of time between the markets' identification of an investment opportunity in a particular country and the

[32] *See* Rory MacMillan, *Proposals for Sovereign Debt Workout Systems*, 16 NW. J. INT'L L. & BUS. (forthcoming March 1996).

[33] Michael R. Sesit, *Mexico's Economic Troubles a Reminder of Risks in Emerging-Market Investments*, WALL ST. J., Dec. 28, 1994, at C1, col. 1.

flow of funds into that economy may be very short. Conversely, any diminution in investor confidence can be reflected in massive and immediate shifts of capital to the detriment of the developing country borrower.[34] Cross-border lenders in the 1990s hope that their borrowers understand these changed circumstances. In an era when good behavior toward one's creditors is rewarded with access to large and beneficent capital markets, and misbehavior can be punished instantaneously by a withdrawal of capital and restricted market access, the borrowers are expected to internalize the right lessons.[35]

That, in any event, is the theory. There are two worrisome qualifications. First, despite the sometimes frantic efforts of finance ministers to distance their countries in the minds of investors from some of their brethren who may be experiencing a reversal of fortune,[36] the markets are still not very discriminating in this regard. Mexico's devaluation in December 1994 produced what came to be called the Tequila Effect felt throughout the emerging markets.[37] Therefore, no matter how prudent, disciplined and conservative the economic policies of a particular developing country may be, the markets may unintentionally punish that country for the sins of its LDC cousins elsewhere. If this trend persists, it will severely weaken the argument that good behavior will inevitably bring good rewards.

Second, free-market technocrats have risen to prominence in many developing countries. These individuals understand what international fund managers expect in terms of economic and financial policies, and they are often personally convinced that such policies are necessary for a country's longer-term prosperity. The challenge in the balance of this decade, however, will be to persuade the citizenry of some developing countries that these longer-term objectives are worth more near-term sacrifices.[38] This may be a difficult sell in countries that endured nearly a decade of economic contraction in the 1980s and where the brief return to the sunshine of creditor approval in

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34 *See* Friedland, *Peso Crisis Highlights Diminished Roles of IMF, World Bank in Latin America*, WALL ST. J., Jan. 17, 1995, at A13, col. 3; Fidler, *More Liberal Flow of Funds Creates Instability*, FIN. TIMES, Jan. 27, 1995, at 4, col. 1; Carrington, *Private-Capital Flows Can Hurt Poor Nations*, WALL ST. J., Jan. 30, 1995, at A1, col. 5.

35 "[T]he markets will begin to exert more discipline on these countries," an investment manager has been quoted as saying. "If people don't like a particular policy, they will react to it, and exert a rather severe penalty on local securities markets." Gilpin, *supra* note 14, at 4.

36 Foster, *We Are Not Like Mexico, Plead Brazilians*, FIN. TIMES, Jan. 12, 1995, at 5, col. 1.

37 *Latin America in the Fallout Zone*, ECONOMIST, Jan. 7, 1995, at 59; Norris, *Mexican Shadow Falls on Emerging Markets*, N.Y. TIMES, Feb. 1, 1995, at D1, col. 2.

38 DePalma, *After the Fall: 2 Faces of Mexico's Economy*, NEW YORK TIMES, July 16, 1995, at Section 3, p. 1, col. 1.

1991-94 did not result in a sense for the average person of being appreciably better off. Unless a significant part of the citizenry understands and accepts that the benign face of open access to the international capital markets will occasionally wear a harsher — perhaps even a punitive — aspect, a return to economic populism will remain a brooding concern.