Crisis Point

The moment of truth came on a Friday in August 1982 when representatives of the Mexican government called on Jacques de Larosière, the managing director of the IMF, and informed him that Mexico had failed to raise the $700m it needed

to meet the next instalment of its $80bn debt and would be announcing a unilateral moratorium on interest payments on Monday. There was little de Larosière could do about it; the IMF was still more of an observer than a player. By chance, Minos had an appointment to see de Larosière later that day and heard the news. He was appalled. As a banker he knew that a moratorium would cause all the banks to take fright and bring things grinding to a halt, the very outcome that needed to be avoided. Moreover, as the architect of syndicated loan agreements, he knew that loans typically carried a so-called "cross default clause" which stipulated that if a borrower failed to repay one creditor, all its other loans would be declared in default as well, and called in. The knock-on effect would be tremendous: other defaults would follow and the banks would have to write off more debts than they had capital to cover. The result could be "the total collapse of the international financial structure". Minos pressed on de Larosière the importance of avoiding any mention of moratorium or default in the forthcoming announcement. Instead the event should be re-defined as "a rescheduling". Mexico was not refusing to pay, merely asking for more time. It was playing with words, but it might work.

In the days that followed, the world's largest banks were coerced by their authorities, and particularly by Paul Volcker at the Fed, into recognizing the inevitability of a Mexican rescheduling. The situation was only eased by an emergency loan to Mexico of $1.8bn from the Fed and the Basel-based Bank for International Settlements, the "central bankers' central bank."

The Mexican crisis opened up a Pandora's Box of debt problems in dozens of countries, and plunged the world into turmoil, forcing a period of tortuous negotiations to prevent collapse. The loans could not be written off, that much was obvious because such action would undermine the discipline of the loan markets and wipe out most of the capital of the world banking industry. On the other hand, the indebted countries needed money to keep their economies going and avert certain chaos. The central question was how to strike a balance between the competing interests of lenders and borrowers, and create some way to institutionalise it and make it safe. Minos, who had now left the world of the banking practitioner and become a consultant, was deeply involved in these questions, and in close contact with senior figures of the financial world who were seeking solutions: central banks, the IMF and World Bank, the large commercial banks of North America, Europe and Japan.

The discussions in which Minos participated reinforced his view that this problem, however urgent, needed a long-term solution, not the short-term bail-out

many people seemed to be advocating. The roots lay not in the cyclical ups and downs of the world economy, but in a major and lasting reshaping of the world economic structure: some countries had become permanently richer, others permanently poorer, and the latter had to be given time to adjust.

The Zombanakis Plan

Minos laid out his analysis and his proposed solutions in a bylined article in *The Economist* in April 1983[26]. In it, he blamed much of the crisis on the failure to understand in the 1970s the depth of the problem, that this was structural not cyclical. He was also critical of the Americans for squashing various rescue proposals put forward by people such as Denis Healey, and for believing that the market would eventually sort it out. His targets for criticism included the Federal Reserve whom Minos accused of complacency, even of granting tacit approval to a hands-off stance. Given this analysis, many of the short-term proposals doing the rounds at the time – temporary bail-outs, quick-fix rescheduling – were clearly not going to work. Something deeper and longer-lasting was needed.

The "Zombanakis plan", as *The Economist* headlined it, was built around a beefed up IMF whose job would be to agree long-term adjustment policies with the debtor countries and then underpin an extended period of rescheduling with repayment guarantees. Minos suggested a period of 13 years, with the IMF guaranteeing repayments in the last three. The advantages of the plan, as Minos saw it, were that it would not require banks to write off any debts, that it would give countries plenty of time to adjust, and that the financial system should be able to continue without interruption. Above all, it gave both sides an interest in, and responsibility for, a happy outcome.

It was a comprehensive proposal which showed Minos' characteristic grasp of a difficult situation and the components needed for a successful work-out. In its official history published a few years later, the IMF singled out the Zombanakis Plan as a good example of private sector debt relief initiative, though by some calculations there were as many as 33 such "plans" doing the rounds at the time[27].

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[26] *"The international debt threat: a way to avoid a crash". The Economist April 30 1983.*

[27] *"Silent Revolution: the IMF 1979-1989" Chap 11, p 480. IMF 2000.*

But the Zombanakis Plan failed to catch on because the financial crisis management community had no appetite for structured solutions[28]. Indeed, few people in the world were even able to get their heads around the problem: instead, they merely dealt with the issue closest to hand: how to keep Brazil solvent, how to stop Citigroup (which, under Wriston's driving leadership, had lent nearly twice its capital to Latin America's biggest borrowers alone) from going bust. *The Economist* itself thought the plan had the makings of a solution, but concluded: "The main tragedy of 1983 is that there is not enough international financial leadership about, even for the first stage."

In the end, there were no grand schemes to solve the Third World debt crisis, though whether this was because of lack of financial leadership or the sheer intractability of this immense problem is a matter of debate. Instead, the world muddled through, treating each country on a case-by-case basis, rescheduling, refunding, drawing on IMF guidance and resources – and steadily chipping away at the debt mountain through bank write-offs. Minos was hotly opposed to write-offs: he believed that by writing down loans, banks would make it impossible to mobilize new finance for the debtor countries. Who would lend 100 cents on the dollar to a country whose loans had already been written down to 50 cents? But time was the great healer. By the end of the 1980s, the crisis had eased and become merely a tedious process of rescheduling. Debtor countries recovered, except for those in Africa which remained a worry, and the banks regained their strength by merging and taking in new capital. It was not a glorious end to the crisis, but at least the world emerged in one piece.