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Transcript of interview with

PIETER P. BOTTELIER

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By: John Lewis, Richard Webb and Davesh Kapur

FOREWORD

The following is a transcript of oral interview conducted by the authors of the World Bank's fiftieth anniversary history: John P. Lewis, Richard Webb and Devesh Kapur, *The World Bank: Its First Half Century*, Washington, DC: Brookings Institution Press, 1997. It is not a formal oral history, and it is not a systematic overview of the work of the person interviewed. At times the authors discussed the planned publication itself and the sources that should be consulted; at other times they talked about persons and publications extraneous to the Bank. Some interview tapes and transcripts begin and end abruptly. Nevertheless, the World Bank Group Archives believes that this transcript may be of interest to researchers and makes it available for public use.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

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[Begin Tape 1, Side A]

BOTTELIER: As we know from the Bank-Fund dialogue of the last few years, collaboration on Algeria was very different and much happier than it was in the case of Argentina. In Argentina, the whole thing was driven to an impossible conflict. In the case of Algeria, I think, it led to a very constructive interaction and substantial modification of--of viewpoints and strategies, particularly on the part of the Fund. Well, if we have an opportunity later to perhaps draw some parallels, because in Argentina case everything went wrong; in the Algeria case, everything went right, at least in the relationship, not in the country.

WEBB: Yeah, okay, yeah.

BOTTELIER: That's a . . .

KAPUR: I mean did--could one speculate that U.S. interests or U.S. influence was more pronounced in one case than in the other?

BOTTELIER: U.S. influence or interests in Algeria is close to zero, and it was heavy in the case of Argentina. But I am one of those who believe that, whereas the U.S. interest played a role in the Argentina conflict, I don't think it was the leading element in that conflict. It was—as far as I can see—important, but in the total picture peripheral. There was a real institutional conflict on substantive grounds between the two institutions.

KAPUR: Because I had—I wanted to ask—I did some materials on Cote d'Ivoire, as sort of Argentina in reverse. And that story, of course, played itself out quite few years, now.

BOTTELIER: I don't know the Cote d'Ivoire story, but I would feel more comfortable having had an opportunity to re-read some of these things on Argentina, maybe if you wish discuss Morocco now, although my knowledge of Morocco is much more limited, because my association with that country has been much shorter. And there have never been any intense conflicts on Morocco, although it's still a very interesting country, I think.

KAPUR: The reason we sort of--I asked you for Morocco that--as we, sort of looking at the whole set of adjustment lending and policy influence at the Bank, we began to find that, look, there are just lots of differences when you look across countries. I mean, you cannot—it's not at all easy to pick one and say, "Look, this is a standard typology." And we've really not looked at any country; we looked a little bit at Turkey in the Middle East and North Africa Region, some at Egypt, the political aspects of that. But then we sort of came to understand that Morocco has actually been one of the "more successful" adjustment cases, very little is known, and also there is a lot of Bank's money, actually. It's one of the largest borrowers in the Middle East, if not the largest . . .

BOTTELIER: Oh it is. Oh, yeah.

KAPUR: . . . in the Middle East and North. And essentially none of us know anything, you know, anything about it. So, that's why we thought we'd sort of ask you because we think, you know, we might be ignoring something which might . . .

BOTTELIER: Well, that's—I welcome the opportunity because I—I did not know much about Morocco when I started working on it, and it was for me a very interesting experience to get to know that story and that country, particularly coming from Latin America where everything after the debt crisis went wrong. And why is it that? Morocco in '82, '83 had a debt situation not too dissimilar from that of the larger Latin American countries, yet it managed to climb out of the hole in a—I would say—more successful way, less conspicuous way. There was less firework in the policymaking than there was in Mexico or in Argentina or in Chile, but there was steady progress towards structural adjustments. Morocco managed its debt crisis in such a way that it did not lead to a contraction of economic output. It is possibly the only highly indebted country that managed to climb out of the hole without severe contraction. That's the interesting contrast with . . .

WEBB: Mexico?

BOTTELIER: Yes. [Laughter]

WEBB: Morocco, yeah. I was wondering, okay.

BOTTELIER: That was a big surprise to me, because how do you explain that? The basic situation in '83 wasn't very different from that in Mexico. If you look at the debt totals and debt service ratios, they look remarkably similar. And I'm not sure if that question has ever been posed in that way or systematically been answered. But merely noting that there are exceptions to the rule of chaos and decline, which has been the pattern in the Philippines, Latin America and Africa, is important.

WEBB: Right, right.

BOTTELIER: Africa south of the Sahara has been a problem, but Morocco shows that it's possible to do it in another way.

I think that Morocco's success is indeed also a World Bank success. I think the quality of the World Bank program in Morocco has been exemplary, and for a period of about 5, 6 years, it was heavily concentrated on adjustment lending. The core of the program was adjustment lending.

The period coincided with the tenure of a new finance minister in Morocco, who was an improbable finance minister--nobody thought that he would be able to get that country straightened out. His name is [Mohamed] Berrada--you may have come across his name, because he was chairman of the Annual Meetings in September--it was Morocco's turn to chair the Annual Meeting and it gave him global exposure. But that was in September '86 at the end of his

remarkable stewardship as Finance Minister. It never caught the attention, partly because in the international financial community (including World Bank and IMF [International Monetary Fund]) few people speak French. So beyond division chief and (if you are lucky) department director, you have very few people who know from first-hand experience what's going on in Morocco, because that's part of the French speaking world. The country that is most closely in touch with Morocco is France, and the relationship Morocco-France has been a very tenuous one, because the Moroccan King, Hassan II, has serious enemies in France, including the wife of President [Francois] Mitterand. So, France isn't going to blow the trumpet for Morocco.

So, Morocco did all these things--very serious structural adjustments in trade policy, in finance, in fiscal policy, in landholding policy, in, well, more micro-oriented financial policy such as interest rates--in a fairly inconspicuous way adding up over time to a remarkably comprehensive package of reforms. And I think it is the steady progress (without making big waves) that explains Morocco's success, led by its finance minister Berrada.

KAPUR: Who were his counterparts in the Bank then?

BOTTELIER: Well, my predecessor from '87 on was Kemal Derviş.

KAPUR: I see.

BOTTELIER: Yeah. I think he had a good program going in Morocco, and he knows the story much better than I do because my association was much shorter than his. But even before him--many of the adjustment loans were made or conceived before the '87 reorganization--those were good quality loans that were, with some exceptions, seriously implemented.

This finance minister Berrada got--to many people's surprise--the wholehearted support of the King. The King of Morocco was never known for his knowledge of, or interest in, economic development issues, but I think that the debt crisis woke him up to that. He became over time more a "development king," more acutely aware of the need to take economic policy issues seriously. The King bought into the objectives of structural adjustment when he saw that this was a way out of the poverty.

If you look at Morocco fifteen years ago, it was way behind Egypt in terms of development and income levels. If you look at Morocco now, it is way ahead of Egypt. In fact, Morocco is doing so well that I think it is the most dynamic country in the Arab world. In terms of level of development and per capita income, Tunisia is ahead of Morocco, but in terms of dynamism and encouraging private banking and private entrepreneurship, Morocco is ahead of Tunisia. Private investment in Morocco (both foreign and domestic) is booming.

WEBB: Is Spain a factor?

BOTTELIER: Yes, yes. Spain, as you know, has benefited enormously from its association with the EEC [European Economic Community], financially and in many other ways, because it encouraged--especially after [Felipe] González became the premier, Spain had confidence in its own business community. And Spain--though cost levels were rapidly increasing to West

European levels, has old historical contacts with Morocco. Morocco had, in fact, colonized part of Spain, and . . .

WEBB: [inaudible]

BOTTELIER: Yeah. Spain-Morocco contacts are very important, and Spain was perhaps the first major foreign investor to take an interest in Morocco. And you now have lots of Spanish enterprises with joint ventures in Morocco. Principally, Spain and France are the main sources of foreign investment in Morocco. But there are also many German and Scandinavian companies that have investments in Morocco. Morocco has started formal negotiations with the EEC on free trade association. It is thereby the first—if you call Turkey a European country—non-European country that is engaging in such negotiations. It is of very great historical significance for Morocco to be doing that, because Morocco has a kind of dualistic character. They are part of the Arab world and part of Africa, but the Moroccan elite feels more European.

KAPUR: That's true of Algeria, too?

BOTTELIER: No, no. Algeria is very different. Tunisia is more like Morocco in the sense that culturally (and its elite) it is also more focused on Europe than on the Arab world.

I was invited to attend a seminar in Seville, Spain, a few months ago where Morocco had invited key business people from all over the Europe to present its case. And they had hired a big hall, and I was a member of the panel to answer questions for the television and so on. And one of the mementos of that conference, presented to all participants, was a little pin which I couldn't quite identify what it was, but it was the Gibraltar bridge. The bridge connected the northern point of Morocco and the southern point of Spain (Gibraltar). So the national psychology, the aspirations of the elite, the top policy makers, is to build that bridge to Gibraltar, literally or figuratively.

And I think the significance of Morocco's structural adjustment program and the Bank's support for it, strongly since Finance Minister Berrada came on board, brought Morocco to a stage where it is accepted as a credible negotiating partner with EEC, which would have been unthinkable a decade ago. Morocco was a backwater. You went there to make a movie or to lie in the sun, but not for serious industrial policy talk. So, Morocco is a very interesting case where I think the Bank has played a significant, by and large successful role, but, as usually, the center of gravity in economic policymaking lies inside the county. The Bank can help a county along once it has decided to get its act in order; it cannot change the course of history. And Morocco is typical of a case where the local leaders were seeing the need for changes in trade policy in particular. They committed the country to reduce protective barriers, modernize the financial system, give more emphasis to social development. All that was supported by the Bank.

WEBB: Just to understand better what happened starting in '85, '86 . . .

BOTTELIER: Yeah.

WEBB: . . . what happened '83, '84, '85? Because the debt crisis is already pretty severe.

BOTTELIER: Yeah, yeah, yeah. Well, they started—I do not know—first, I should qualify that I do not know the history in detail of those two years. They had a big debt crisis like everybody else and were thrown to the IMF and to the Paris Club and had a big, had a whole series of multi-lateral debt reschedulings starting in—I think the first one was in '83. And their structural reform program, the first outlines of it were also conceived in '83. How much progress they made in the first two years, I don't know. I should know, but I don't. Kemal Derviş and/or Jed [John D.] Shilling probably know the history better. Jed was the division chief before Kemal came on board, before the '87 reorganization. If you want to know that earlier history, I recommend you talk to Jed Shilling.

WEBB: You know that name?

KAPUR: Yeah, yeah.

BOTTELIER: You know him. He is very—he is now COD [country operations division] chief for Indonesia, a very good man.

So, the program has its roots in basic decisions in '83, but it didn't gather real momentum until '85 or '86.

WEBB: Right. Um-hum.

KAPUR: What—I mean, you opened the conversation by saying that, look, here is a puzzle, that you have a case which sort of adjusted its way out of crisis without a shock in production.

BOTTELIER: Right.

KAPUR: Now, how—do you sense a difference in the design of the program, the Bank's, the way these SALs [structural adjustment loans], these adjustment programs were conceived? How do you see—how do you explain that?

BOTTELIER: I should be able to answer your question with better knowledge than I have. I haven't systematically studied it but I have some observations. I think the Moroccans have been fiscally more acutely aware of the need to strive for balances than most of the Latin American countries. Most of the Latin countries allowed fiscal balances to get out the whack for much too long. They had a much more conservative tradition of fiscal policy than Mexico—than Latin America. And the second major factor, I think, is that they did not begin the process with external trade liberalization. I think they concentrated on a revival of domestic agriculture and small industry and trades and services before embarking on the much harder step of becoming integrated in the world's economy. They didn't start doing that seriously until the latter '80s.

KAPUR: That was sort of—at least from the rhetoric of the Bank, the sort of Anne Krueger . .

BOTTELIER: Yeah!

KAPUR: . . days, and the sort of intellectual voice of the Bank would seem to portray policy . .

BOTTELIER: Yeah!

KAPUR: . . . at least if one looked at it from outside, as sort of a centerpiece of what one ought to [inaudible]

BOTTELIER: Right! I know it's been part of the discussion, but I also know that the Moroccans, maybe more by default than by design, didn't really concentrate on that until much later in the adjustment process.

WEBB: And the Bank did propose; it just didn't insist?

BOTTELIER: I do not know that history of the dialogue. I know that the big steps towards trade liberalization didn't come until much later in the process.

WEBB: Yeah.

KAPUR: That's also true of the other countries where the Bank has had more successful adjustment. China, for sure it liberalized slowly its external trade. Indonesia, again the same, with a gradual but no big bang trade liberalization.

BOTTELIER: Yeah, yeah.

KAPUR: Thailand.

BOTTELIER: You are on an important thing here. The Krueger legacy in the Bank is to give priority to external trade liberalization. It has been the Bank's ideology for many years. There are obviously many, many sides to this, but I am inclined to the view that was a mistake.

And I'm seeing that now again in Algeria; we put that on the front burner in our policy dialogue with Algeria, made it the subject of our second major adjustment loan. With the benefit of hindsight—and I have gone on record in Algeria to say so – it was perhaps a mistake. The Algerians were very surprised when I was saying that in public, because they think that an institution like ours would be able to correct itself.

WEBB: It's not very usual!

BOTTELIER: I make that point because I believe that the Algerian situation wouldn't be such a mess if they and the Bank hadn't concentrated so much initially on trade liberalization. To create sources of income and income growth for large numbers of people, we should have concentrated first on enterprise reforms, domestic trade reforms, service sector reforms, and agriculture. Once you have a growing income base for large numbers of people, like in China today, you can become more adventuresome and focus on external trade liberalization. It was probably a mistake to put so much stake on external trade liberalization before the country's domestic house was better in order. So, it's a very important scene to explore, I think, in your . . .

WEBB: And it's just, by the way, you know--I think it backfired in Peru.

BOTTELIER: Yeah.

WEBB: Because the Bank really pushed it in '82, '83 . .

BOTTELIER: Really.

WEBB: . . '81, '82, '83. The leverage really came starting the end of '83 with the crisis.

BOTTELIER: Were you the governor at that time?

WEBB: Yeah, and I was generally pro-reform, but the Bank was really pushing it. And I think things went—well, for that time it was far, now it was nothing but at that time it was far. And then there was a political reaction because then, as the crisis deepened, everybody blamed liberalization for the crisis.

BOTTELIER: Exactly.

WEBB: And then you had Alan Garcia who went completely the other direction, and that made all the problems much worse than before.

BOTTELIER: Yeah, yeah.

WEBB: Do you remember that?

BOTTELIER: Well, I do know the Peru story a little bit, because I was at one point director of the Bank's Southern Cone Department which included Peru, at least for a while.

WEBB: How long were you in?

BOTTELIER: Well, I--when I started as a director in Latin America in June '87, Peru was part of that department. But Peru had begun its default on its debt to the Bank already in January or February of that year. We couldn't lend to Peru and there was little my department could do other than keeping track of the economic situation and building contacts . . .

WEBB: In '87.

BOTTELIER: In '87. I became the director in June, I think it was. And in August, after several attempts to avoid it, Peru went into the non-accrual status because by then we had reached the 180 days.

And I have always thought that David Knox's demise in '87 was not entirely unrelated to this disaster because David Knox had been to Peru in April of that year, had spoken to Garcia personally, and had come back with the notion that Garcia wanted to avoid a debt crisis with the World Bank. He had told David Knox—I don't know how much of this is on file, and this is

completely outside the Morocco story but . . . He had told David Knox--I have a very vivid memory of that—that his prime minister, who was it again?

WEBB: At that time?

BOTTELIER: [Luis] Alva Castro.

WEBB: Yes, Alva Castro.

BOTTELIER: Yeah. Garcia told David Knox that Peru would settle its debt issue with the World Bank and that Alva Castro would confirm in three days. And that was at the time that [Barber B.] Conable had just become the new president of the World Bank. And Peru was one of the big issues with Price Waterhouse, the Bank's auditor. The immediate issue facing the Bank then was how to present the Peru situation in the '87 annual report. David Knox assured Conable that the problem had been licked. Well, Alva Castro never sent the telex, never sent any payments, and Peru just left the Bank dangling. David Knox looked just awful, because he had just given this brand new president assurances that the problem had been solved.

WEBB: Gee. I can just see--yeah. I didn't know that story . .

BOTTELIER: No?

WEBB: . . but I can understand it. He--Alan Garcia--fooled every one. He made it his business; it was almost a fulltime occupation. He was really perverse. He just loved to fool people. And he's a great actor.

BOTTELIER: Yeah, yeah.

WEBB: His own staff—he'd start with his own people. He would actually pick up the phone and call one of his own cabinet members, and he would mimic the voice of someone else.

BOTTELIER: No!

WEBB: He was a great mimic, and he would pretend to be--like as if I called you and I would pretend to be John Lewis, and I would tell you, "Devesh, you know what--that Richard has been saying these things about him? What do you think about, I mean?" And then he'd hang up and then he'd wait to see what happens. Well, he would do these things with his own staff. And, of course, he'd see if David Knox, being a straight-forward fellow, had been taken in.

BOTTELIER: I see.

WEBB: What a shame!

BOTTELIER: Well, that was the beginning of my association with Peru; it was a sad story. We tried very hard to persuade Peru to change its ways. My point man was a Spanish economist named . . .

I personally also spent a lot of time on the problem. We received a lot of missions from Peru. Every cabinet minister from Lima who had a chance to go to the United States came to visit us and tell us that they wanted to put the things right.

And, you know, in the beginning Peru's debt problem was not insurmountable. We kept in touch with all the project agencies in Lima and elsewhere to encourage them to keep doing things in line with Bank procurement guidelines and keep the accounts (and auditing requirements) in good order. "Even though we cannot disburse," we told them, "keep all your accounts in order and file your disbursement applications; they'll probably be good for money at some point."

WEBB: Yeah.

BOTTELIER: And, you know, in the first six months or so the arrears didn't really amount to more than maybe 80, 90 million dollars, and we were accumulating disbursement applications at roughly the same rate, so there was still in the back of my mind and my colleagues' the idea that if we can get a decent economic program agreed with Garcia, then they have so much accumulated eligible withdrawal applications that we can cancel out the debt: end of the problem. That was our strategy, but, of course, time was working against us.

KAPUR: Would you—I'm sort of—I'm sorry—I'm just wondering, do you think that if the fact that Garcia was thumbing his nose at the commercial banks, that the G-5 [France, United Kingdom, Spain, Italy and Germany] would have accepted that? I mean, do you think you would have come under pressure in any case?

BOTTELIER: Well, you know the Bank kept doing business with several countries that were in trouble with the commercial banks. Argentina is a prime example.

WEBB: Bolivia.

BOTTELIER: Yeah. I mean, we wouldn't have liked it, and there would have been a lot of dirty faces in the Board [of Executive Directors], but I think we would have done it. They'd, of course, stopped paying the Fund much earlier; I think they stopped already in '85. They stopped the Bank in early January or February '87. Why, I never understood.

But, I'd be quite happy at some point, if you wish, to go through my recollections of the Peru case, because that was a fascinating story.

WEBB: Yeah. Let's go back to Morocco.

BOTTELIER: Let's go back to Morocco.

WEBB: For us it's more novel than . . .

BOTTELIER: The broad picture I have painted of a country that successfully climbed out of the hole it was in is basically correct. The country is now in a position to embark on major new things. They, Morocco, could have high sustained growth, if they can effectively deal with two

major problems. One is the EMS [European Monetary System] in Europe, which is unstable and essentially unhinged. Morocco is critically dependent on its trade relations with Europe. Its exports to Europe have been booming, but its exporters are exposed to the EMS system. So for Morocco a stable Europe, a stable EMS system, preferably a Maastricht type of Europe, is very important for Morocco.

The second major cloud overhanging the Morocco situation is Algeria--again a problem not of their own making. As you know, both are Islamic countries. The big risk of growing instability in Algeria is that it will spill over, in the first place, to Tunisia, but Morocco is not immune. It is somewhat better protected than Tunisia, because of the king, a significant real power representing a source of political stability. But . . .

KAPUR: That's especially true in the spread of Islamic fundamentalism.

BOTTELIER: Yes, that is the big risk. And I think if—if Algeria gets unhinged (and that could happen) it could be very serious for the whole Arab world. Algeria, as you know, was a kind of leader in the Third World. It provided an alternative. Algeria, Yugoslavia, India were the leaders of the non-aligned movement. There's still that image, even though it is no longer based on reality. But in north Africa, Algeria is still being looked at as the country that could modernize without compromising its independence. It would be very dangerous for Morocco if Algeria became unstable.

KAPUR: Right. How much—I mean, I think we were looking at Algeria in a different sense, which was how the Bank has sort of over time dealt with, you know, kind of centrally-planned economies before the recent East Europe case. But over the past few years when we've been in that--we've been looking at Algeria also. I mean, Algeria and Algerian links with France are perhaps of a different order of magnitude than, say, Morocco and France.

BOTTELIER: Oh yeah, totally, totally.

KAPUR: And I believe that France is also very worried because of, you know, if you want to call it migration, potential immigration problem and so on. Has France been pressing the Bank on Algeria, by the way?

BOTTELIER: Well, not that I'm aware of. I've never experienced it as director for North Africa (Maghreb), although there have been some instances where the French ED [Executive Director] in the Fund was throwing around his weight, but that was not on Bank programming. It was on something else, more on the debt strategy.

You must realize that in the post-Second World War period, the two most bloody and serious independence wars were Vietnam and Algeria. Everybody knows Vietnam; far fewer people know Algeria. It has been a terrible period from '54 to '62. It has been a very bloody, cruel struggle, involving one million dead on the Algerian side, which represents ten percent of the population.

KAPUR: Much more than in Vietnam?

BOTTELIER: Yeah.

WEBB: I didn't realize that.

BOTTELIER: Yeah. It's awful.

KAPUR: You should see "The Battle of Algiers."

WEBB: I have seen it, a long time ago.

BOTTELIER: Yeah. It's a very good Italian-made movie, black and white, very powerful, it pictures the trauma very well.

Much of that still plays a role today. There's a schizophrenic relationship between France and Algeria. The Morocco-France relationship is very different; more to do with the personality of the king and the role of Mrs. Mitterand. There were some hostile books against the King that had been published in France and were publicly endorsed by Mrs. Mitterand.

France cannot rescue Algeria. Algeria is too big for France. So, France is in a box. They see things unraveling in Algeria but cannot do much about it, partly because they have no real relationship of trust and friendship with Algeria. There are a lot of contacts; a lot of Frenchmen still travel to/from Algiers, but there is so much suspicion still on the Algerian side that France can never be Algeria's main partner again. The World Bank is, I think, the main external partner of Algeria right now, but even we cannot do much there.

The Bank made big mistakes in Algeria. Whereas the Morocco program, on the whole, was well-conceived, the Algeria program from the mid-'80s onward was not well-conceived. We misread the economic problems in Algeria, I think. We've glossed over the depths of the public enterprise problems and of the debt problem. I was astounded to read in the president's reports on Algeria that went to the Board in '86, '87, '88 not a word on the debt problem while the country's debt service ratio was already around 70 percent.

WEBB: Did the debt service ratio go even higher?

BOTTELIER: Yes. 75 percent this year. Even higher than Morocco in '83. And somehow the Bank choose not to make that a prime issue, and they didn't make it a prime issue because the Algerians thought they could refinance their way out of the problem by gradually stretching maturities. And the Fund bought into that. It subsequently became one of the major issues in the dialogue between the Bank and the Fund. Both institutions failed miserably. When our perspective on Algeria's debt problem was eventually also accepted by the Fund it was too late. They are stuck now, totally stuck.

So, Algeria is the second biggest threat to Morocco. You have the instability of the EMS system (and the uncertainty about Maastricht), and then you have Algeria.

But otherwise I think Morocco is in a good position. They have modernized their public administration and take governing very seriously. They have begun to privatize state enterprises.

Morocco is different from all other countries in Africa that I have worked with, even different from Tunisia which is otherwise comparable. Morocco is well organized and has competent, strong leadership. If you go to a Moroccan government ministry, everything is punctual; people are on time and well prepared for meetings. You will not find trash in the corners. Everything is well-maintained. The streets are clean. It's amazing. I am told that it was not always so, that ten years ago Morocco was a backwater, a dirty country. It was, I'm told, when the King realized that the country was in trouble economically that he began to take economic policy issues more seriously, that he began to take discipline and maintenance as serious issues. Finance Minister Berrada took this to heart. People who have known Morocco over a long period of time say, "You just don't believe it, but everything is spic and span in Morocco now. Government offices used to be dirty, like in most poor countries."

WEBB: You mentioned Morocco's Finance Minister. Was he the beneficiary, or was he the cause of that change in attitude?

BOTTELIER: I think he was a major player in the improvement process. He was a man with vision and stamina; he enjoyed the King's personal support.

WEBB: But he was also persuasive...

BOTTELIER: A persuader and a powerful negotiator. He struggled with the major state-owned enterprises that, under the Moroccan patronage system—which is not completely dead yet—have significant political power. The largest Morocco state enterprise is LTC, a large phosphate company. Morocco is the largest phosphate exporter in the world, and the business is state-controlled. LTC is basically a state within the state, outside the budget. Other powerful state enterprises are the railways and the electricity company. With regard to LTC, the Finance Minister has shown that he has control over their investment budget so they can no longer spend whatever they please. It is an attack on the patronage system, which is still part of Moroccan culture, but much less so now than in the past. Morocco is indeed becoming a more secular, modern state.

WEBB: They sort of worked at this gradually.

BOTTELIER: Yes, bit by bit. The process is aided by the fact that Morocco's public administrators are competent and that the system has institutional memory; public servants usually stay on their jobs for a long time.

WEBB: [Laughter] I am laughing at the memory reference. Maybe they could advise the Bank.

When you were working on Morocco, did you have a sense that you were working with a reform group and trying to support them, reinforce them vis-à-vis others in government, or were you with the country--were you politicking, in that sense?

BOTTELIER: Yeah, yeah, yeah, in that sense. Morocco is not comparable to China, a country I don't know yet. But I understand that the Bank works with China, not with special groups within that country. In Morocco there is still some politicking (game-playing) by the Bank going on.

Nonetheless, the Bank played a constructive role in Morocco in my opinion. It helped the government consolidate power over state enterprises and supported significant public enterprise reform (e.g., through a loan in '85). One of the conditions of that loan was that inter-company arrears, which provides opaque opportunities for hiding problems, had to be cleaned up. Some of the problems reappeared later, but they are significantly less serious than they used to be.

In the case of Morocco, we battled less with the private industry lobbies than in Mexico or Argentina, for the simple reason that private enterprise was relatively less significant than in those countries. Although private enterprise is now coming up very rapidly in Morocco, we are still mostly concerned with social policy and the delivery of public services such as health and education.

KAPUR: Even, I believe, in '92 there was a SAL, a poverty-type SAL in Morocco.

BOTTELIER: Yes, very interesting loan.

KAPUR: And at first, I understand, the Moroccans refused to admit that there was serious poverty in the country.

BOTTELIER: That is correct, but I don't know the details. The Bank-led breakthrough in government thinking in Morocco about social issues preceded me. My Bank colleagues tell me that five years ago you could not even talk about the poverty problem in Morocco in official discussions. The government, led by the King, would not acknowledge that poverty was an issue, yet all the statistics indicated that it was. When I became director of the Maghreb department, I was pleased to learn that phase of the dialogue was behind us and that you could now openly discuss things like poverty with key Ministers, who actually asked us to do more in this field.

My first mission to Morocco was remarkable. I went there to discuss the lending program and other things, including a second PERL [public enterprise reform loan]. The program also included some large investment projects for railways and telephone communications with significant policy conditionality. I didn't like that too much, but I was inheriting the program. In the course of my first mission I began to develop doubts about the merits of a second PERL, partly because the country's overall economic situation was much better than I had expected and its forex [foreign exchange] reserve situation was in fact quite comfortable. Morocco benefited enormously from its support for Kuwait and Saudi Arabia. Saudi Arabia basically forgave them the two and a half billion dollars worth of debt.

KAPUR: [inaudible]

BOTTELIER: Yes, Morocco benefited financially from its role in the Gulf War, which was a risky thing to do. It was very much the King who was behind that policy; most ordinary people

didn't understand or like it much. There were, in fact, popular demonstrations against it, but the King prevailed. Now that this episode is behind us, we have to recognize that Morocco benefited enormously from the King's decisions regarding Morocco's role in the Gulf War.

[End Tape 1, Side A]

[Begin Tape 1, Side B]

WEBB: Excuse me. I'm embarrassed but I don't remember pearl. What is pearl?

BOTTELIER: Public Enterprise Reform Loan (PERL). Sorry. We speak in acronyms in this institution.

WEBB: Yeah. I'm used to it, but I still don't know them all.

BOTTELIER: In the course of my first mission to Morocco--just to finish on that story—I developed, as I mentioned, considerable doubts about the justification for a second SAL-type, quick disbursing loan, because the overall economic situation was in fact quite good. The balance of payments situation was quite strong and reserves were growing. There were other reasons for my reservations about a second PERL as well. So, I proposed to Finance Minister Berrada that he might wish to drop that loan request and use the money (about \$300 million) for other projects.

Berrada latched on to that idea. He had real vision and he was decisive. He said, "Not only do I drop that PERL, I also want to drop the proposed railway and telecommunications loans. I can get money from other sources for that. I want to use the World Bank to help me develop more difficult sectors, where it is harder to get international money and technical assistance. I want to use more of the Bank's money for the social sectors." It was the beginning of a significant shift in our lending program for Morocco.

KAPUR: That was which year? '90?

BOTTELIER: '90, yeah, October '90.

KAPUR: October. So just after the Gulf crisis.

BOTTELIER: Yeah. It was obvious that the Moroccans were riding on a wave of confidence in themselves, in their ability to not only climb out of the hole but stay out of the hole and get consolidated improvements in their economy. And it was rare that a Finance Minister had the vision and the confidence to voluntarily drop some large, relatively easy projects in favor of social projects such as urban slum upgrading and anti-poverty programs. But that is precisely what he did; he had to over-rule everybody in the cabinet. I had dinner with him and half the cabinet where this came up. Everybody hemmed and hawed about his proposed shift, but he stood firm. He said, "Now this is the way we're going to do it." And after that, nobody questioned him. Berrada, supported by the King, was Morocco's key economic policy maker. And he was fiscally conservative. He brought the budget deficit (which had been as high as 30%) to around 1% at present and never allowed it again to rise.

WEBB: What's his background?

BOTTELIER: Business. His father was a businessman. He'd actually run a factory, a textile mill and he also had a teaching post at the university. He received formal economics training in France. He later became a university teacher, but his main job was running a textile mill. He was grounded in economic reality.

WEBB: A great combination.

BOTTELIER: Yeah. And when he became Minister, some of his colleagues in the Cabinet thought that he could not even balance his own books, so how could he run the country? Individuals (like Berrada) can make a big difference in a country's economic management.

WEBB: Yeah. I know. It makes it hard to arrive at rules.

BOTTELIER: Yes. Yes.

WEBB: But it makes more fun for history, in a way.

BOTTELIER: Absolutely. Yeah. The broad generalizations we like to rely on have not always led to valid conclusions.

KAPUR: That's true of Mikhail Gorbachev.

BOTTELIER: Yeah.

KAPUR: Well, sorry, how do you see this [inaudible] for the institution's own advice, say, on trade policy and the like? Just as a counter-factual, do you think it's because the Bank itself, in proposing SALs and PERLS, had insufficient knowledge of country conditions on the ground?

BOTTELIER: Well, that's a very interesting question: how did SAL-type lending become so popular in the Bank? I think Anne Krueger and the people around her had a lot to do with it. And I think if you try to recreate the situation in the late '70s, early '80s, we would then begin to look for the first time systematically at the success of the Asian countries and trying to find and distill reasons from it. The main general lesson that our economic research people, led by Anne, came up with at that time was that it is critical to have openness to trade, or at least that exporters should have unrestricted access to imported inputs. That was the Korean model and so on. Liberal trade theory thus became the heart of development economics.

You remember the [Jan] Tinbergen development economics of the '50s and the '60s where economic growth was seen as dependent on capital formation and technology improvements. [Robert M.] Solow refined the second element in the development model by calculating total factor productivity. [Robert S.] McNamara saw development as something that was critically dependent on capital formation. He--for a while at least--defined the development problem in terms of money needed for investment.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

KAPUR: [inaudible] model.

BOTTELIER: Yeah. Capital output ratios. The Bank's research on the importance of trade liberalization for economic development was undoubtedly significant. But in our enthusiasm for liberal trade policies, we may have lost sight of other important factors that underpin sustainable development. We almost all jumped on the trade liberalization bandwagon; it gave the Bank a new philosophy, a new lease of life, it gave us something to talk about with the customers. We may have overdone it.

WEBB: It makes life a lot easier in the [inaudible]

BOTTELIER: Yes. Exactly.

WEBB: Almost like being in the Fund.

BOTTELIER: Yes. But it was only recently that trade liberalization ideology began to subside in the Bank. Larry [Lawrence H.] Summers was partly responsible for this.

KAPUR: Not Stan [Stanley] Fischer as much, you think?

BOTTELIER: Well, yeah, Stan was not an ideologue, but he did not provide strong counterweight to ideology as Larry did.

KAPUR: When you see the examples of adjustment lending success—Mexico, Ghana, Morocco, China, Indonesia—one common feature is that they are all closed, or relatively closed, systems of decision-making. Mexico might be democratic, but is ruled by a tightly knit elite. Ghana for sure.

WEBB: Authoritarian.

BOTTELIER: Yeah. Chile.

KAPUR: Chile. How do you see that? I mean, does Morocco fit that mold?

BOTTELIER: A little bit. The King was critical in bringing about the change. No minister could have done his job.

WEBB: I'm ignorant. Are there elections there? Is there a congress?

BOTTELIER: Yeah, but it's a strange kind of democracy. There is a congress and there are multiple political parties, but congress doesn't have much power. It's changed now. The interesting thing is that Morocco has, of its own will, partly to please the Europeans who keep pressing them, changed their constitution last year, reducing the power of the King. The King can no longer appoint just any prime minister. The new constitution was approved by a national referendum. The King now has to pick a prime minister who reflects the outcome of

parliamentary elections. And then the prime minister will pick the cabinet. It's a major political change. It seems perhaps a small step by western standards, but by Moroccan standards it's a leap towards reducing the patronage system.

And the interesting thing is that the constitutional change was masterminded by the King himself. In some ways you might even compare him to [Augusto] Pinochet, although the Moroccan King's source of power was very different. We should not forget, however, that Pinochet, contrary to most people's expectations, stepped down from power voluntarily after [Patricio] Aylwin had been elected democratically. He didn't kick up the fuss that most people had expected. The transition of power in Chile (from Pinochet to Aylwin) was in March '89. Or was it in '88?

KAPUR: It was the fall of '88.

BOTTELIER: Fall of '88, but the new government started March '89, I believe. Pinochet and the King of Morocco both stepped down from power, which is the hardest thing to do in politics.

WEBB: Yeah. Also sounds a bit British. Compressed in time, but everything is compressed in time.

BOTTELIER: Yeah, so Morocco has begun to move in the right direction. It is still, I think, quite a distance from a modern parliamentary democracy. And I don't think there is any intention for the King as such to step down completely, but he seems to be prepared to recede as he finds that the country can take care of itself.

You raised the question what the common threads are in the countries that somehow managed much better than others. And I also know the Indonesia a little. I was in the resident mission in Jakarta from '79 to '83.

KAPUR: That's after Stanley Please?

BOTTELIER: Well, Stanley Please's role as head of the Bank's resident mission in Indonesia was short and very unhappy.

WEBB: It was less than a year, wasn't it? Six months?

BOTTELIER: Oh, less than that, even.

KAPUR: You were there then . . .

BOTTELIER: I was the lead economist for Indonesia from '77 to '83, and the last four years I was in the resident mission.

KAPUR: . . . in the resident mission?

BOTTELIER: In the resident mission.

KAPUR: What precipitated his breakdown?

BOTTELIER: Stanley?

KAPUR: Right.

BOTTELIER: Well, only he can tell you. I have my thoughts about it if you want to digress for a moment on that.

I was invited to come to Indonesia by Jean Baneth, who was the Res Rep [resident representative] from about '74. In the end I couldn't go because of family reasons (my wife became very ill). I continued working on the basic economic report at headquarters at a time that serious conflict developed between Shahid Husain, the regional vice president, and Jean Baneth. Personality-wise you can't think of more different persons. Shahid didn't like Jean Baneth and thought he didn't do a good job and wanted to replace him.

By that time I had come to know the Indonesians reasonably well and was the carrier of a message to headquarters from Widjojo [Nitisastro], the chief economic minister to the government, that they actually liked Jean Baneth quite a lot and hoped that his Jakarta appointment would be extended. It was a personal message. Shahid ruled it out: no way. He wanted Ping Loh, who was already the deputy director of the Jakarta office, to become the next director.

And I again served as messenger, this time to sound out the Indonesians how they would react to the suggestion that we would appoint a Chinese to head of the office there. I knew Indonesia a little bit, but not well enough to know when an Indonesian "yes" means "no" or "no" means "yes." And I was not the only one who made that mistake. So, based on my soundings in Jakarta, I thought that the Indonesians would accept Ping Loh in the role of director of the Bank's Jakarta office.

However, when Shahid's proposal to appoint Ping Loh as the next director became official, the Indonesians had to show their true colors; they then informed the Bank that that would not be acceptable to them. We then understood that the key issue was the fact that Ping Loh was Chinese.

As a matter of fact, the issue of Ping Loh's appointment as head of the Bank's Jakarta office went all the way up to President Suharto. He, apparently, could not tolerate a Chinese in such a sensitive position in his country. Of course, the Indonesians officials at a lower level couldn't say so or explain it on paper. The official reason given to the Bank for the government's decision to turn down Ping Loh was that he only had the rank of Division Chief whereas the head of the Jakarta office had always been a Director. So the official reason was that the appointment of a Division Chief-level person implied an unacceptable down-grading of the office. Therefore, the official Bank response had to be to appoint a director as successor to Jean Baneth. That's how Stanley's appointment as head of the Jakarta office came about.

Stanley Please, who was programs director for the East Asia Vice Presidency under Shahid Husain (after having served as chief economist under Shahid in East Africa), was picked by Shahid to become Res Rep in Jakarta, in a gesture to be responsive to official Indonesian concerns about the rank of the head of that office. Stanley never liked the idea of moving to Jakarta but accepted it because he respected Shahid very much and wanted to be constructive. But Stanley's wife Margret liked the idea even less and that became a huge problem. They went to Indonesia, but Margret was so unhappy they never even tried to find a house in Jakarta. They stayed in a hotel and made little effort to integrate themselves into the local society. When they went on home leave for Christmas, they never came back. Stanley had a serious nervous breakdown and that became the medical reason for ending his job in Jakarta.

Then we were really in trouble: Shahid had botched the appointment of a successor for Jean Baneth twice, once by proposing Ping Loh (after not extending Jean Baneth), then by appointing a director who turned out to be unfit for that job. It was only then, after 8 or 9 months during which Ping Loh served as acting director of the Jakarta office (with me as his de-facto deputy), that Russ [Russell J.] Cheetham was appointed as the new director.

That was also the time. I believe it was in 1981, that we were discussing a critically important economic report with the government. At the time the oil price was going down, which changed many things for the Indonesian economy. Our economic report, which was managed from the field, made an in-depth analysis of all the dire consequences for Indonesia if the government failed to adjust to the lower oil price. The draft report was discussed line by line, over several weeks. The grey cover (final version) of that report, which came out six or nine months later, bore little resemblance to the draft (green cover version). It was a thin report, which noted that the government had done this and that, including many policy changes in response to the changed outlook for international oil prices. For example, Indonesia adopted a different exchange rate policy, modified its public investment program—by dropping several big petrochemical projects which had become unaffordable and uneconomic. Although the Indonesians made all the decisions, the Bank's role was very important and constructive. In the end Indonesia became the only oil exporting developing country that avoided the debt crisis. Other major oil exporters—including Mexico, Venezuela, Nigeria, several of the Arab countries--experienced crisis conditions because they were unable to anticipate the problems or did not have the political power to make the necessary policy changes. Suharto, with his closed decision-making systems, had the political power and the wisdom to recognize the problems and to take appropriate (and timely) action. The Bank's role was pretty fundamental in this.

WEBB: Would much of this have gotten to him personally?

BOTTELIER: To whom?

WEBB: Suharto. The [inaudible] reports?

BOTTELIER: No, we had no direct dealings with Suharto.

WEBB: It was through Widjojo?

BOTTELIER: Through Widjojo. Yeah, yeah.

WEBB: Key decisions were taken by him?

BOTTELIER: Yeah.

KAPUR: Just a quick aside: Widjojo is on our advisory council for this book.

BOTTELIER: I see. Well, talk to him. He's a great economist and historian.

WEBB: If he ever shows up. But we talked to him when we went to Indonesia.

BOTTELIER: I see.

WEBB: We were there a week and talked to him. In fact, he took an enormous interest in the project—almost too much because he kind of shepherd [inaudible] of our work. He would call everyone we were going to visit before and brief them.

KAPUR: [inaudible]

BOTTELIER: Really.

WEBB: So we thought that we were a little bit manipulated.

BOTTELIER: Well, I'll tell you that, as lead economist in Jakarta, I got to know Widjojo and his colleagues reasonably well. And when, in a later assignment, I saw the great potential of Morocco, I advised the government there to study Indonesia's economic experience and policymaking capacity seriously. The Moroccans did precisely that and were impressed by what they saw.

WEBB: The Moroccans.

BOTTELIER: I proposed to them that we organize a seminar in Morocco for the government and the private sector on the Southeast Asian experience. I offered to organize it with contacts in Korea, Indonesia, Malaysia and Thailand. And I invited speakers from those countries; I even invited Widjojo from Indonesia, but had no expectation that he would come--I hadn't been in touch with him for years. But he did come and participated fully in a two-and-a-half day conference we had organized. It was a big thing for Morocco. Widjojo recounted several of the stories I have just been telling you. He confirmed that the Bank had played a major role in shaping his country's economic policies. Most of these stories have never been written up.

WEBB: I must say we talked to a lot of people while we were there for a week. I've really been worried because everyone we talk to gives us the same story.

BOTTELIER: Is that right? Really?

WEBB: Yeah. Or just about. It's a very nice story about the Bank's value added. But also it's interesting to know more about the Bank's methods; the policy dialogue, the rather low profile, the non-pushy manner.

KAPUR: The four or five page memos which are [inaudible]

WEBB: It's a very interesting story. It's nice to have such a story.

BOTTELIER: Well, it's--that story is one of the important experiences that helps me prepare for my next assignment: China. I understand they want to try something similar.

KAPUR: Do you see some similarities when you see these case studies where the bank has been successful?

BOTTELIER: Well, the Mexico story I know reasonably well, also. After Indonesia I was asked to become the programs Division Chief for Mexico, in July or August '83, right after the crisis.

KAPUR: When Reiner arrived?

BOTTELIER: Reiner Steckhan started his assignment as programs department director in April of that year. I became the programs Division Chief a few months later, when D.B. [Devbrat] Dutt left and Eugenio Lari was replaced by Reiner. I don't have the time now, but if you are interested--I know you must have spoken to many people on Mexico, but I know the history of the period '83-'87 . .

WEBB: That was a very interesting . .

BOTTELIER: . . and there are not too many people who know that. Reiner was--with all respect to him--was not at the center of it, and neither was David Knox.

WEBB: Well, then we would really like to talk to you about that.

BOTTELIER: The two most interesting stories in my Bank career so far are Mexico and Argentina.

KAPUR: Well, that would be—we would need an hour for all that. [inaudible]

BOTTELIER: I feel flattered. I'd love to tell you my understanding of the Mexico story some time.

[End Tape 1, Side B]

[End of Session]

Session 2
January 11, 1993
Washington, D.C.

[Begin Tape 1, Side A]

BOTTELIER: . . what I am going to tell you is for you people and not for other uses.

WEBB: No, no way. If we wanted to, we'd call you up and say . . .

BOTTELIER: Yeah. Okay.

LEWIS: And I will in advance apologize. I'm going to peel off about 5 o'clock as I have to go catch a train, but I wanted to be in on at least a good part of this conversation. So why don't you set it in motion?

WEBB: Have you seen the [Jacques J.] Polak piece?

BOTTELIER: Yes, yeah.

WEBB: I'd very much like to go to the Argentina story.

BOTTELIER: Yeah. Okay.

Well, I read Polak's draft chapter with considerable interest, partly because of its generic importance but also because I was an actor in the Argentina story.

My overall reaction is that, although the chapter is very well written, it leaves me profoundly dissatisfied, mainly because it doesn't ask the right questions. It starts from overly simplified notions about the distribution of work between the IMF and the World Bank, notions that are not subsequently questioned or analyzed. And when it comes to specific illustrations of where things went well or not so well, the author does not raise any questions regarding the substance of the underlying issues; he simply takes the primacy of the Fund for granted. That is where, in the eyes of key actors at that time, much of the problem lies. The difficulty with the Argentina story in the chapter is that the facts as described, though supportive of the conclusions, are questionable. We need a detective of superior capacity who can see realities beyond the so-called facts, to come closer to the truth.

In the Argentina case the reality of the facts and circumstances underlying the story is much more complex than described in Polak's draft chapter. I urge you to come to grips with the substance of the issues that we dealt with; then you'll see that there is a very different story on the role of the Bank in the Argentine case--the devil is often in the detail. You will find that the substance of the issues we dealt with support a very different story from the one that is presented in the draft chapter.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

Argentina became a showcase of faulty interaction between the IMF and the World Bank for a variety of reasons. The Argentine country managers responsible for economic management and contact with the Bretton Woods institutions were not entirely innocent themselves. When they saw the possibility of a split between the two Bretton Woods institutions, they tried to play one against the other.

WEBB: Um-hmm.

BOTTELIER: I got a copy of Shahid Husain's response to the draft chapter, which I thought was excellent. I would have gone even further on some points. Polak's characterization of Bank involvement in Argentina as a "debacle" or a "disaster" is vastly overdone. One could easily characterize the Fund's involvement as an even bigger disaster. The author doesn't analyze the underlying substantive issues, leaving the reader with the impression that the debacle was entirely on the Bank's side and that the Fund did the right thing. The truth of the matter is very different.

When I came on the scene as programs director for the Southern Cone of Latin America in mid-'87, there was already a considerable history of unhappiness between the Fund and Argentina. After [Raul] Alfonsin had won the elections and [Bernardo] Grinspun, the first Economy Minister--before [Juan V.] Sourrouille; was it not Grinspun?

WEBB: Grinspun? I don't remember. [Mario] Brodersohn?

BOTTELIER: Brodersohn was the finance secretary under Economy Minister Sourrouille.

Anyway, the Fund had attempted for some time to support macroeconomic stabilization efforts in Argentina, but had failed quite badly. This was a reflection of the enormous difficulty that Argentina had in coming to grips with fiscal problems at the central level. Those fiscal problems are due to many underlying problems that to our knowledge were never thoroughly examined by the Fund. It led to growing problems between the Fund's management and Board on Argentina.

For example, the need for repeated waiver requests led to an angry exchange in the Fund's Board in December of '87, when an ongoing standby had, once again, run into trouble. I was present at that Fund Board meeting and recall that the MD [Managing Director] was sharply criticized, particularly by the Europeans, for having been too soft on Argentina. Whilst the Board agreed to the management's waiver, the MD had to accept that this was the last time that the Board would entertain a request of this kind. That set the tone for a much tougher attitude from the Fund's management to Argentina and growing tension between the Fund's management and Board on that country.

The Fund's management then proceeded with the redesign of its Argentina program. It became almost a new program. It was under preparation in January-March of '88. It was our impression that, partly because of the growing tension between Fund management and Board, the management was eager to set standards for Argentina that were seen to be fiscally very demanding. That was early '88, a time that major debt restructuring agreements, linking

commercial bank tranche releases to the borrowers' eligibility for Fund drawings, were beginning to work.

We in the Bank became quite concerned that the Fund's fiscal demands on Argentina were excessively tough. We worried that those standards would jeopardize the debt restructuring agreement with that country.

LEWIS: Just one minute. I want to ask you: the toughness in the Board of the Fund—was that across the whole Board or was it mainly the OECD [Organization for Economic Cooperation and Development] members or the G-7?

BOTTELIER: Mainly the G-7, and mainly the Europeans, the Australians and the Scandinavians.

LEWIS: Not the U.S.?

BOTTELIER: No, I don't remember that the U.S. took a leading role in this. It was mostly the Europeans, the Germans, the Dutch, as well as the Australians and the Scandinavians.

KAPUR: The Australians?

BOTTELIER: Yeah.

KAPUR: Quite amazing . .

BOTTELIER: They were the worst of all.

KAPUR: . . given their own deficits.

BOTTELIER: They were the worst of all. They couldn't . . . [Laughter]

At that time the World Bank had, for the first time, a self-standing Argentina program division. Argentina was considered so important that, a few years earlier, the Bank set up a special division to focus on that country. Hence, we had accumulated a lot of in-depth knowledge of the underlying reasons for Argentina's fiscal problems, particularly with regard to relations between central government and provincial governments. For example, we knew a lot about problems of the state-owned railways, ONS [Obras Sanitarias de la Nación] problems, Yacyretá [dam] problems, which constituted an enormous fiscal drain, already in those years. We felt that the Fund's emphasis on fiscal aggregates was too simplistic and unsatisfactory, because that approach was blind to the underlying structural and sector-specific problems. We became increasingly convinced of the critical need to focus on those underlying factors and that an exclusive focus on the fiscal aggregates could lead to the wrong remedies.

And yet, in typical Fund fashion, with fairly short-term analysis and limited knowledge of the underlying sector issues, the Fund continued to concentrate on the fiscal and monetary aggregates. It had its own logic, but made limited sense to us in the case of Argentina, because it

was possible to improve those aggregates in ways that would worsen the country's economic problems in the longer run.

And that became the essence of the debate between the Bank and the Fund on Argentina.

WEBB: Excuse me, excuse me. Just to be clear on that: it was completely focused, then, on fiscal, the debate?

BOTTELIER: The debate between the two institutions at that time was almost entirely on fiscal issues.

WEBB: It wasn't exchange rate, didn't come into this?

BOTTELIER: No. It was not because we disagreed on the logic of macroeconomics and the need to have certain aggregate standards, but we became increasingly convinced that, unless the desired aggregates were achieved in a certain way, it wasn't worth it, because aggregate fiscal adjustment can be achieved in sustainable or unsustainable ways. For example, we wanted to get rid of export taxes, while the Fund didn't seem to mind raising them to reach certain aggregates.

WEBB: I'm sorry, because this is really, I think, interests me. The debate was about sustainability. I presume that was the heart of the question.

BOTTELIER: Yeah. We called it "the efficiency of the adjustment process." We didn't really disagree on the logic of the aggregates, but we were more relaxed on the timing of achieving macroeconomic adjustments, provided the adjustments themselves were the right ones (sustainable and efficient).

WEBB: I mean, there's certain things you can--you can hold your breath for a while but not indefinitely. This sort of thing.

BOTTELIER: Yes, exactly. Argentina's problems of inter-provincial and provincial-central arrears are absolutely critical. But those problems can be relatively easily hidden through central bank overdrafts which don't appear in fiscal deficit as typically defined by the Fund. The World Bank was in fact tougher on Argentina, because we had a more comprehensive definition of the fiscal deficit. By our standards of analysis--and that's an irony, because we are not supposed to be specialists in macroeconomic work--the fiscal problem in Argentina was much greater than the Fund made it out to be. For example, we included a large part of the automatic overdrafts of the provinces on the central bank in the fiscal deficit; in the Fund's definition those overdrafts were simply central bank assets.

We published articles on the definition of Argentina's fiscal deficit, including the quasi-fiscal deficit. We exchanged articles with the Fund on this. In the end, on this particular issue, the Argentines became persuaded that our definition was the correct one. Subsequently, the Fund adopted the Bank's definition.

I think we won the debate with the Fund on Argentina's fiscal problems. Why? Because we knew in much greater detail what was going on in the sectors and in the provinces. We knew that the provinces could never repay all their loans. We knew that some of them were in the nature of fiscal deficits while the Fund accepted them as assets of the lender.

WEBB: Were you also looking at—since you mention the word “efficiency”—the effects of cutbacks, in investment in particular, how that could be done in the least damaging way possible?

BOTTELIER: Yes. Very much so. Yes. In the--well, I shouldn't accuse the Fund lightly; of course those fellows are very intelligent and the quality of the Fund's work is improving a lot--but in the Fund you can achieve your fiscal aggregates in all sorts of ways, one of which is to reduce your investments. We were very concerned, because Argentina's infrastructure was already falling apart, with the overall investment level in the economy having fallen to below ten percent of GDP, not even enough to fill the potholes. We were concerned about the tremendous “decapitalization” in Argentina, an issue that was never raised in the Fund. We didn't want any of the burden to fall on otherwise sound investments. And, of course, within investments you have to prioritize. We wanted the burden of fiscal adjustments to fall on recurrent expenditures, privatization and public enterprise reform in general, cutting overheads in the civil service. Some of those fiscal adjustments subsequently became objectives of World Bank-supported projects.

We were focused on more comprehensive, structural reforms in the Argentine economy and were concerned that the Fund's relatively easy, short term, aggregate-macro programs could do more harm than good in the longer run. We were working on a series of major sectoral adjustment loans in agriculture, power, housing, and trade, that we thought over time would attack the underlying fundamentals, thereby permitting the country to make the necessary fiscal adjustments in a more sustainable way. That was the heart of our argument. When we alerted the Fund to our concerns about their fiscal adjustment program for '88 and '89, they brushed those aside.

We escalated the issue internally in the Bank and brought in Stan Fischer, who was then the Bank's Chief Economist. When we read Polak's draft chapter, we got the impression that Stan Fischer was more on the side of the Fund than on the side of the Bank. And at some point Stan became very concerned about Argentina's performance. When he focused on our arguments, he was entirely on our side; he agreed that the issue was so important that it had to be raised with the Bank's president Barber Conable.

Stan was present at a long meeting we had with Conable, who invited Paul Volcker. That's another detail that is not mentioned in Polak's chapter. Conable had never been confronted with so much disagreement between the Bank and the Fund on substantive issues. He offered Paul Volcker a twenty-day-a-year contract at that time. We jointly reviewed the conflict with the Fund on Argentina in Conable's office with [Moeen A.] Qureshi, Paul Volcker, Stan Fischer, Shahid Husain, myself, and, of course, Conable himself. The U.S. government, which was thought to be the leading agent in this conflict, was nowhere on the scene at that time. It was essentially an argument on substantive development policy issues between the two Bretton Woods institutions.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

LEWIS: When you say that Stan had, at another time, taken a more Fund-like attitude, was that earlier?

BOTTELIER: Later, when Argentina clearly under-performed and perhaps even “used” the Bank for its own purposes, Stan began to express the need for caution. But in those times—and I am talking about March, April ’88—Stan, Volcker, Conable, Qureshi, Shahid Husain were all of the opinion that the Fund was going in the wrong direction on Argentina. We all recognized, of course, that Argentina was a very difficult country. We agreed that Conable should write a letter to [Michel] Camdessus on the Argentina issue, which he did.

We drafted the letter (which he changed a bit), but it wasn’t even mentioned in Polak’s draft chapter. The letter said, “Could we please discuss with you these overall fiscal targets that you have set for Argentina, because we are concerned about their achievability and their effects if they are not met.” It was all in polite language and very general but very clear about our concerns.

Conable’s historic letter to Camdessus (which was endorsed by Paul Volcker) was never responded to. I remember quite clearly Paul Volcker telling Conable, at the meeting I referred to, that the Bank was right and should take the “high road” in the case of Argentina. And this was before the conflict with the Fund came into the open. I repeat, the conflict was on substantive policy issues, not on ideology.

Since we didn’t get a reply to the letter, we requested a meeting. A meeting with the Number 2 in the Fund—I don’t remember his name—took place several weeks later.

KAPUR: Wasn’t it Dick [Richard D.] Erb?

BOTTELIER: Indeed it was Dick Erb. Other Fund staff at that meeting included Ted [Edmar L.] Beza, the Division Chief and the country economist for Argentina, whose name slipped my mind. On our side we had Moeen Qureshi, Shahid Husain, myself and the country economist, which must have been Desmond McCarthy at that time. It became a disastrous meeting; the Fund did not want to listen to the Bank on macroeconomic policy issues. They essentially told us, “Get off our turf.” It was a very unpleasant meeting, and it made Qureshi, in particular, very angry. The meeting, along with other factors, led to a further deterioration in the relationship between Bank and Fund.

There was another aspect to this story, which was very important and you should talk to Qureshi about it. There was an ex-senior Fed [U.S. Federal Reserve] member called Ed Joe—I don’t know if you have come across him?

WEBB: Ed J-O-E?

BOTTELIER: J-O-E, yeah.

WEBB: No.

BOTTELIER: Joe had worked for Volcker and for [E. Gerald] Corrigan in New York and was a kind of special agent used by the U.S. government.

KAPUR: Oh, he's mentioned, I think, in Bresser's [Luiz C. Bresser Pereira] paper. I remember he used the word "secret agent."

BOTTELIER: Yeah? Did he? Really?

KAPUR: Yeah. Ed Joe, yeah.

BOTTELIER: A very important figure, who never put anything on paper and didn't work with any personnel. He only worked with the top guys and for some reason was particularly interested in Argentina. Ed Joe was the one who had steered the Argentinians away from dealing with the Bank on macro issues and said you'd have to go to the Fund. Ed Joe was at once the secret agent of the Fund and of the U.S. Treasury—or maybe I should say the Fed.

KAPUR: Yeah, he mentions, "Meanwhile, I was discussing with Edwin Yeo . . ."

BOTTELIER: Yeah, that's him.

KAPUR: ". . . a mysterious representative of Paul Volcker . . ."

BOTTELIER: Y-E-O.

WEBB: Y-E-O. I remember now. . .

KAPUR: ". . . and Michel Camdessus was called 'the pigeon' by Latin American finance ministers."

BOTTELIER: I see, yeah.

Well, I am raising it, because in the evolving story of World Bank involvement in structural adjustment and macro issues, Moeen Qureshi hadn't really been accepted internationally, and this fellow, Ed Yeo, was essentially the one who made it even more difficult for the Bank than it was already. After the disastrous meeting with the Fund I mentioned, Qureshi in particular felt motivated to prove that we could do decent macro work also. The quality of the sector and macro work that we had done on Argentina was such that Moeen felt comfortable on substantive grounds.

Our concerns about the tightness of fiscal targets in the Fund's revised Argentina standby proved justified. Already in May, after their Board approved the revised standby in late March or early April, Argentina ran off the track completely, making it impossible for them to comply with some conditions of Bank SALs, while giving the commercial banks an excuse not to disburse their tranches. What we had feared might happen did in fact happen.

I'm not saying that the Argentines were beyond reproach, but in May we had an impossible situation because they had fallen out of compliance with the Fund. We therefore theoretically had to suspend all the work on the major adjustment loans that were in one stage of preparation or another, which represented a major investment of Bank time and resources.

The Alfonsin government had begun to make the right noises on where they wanted to go. Alfonsin had made a major speech in October or November of '87 in which he outlined his strategic objectives, including privatization and a realignment of the fiscal/financial relations between provinces and the central government. We felt that the failure of the Fund's program less than one year before the next election was a terrible thing; it threatened to unhinge a sound emerging adjustment program in a very difficult country.

The Fund couldn't do anything; they were boxed in. This is an element that isn't explained at all in the Polak story. Camdessus couldn't go back to his Board; he couldn't develop a new program; he couldn't go for a waiver. There was nothing he could do. The only agent that could do something was the World Bank. In Polak's story, it seems as though the Fund made a deliberate decision to sit back and wait for the elections. The Fund was in fact boxed in; it couldn't do a thing. The Fund's management had lost its credibility on Argentina with the Fund's Board.

I forgot to tell you one important thing. In early '88, because the situation was so complicated, we proposed a somewhat unorthodox approach to formulating an international assistance strategy for Argentina. For that purpose, we proposed to create a forum, including the Argentine government, the IMF, the World Bank, and the U.S. Treasury--the four main actors--to see if the four of us, by exchanging information more intensively, could come up with solutions (involving the commercial banks) and steer away from disaster.

WEBB: When was that?

BOTTELIER: Early January '88. That was an initiative we had taken with the support of the Argentines to broaden the dialogue on Argentina's macro situation and debt. The debt problem isn't even mentioned in Polak's paper, but that was, of course, a major aspect of the situation. The Fund said "NO" to our proposal. They didn't want to have any of this. Consequently, our proposal fizzled out.

When Argentina had fallen out of compliance with the Fund in May, the Fund was stuck--we were potentially also stuck--but then came a very interesting initiative. Sourrouille asked the Bank--in July, I think, maybe end June, July--if, in the absence of the Fund, we would be prepared to be their partner in the formulation of a medium term structural program and a parallel short term macro adjustment plan. He was determined to go forward with the structural program that was under preparation. That request was made to Qureshi, who was psychologically ready to accept it because he had been rebuffed by the Fund on several occasions. He also had to prove Ed Yeo wrong and show that the Bank could do decent macro work in important member country. What exchanges with the U.S. Treasury took place at that time between Qureshi and/or Conable, I don't know. I only heard about U.S. Treasury involvement at a later point.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

Qureshi accepted Sourrouille's request with both hands and asked his regional vice president, Shahid Husain, who was then in Ecuador for Spanish language training, to go to Argentina ASAP [as soon as possible], assemble a team of top-notch macro and sector experts, and respond to this unusual request. Shahid then put together a high-powered mission, precisely as Sourrouille had requested, ASAP.

I was the department director at that time and became heavily involved in putting together a combined medium-term and short-term adjustment program for Argentina, knowing that the Fund was essentially counted out; it couldn't come back. I visited Argentina several times during a short period of time to work out the details. It became a highly structured program of medium-term sectoral policy adjustments, supported by four major quick disbursing loans, combined with a short-term macro adjustment program, which looked in many ways like a typical Fund program.

The whole package was then negotiated in Buenos Aires, just before the Annual Meetings in West Germany in 1988. I flew directly from Buenos Aires to Berlin and reported to my superiors, who were already there, that we had reached agreement with the Argentines both on the medium-term package (which would be supported by Bank loans), a short-term macro package with specific short-term monitoring criteria, and on the remedies. We had very strict remedies, because we knew this was a high risk game; we didn't want to expose the Bank to excessive risks. We wouldn't have to disburse on any of the medium-term structural adjustment loans in case certain short-term conditions/objectives hadn't been met. We were almost acting like the Fund.

I briefed the Fund on this, Beza in particular, in Berlin. I went to his hotel in the middle of the night to make sure that the Fund knew exactly what was happening. "Conable is going to announce the package tomorrow," I told him. "We hope that this is only a temporary aberration from the normal pattern and that there will not be permanent damage to our institutional relationship. We think it's in Argentina's best interest that we go forward with this, and we hope that the Fund can come back in at some point." Although they all knew that the Fund's hands were tied, they were not a little upset by my message. [Laughter]

With the benefit of hindsight, one could say that Conable took a big risk. He stuck his neck out for a country that wasn't exactly our most credible client. But he nonetheless did it, and, although I don't know all the facts, we thought that he probably wouldn't have done it if he didn't have the support of the U.S. government. I was informally told that the U.S. government did in fact support the Bank's initiative, as Paul Volcker had supported our substantive arguments some five or six months earlier.

WEBB: Bert [Felix Alberto] Camarasa told us the story, that Conable had been asked by the Secretary of Treasury to go down . . .

BOTTELIER: Oh, that's a—let me--as I'm talking, more and more things come back to the surface, and one or two of them may be relevant to this story.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

Conable was asked to go to Argentina not long before the Annual Meetings but was initially hesitant to go because he doesn't like these long trips on short notice. However, he was persuaded by—who was the foreign secretary at that time?

WEBB: [James A. III] Baker?

BOTTELIER: No, the foreign secretary.

WEBB: [George P.] Schultz. State Department?

KAPUR: Schultz.

WEBB: Yeah, Schultz. It was George Schultz.

BOTTELIER: Yeah, I think he was persuaded by Schultz on behalf of Baker; the pressure had come from Baker and the State Department had to be involved.

Conable did go; I accompanied him. It was a very short visit, less than 24 hours. He met with Alfonsin and banged the table, saying “Listen, if we are to stick out our necks for you, you had better deliver on . . .”

Alfonsin was extremely compliant and promised Conable full cooperation. That must have been one of the factors that Conable had in the back of his mind in Berlin when he decided, with the encouragement of Qureshi, to go forward with this whole thing and make it public.

But there is a major other essential detail that I completely forgot to mention; it is not part of Polak's chapter either. Polak mentions that [Ernesto] Feldman, the Argentine Executive Director on the Fund's Board when the amended standby of March '88 was presented, made a voluntary offer to reduce the fiscal deficit of Argentina in '88 by a further 2 %. In his chapter, Polak implies that the Argentines were stupid to make this offer because they didn't have to and that they dug their own grave with it.

The truth of what happened is totally different. I only came to know the story a month or two later when I visited Buenos Aires and [Jose Luis] Machinea, who was still the governor of Argentina's central bank then, took me aside and told me that Camdessus had secretly met with Alfonsin and Sourrouille in Madrid a few weeks before the presentation to the Fund's Board of the amended standby in March '88, without informing his Board. Although this meeting took place while Camdessus was in transit from Singapore to Washington, DC, he nonetheless should have informed the Fund's Board of his meeting with the president (Alfonsin) of an important member country.

This was not the first time that Camdessus had upset key members of his Board by meeting with a member country without informing his Board. In December 1987 he had gone to Buenos Aires, ostensibly to visit relatives, telling the government that he needed another 2% deficit reduction to retain Fund support. This, as I was told by Machinea, was the background to Feldman's 2% offer during the Fund's Board meeting in March.

Allegedly the Argentines told Camdessus in December '87, that they couldn't possibly reduce the deficit by another 2%. Then the Fund's representative is alleged to have said, "But there is a good chance that at the Interim Committee meeting of April ('88), there will be progress on a global scheme for debt reduction in the management of which the Fund is likely to have a lead role. In that case you (Argentina) will be our first customer, and we will make sure that you will get one-third external debt service reduction."

Argentina's external debt service burden was about 6 percent of GDP at that time. One-third of that was 2 percent. That is the origin of the 2 percent. Obviously, Camdessus couldn't have promised such debt reduction, but he created an expectation that the Interim Committee meeting of April would give him that power.

I believe that I was the first non-Argentine to hear this incredible story. Conable heard about it and allegedly said, "But this is incredible. Sourrouille has to go to Baker and tell him his story."

The next time that Sourrouille came to Washington, a few weeks later, he did see Baker and told him the story. Baker was apparently very upset with the Fund. I should furthermore mention that the Interim Committee meeting in April didn't reach any agreement on debt reduction. In the meantime, the Argentines had been coerced to make their additional 2% deficit reduction promise.

So Baker was really mad at the Fund, and that was another reason why the U.S. government encouraged the Bank to take the high road on Argentina. By the time of the Annual Meetings in Berlin, the U.S. Treasury did give Conable full support on this whole thing. It's a much more complicated story than appears in Polak's piece. He didn't know half the story when he wrote it.

WEBB: One detail in that U.S. role is that—Camarasa, I can't remember exactly what he said, but he said that there was an interruption here in [David C.] Mulford's influence when this occurred.

KAPUR: What he said was that Baker at that time had left for [George H.W.] Bush's re-election campaign, and that left Mulford, almost by default, in charge of U.S. policy-making and that began to have certain effects which . . .

LEWIS: Baker left in July or August.

KAPUR: Right, to take over Bush's re-election campaign, so the sorts of promises or understandings which Baker had with the Argentinians and the sort of dealings that Mulford began to have seems to have been slightly different.

BOTTELIER: Well, that may be the case. After Conable's announcement in Berlin of the Bank's package for Argentina--it must have been of September--we didn't go to our Board with that package until end October. We needed about a month to prepare all the documents for it. Then to our great surprise and annoyance, U.S. support for the package at that Board meeting was very wishy-washy.

LEWIS: That's Mulford, then.

BOTTELIER: Contrary to what we had expected and what Conable personally had expected, U.S. support was only lukewarm. The U.S. ED made one short speech and did not participate in the debate. Several of the European EDs lambasted the Bank for trespassing the Fund's turf. They just took Conable to court; it was terrible. I was in the "hot seat" at that time, so I was rather upset and did not know how to defend the package, which was in the end approved.

KAPUR: Now—I'm sorry--prior to the Annual Meetings, I mean, in Conable's Argentina files there is a memo from Stan Fischer in which he seems to say so—in fact, he puts it in so many words--that "we are going in in this" and he says "at the behest of one major shareholder."

BOTTELIER: What is the date of that memo, do you know that?

KAPUR: Why don't you go on with the conversation and I'll track it down.

BOTTELIER: Stan may not have known the whole story either. It is possible that at top management level, considerations other than the substantive economic arguments we had been working on played a role. We didn't necessarily know what was going on in the Bank's discussions with the U.S. Treasury. At the working level in the Bank, this was seen as a disagreement with the Fund on substantive economic policy issues.

WEBB: Now, Shahid's letter really puts most of the weight on something that you really haven't mentioned, which is the political calculation, the support for . . .

BOTTELIER: Yes, yeah. Well, I think it depends again a bit on where in the hierarchy of the Bank you are, what is the nature of the concerns you are dealing with. As department director I was, of course, aware of the political transition in Argentina and the elections that were coming up. But that knowledge was never a leading factor in the technical work we were doing. All the position papers that we prepared were of a technical, analytical nature.

The Argentines played their political card through Camarasa with the U.S. State Department. They said, "Listen, here is a fledgling democracy. We have a very tricky domestic situation. If you drop us after the Fund dropped us, we cannot guarantee that the military will not come back."

Shahid was probably more aware of the political at dimensions of what was going on than I was. It wasn't part of my responsibilities as department director. At least I did not see it that way.

[End Tape 1, Side A]

[Begin Tape 1, Side B]

BOTTELIER: Yeah, I read Shahid's letter and thought it was a nice, after the fact account of what happened. It was a reaction to Polak's piece, which was highly biased and ignorant of many of the relevant facts. I couldn't really blame Shahid for going a little bit overboard. [Laughter]

WEBB: So long, John.

LEWIS: Bye-bye. I'm sorry to bow out like this. It is fascinating. Thank you very much.

KAPUR: Just one more figure hasn't been mentioned. What was Ernie Stern saying?

BOTTELIER: Did you find the date of the Stanley Fischer memo?

KAPUR: No, I'll have to go through Conable's . .

BOTTELIER: Okay. I'd be curious. I've never seen it, but . . .

KAPUR: What was Ernie's role in this? What was he—I mean, what was your impression of what he was—was it a stance, because Qureshi had a stance he had a different stance or . . .

BOTTELIER: I don't know. I was not present at any meetings with Ernie on this subject. I would be very curious to know where Ernie stood on the issues. Ernie was present at Conable's meeting with the press after the Board meeting and, I believe, supported the whole thing. If he didn't, I never knew about it.

KAPUR: But I'm also basing it on Ernie's written reaction to Polak's paper, which we have. There were also a couple of anonymous memos on this to Conable, but Ernie's wasn't. Do you recall it, Richard?

WEBB: I don't remember the words but I remember the tone.

KAPUR: The tone was, "Look, here were a bunch of guys in the Bank, out of their depth, and they got a lot of egg on their face" . . .

WEBB: It's a bit superior and "know-it-all," and you know, "it was bound to happen, it was a mistake."

BOTTELIER: Yeah. It appeared to be that way. It appeared that we went in an area in which we had no competence in and that we should never have done it, because actual developments proved the Fund right. In a way, at one level of reality, that is so, but at another level it is not at all. I believe that the quality of the Bank's macro work was much better than that of the Fund. An illustration of that was our disagreement on the definition of the "quasi-fiscal deficit."

We were very concerned about institutional factors underlying Argentina's precarious fiscal situation. The Fund knew very little about that. We began work on a fiscal administration project and trained 600 tax collectors in Argentina. We computerized the central government's tax agency in Argentina. We discussed with them a new value-added tax system. The Fund claimed to be a lead agency on macro work, but most of the substantive work was in fact done by the Bank.

In fact, the tax administration project I mentioned was a big success--with a one- or two-year lag. The fact that the fiscal situation improved so much in Argentina and that [Domingo F.] Cavallo became Finance Minister is partly due to that project.

WEBB: Cavallo.

BOTTELIER: Cavallo was very able, you know. He put bite in his tax collection threats. He introduced comprehensive computerization of the tax department under the Bank's project. He trained tax assessors and tax auditors so that he could track month-by-month who was delinquent. It was Bank, not the Fund who concretely supported him in all that. We feel slighted by all the criticism that we had to deal with.

WEBB: When you were working on this in '88, developing the view that you had to go beyond the surface of the fiscal aggregates to straighten things out (e.g., with the fiscal administration project and the sectoral adjustment projects), did you have a sense that you were really innovating? That this was something that the Bank hadn't done before but should have done, perhaps also in other countries? Or did you have a sense, instead, that this was what the Bank had done in other cases? I'm curious just how you saw this.

BOTTELIER: Well, I was relatively new as a department director. I didn't have a lot of comparative information. I'd worked on Mexico before, but there we never got anywhere near the depth of fiscal work we got into in the case of Argentina, which was probably exceptional. The depth of the macro work by the Bank on Argentina, including details of fiscal administration, was probably not common.

WEBB: But you didn't have much sense of history, one way or the other, when you were doing it.

BOTTELIER: At that time not, no.

WEBB: You were simply trying to tackle the problem itself.

BOTTELIER: Yeah, one thing led to the other. I mentioned to you the key aspects. We thought the Argentine problem had three legs. One was the poor performance of public enterprises; there was no effective control on public enterprises. The second was provincial-central government relationships; there was no effective control over provincial finances. There was an almost automatic overdraft facility at the central bank for provincial governments. The third leg of the problem was the social security system; Argentina had built social security systems in the early part of the century, when they were rich and growing rapidly. We all know how much their economic fortunes have since turned around. So we had analyzed the three major legs of their fiscal problem and did in-depth work on all three of them.

To give you another illustration of what I am talking about, let me explain why we thought that Argentina's fiscal problems were in fact more serious than reported in Fund reports. It concerns something that was referred to as the "quasi-fiscal deficit." Our numbers on Argentina's total fiscal deficit, including the "quasi-fiscal deficit" were higher than the Fund's. The Argentines

were initially mad at us for drawing attention to their huge (but unreported) “quasi-fiscal deficit” in the form of central bank overdrafts to the provinces. We discovered that the central bank had no accurate, up-to-date record of those overdrafts, which were more or less automatic. They were not systematically collecting on those “loans.” The Fund initially accepted these overdrafts as assets. We argued that these overdrafts to the provinces weren’t “assets” but hidden fiscal deficits. In our operational work, we (the Bank, not the Fund) began to install, in the central bank, computerized systems for keeping track of provincial debts. We were more involved in the details of Argentina’s macroeconomic situation than the Fund was.

KAPUR: We had a conversation a few months back with Suman Bery, before he left. And he—I don’t know if he was working on Argentina at that time. I forget.

BOTTELIER: Yeah, Suman was the division chief for Argentina in my department.

KAPUR: He said that when he looked at Argentina, he was reminded of his experience in Yugoslavia where the same problem of provincial debt to the central bank had impacted the design of a Bank SAL in the early ‘80s, one of the first. A lesson he had learned then was that such hard to see quasi-fiscal deficits sometimes lie at the root of a country’s macro-fiscal problems. That’s why I was wondering if the painful Argentina episode of ‘88 was a relatively new thing, or whether the Bank had learned earlier to look below the conventional structural economic indicators.

BOTTELIER: Well, you may have an important historical point here. We wanted to get to the bottom of Argentina’s structural economic problems. We were dissatisfied with the Fund’s approach in Argentina, which in our opinion didn’t dig deep enough. Obviously, a country’s macroeconomic aggregates are important, but if you limit your analysis and program targets to the aggregates, you miss an awful lot, especially in the case of Argentina. You could even make things worse. That realization drove us to dig deeper and deeper into the underlying problems.

Unfortunately, the information and analytical gaps between Fund and Bank widened, before the situation improved later.

WEBB: You mean on the Argentina situation in particular or in general?

BOTTELIER: On Bank-Fund relations in general. Yeah, after we suffered a bloody nose on Argentina because we couldn’t disburse on the package approved by the Board (because the Argentines weren’t able to deliver on their promises to us), the relationship across the 19th Street began to improve. We had a bloody nose for the wrong reasons. The substance of our analytical approach was correct, but we didn’t know the political constraints in Argentina well enough. The substance of the Fund’s approach was not correct. That is a dimension in the story that doesn’t come out in the Polak report. We were mad at the Argentines for letting us down. Not that we were terribly confident about their capacity to comply with all conditions--we weren’t. We had structured the whole deal in such a way that if they would not deliver, we would not have to disburse. And in the end, we disbursed very little.

WEBB: Yes, we saw that.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

BOTTELIER: We began to worry about things already one month after the Board presentation. I remember being on the phone to Brodersohn almost daily. I said, “Listen, your electricity rates are lagging and you are delaying the VAT increases, while your inflation is going higher than expected.”

We began to have some worries already in November and more seriously in December. In December there were military barrack riots in Buenos Aires, which scared the hell out of everybody; they further delayed utility price adjustments and VAT increases. By the end of the year we were really worried. Polak was right in saying that only two months after the Board presentation the whole package was off track. But we were the first to know it. We’d tracked it on a daily basis. It wasn’t as though we were taken by surprise.

We felt terribly let down by Brodersohn and his team. Later, Sourrouille put the blame on Alfonsin. He said that Alfonsin didn’t have the political backbone and the courage to do the things that had to be done. We thought that Sourrouille wasn’t pressing hard enough for the reforms that were necessary and had been agreed.

Then in late January we sent a mission for a formal assessment on the situation. I joined that mission. We had agreed to meet in a hotel in Mendoza, away from Buenos Aires, to spend the whole weekend going over the numbers. We already knew then that the thing was off, but we had to do the analysis; we had to do the numbers.

WEBB: This was January?

BOTTELIER: Yeah, late January. At the end of our stay in Mendoza, I concluded that there was only one route was open to us: to tell the Argentines the deal was off because they hadn’t delivered. We cannot recommend to the Bank to go forward with the tranche releases. It was a terribly difficult situation for us.

We then travelled to Buenos Aires to meet with Machinea and the others. I remember our meeting with Machinea. I told him that the mission had concluded its work and deeply regretted not to be able to recommend to the Bank to go forward with tranche releases. Machinea turned pale--I still remember his face--he literally almost fell off his chair. I tried to calm him down by saying, “Jose Luis, this is not the end of the world.”

And he said, “Well, it’s as close to it as I care to come” (in Spanish).

That was basically it. Then we came back. We reported our conclusions at HQ. Shahid agreed with us that it was not possible to recommend tranche releases; we then requested an information session with the Board--I think it was early March--to explain what happened.

But we had the initiative all along. We suffered a debacle, but not because our approach had been wrong. We took a calculated risk. We lost out because the Argentines couldn’t deliver. And that was partly because of the tremendous electricity blackouts in Buenos Aires that year, which contributed to the barrack revolts.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

WEBB: Pretty hard to raise electricity rates when it's not provided. [Laughter]

BOTTELIER: Yeah, the circumstances were extraordinarily difficult. We could not recommend tranche releases and there was no way that we could consider a waiver request to our Board. We decided to cut our losses instead. From my perspective, it was indeed a debacle, but not in the sense that Polak describes it in his piece. We were not a bunch of incompetent fools not knowing what we were doing. Not at all.

KAPUR: I have a question I'm not very sure of. I'm puzzled why, both in the Fund Board and in the Bank Board, the European EDs [Executive Directors] were especially critical of the Argentines.

BOTTELIER: Well, because the Fund is a European province.

KAPUR: But you also said that Conable was raked over the coals in the Bank's Board.

BOTTELIER: Yeah, yeah, yeah. It was particularly the Europeans, the Brits, the French, the Dutch and the Scandinavians, but also the Australians, who felt that this was a clear illustration of the fact that the Bank didn't know what it was doing and had to stay out of matters that were more typically the responsibility of the Fund.

It's up to you guys to interpret this thing.

WEBB: Well, who knows? Sometimes it's so hard to know. From my own experience in the central bank of Peru, I sympathize enormously with what you were trying to do. I was always wishing that we had more help of that kind, but . . .

I asked you about public investment before. Just as an example: when all this began in Peru in '83, the first crash, we had El Nino combined with the debt crisis. And we had a very orthodox minister of finance, pushing up gas prices while devaluing faster. Inflation went through the roof, and everything collapsed.

And we, the economic team, decided to slash public investment. Well, who can do that? I was asked, "Well, why don't you in the central bank?" There was no one in the ministry, there was no sense of a joint—just of the whole investment program: "Where are the projects? Where are we with each project? What are the next steps? What difference does it make if we interrupt this project as against this project?" There was absolutely no sense whatsoever.

And I was asked to come up with a list of cuts, project by project. It was an absolutely meaningless exercise. There was no one in government that had the capacity to do that. We didn't even have the project accounts needed for such an exercise. In addition we needed advice on which cuts make sense, what don't. For that we would have to talk to a hundred different project officers. We needed some centralized.

In the end no one gave us the advice we needed; I was really amazed. Surely, the Bank is always telling clients, “Cut your public investment,” and it makes all the sense in the world then for the Bank to be able say, “Look, do it this way to minimize the damage.”

BOTTELIER: Yeah. The facts are there to prove that once there was an Argentine President with political guts, who appointed a finance minister with political guts who committed to undertake the needed structural adjustments, those difficult things with vested interest groups such as state enterprises and provinces. All of those commitments, which would come to fruition eventually, were linked to Bank sector work.

For example, Argentina’s privatization program was also linked to the Bank’s analytical work, another fact that is little known. We do have a specialized privatization division in the Bank, but in the case of Argentina, most of that work was done by staff in the LAC [Latin America and Caribbean] Region.

KAPUR: This was in what years? After [Carlos S.] Menem?

BOTTELIER: Yeah. But it started before him, the big public enterprise reform loans, the big loan for Argentina--what was it called again? The public . . .

KAPUR: [inaudible]

BOTTELIER: No, it was the state reform loan in support of the restructuring of seven ministries, involving the layoff of 120,000 redundant civil servants, severance payments and the beginning of the railway privatization. It was all done in the context of Bank-Argentina cooperation.

WEBB: [inaudible] as results?

BOTTELIER: Oh, yes, no question. The reorganization of Argentina’s railway corporation, including its privatization, resulted from years of interaction between the Argentine government and the Bank. For a long time, our involvement seemed to be going nowhere. The same applies to the privatization of Obras Sanitarias de la Nación. Let me think; what else was there . . .

WEBB: Aerolinas?

BOTTELIER: We were not involved in Aerolinas Argentinas as we were in the reform and privatization of other major public enterprises and in the reform of the public sector as a whole through the P-S-R-L. That was a big loan supporting the reform of a large part of Argentina’s civil service.

KAPUR: Just one small question on that. You said the Bank had agreed to pay severance pay, or at least the loan had to pick up the tab for the severance pay for the 120,000 odd employees. How--were there any legal complications?

BOTTELIER: No, it's not in the legal documents. The proceeds of the Bank loan could and would not be used for that. But we had agreed that the Argentines would use their own counterpart funds to set up a special fund for that purpose.

KAPUR: So it was de facto, but not de jure.

BOTTELIER: Yeah, it's a bit of economic trickery; you don't add real resources, but you do make it possible, politically and administratively, to go forward with painful but necessary layoffs in the public sector.

KAPUR: It's curious. A few times we have looked at what the Bank did or did not do in land reform--there was a big case in '86-'87 when [Corazon] Aquino came to power in the Philippines and the Bank justified the use of counterpart funds to buy off the larger hacienda owners even though that was not a "productive" investment. I'm just curious, because the Argentine case seems to have been similar. Where there was a will there was a way.

BOTTELIER: Yeah, yeah. But it was an artificial construction that made a lot of sense. It was the critical factor that enabled the Argentines to go forward with difficult decisions at a critical time. But you will not find in the legal documents anything that says that it had to be done.

I think that Shahid's overall conclusion--that this debacle, in the end, was a major factor permitting Argentina to climb out of the hole--is correct. The amazing things that Menem did in his first nine months had been started by Alfonsin.

WEBB: Yeah, that's right. It was crazy.

BOTTELIER: Menem had his setbacks too. His first finance minister died after a few weeks. The second one had to resign. It was only the third finance minister ([Antonio] Erman Gonzalez, the obscure little fellow from La Rioja, who had little experience in economics and finance) who did some amazing things.

KAPUR: Just like Menem.

BOTTELIER: Just like Menem, he came from La Rioja. And like Menem, he understood in his guts what was the problem in Argentina. He wasn't a Buenos Aires sophisticate who could fool everybody, but he was a man from the provinces. "El negro," they called him, in a condescending way.

KAPUR: Which means?

BOTTELIER: The black fellow. His skin was slightly colored. In Buenos Aires racism was alive and well.

WEBB: But when you call someone "el negro" in that way, it's almost affectionate.

KAPUR: Oh, I see.

WEBB: You could use it in a derogatory way, but you would never use it that way. So, when it's used that way it's actually affectionate.

BOTTELIER: It's affectionate in a funny way; it's a bit of a joke.

KAPUR: It's a bit like telling a Polish joke.

BOTTELIER: Yeah. But this fellow, Erman Gonzalez, with Menem's support, began to put things right. And Gonzalez did all the things that we had been working on for years. Suddenly, the Bank's program for Argentina began to fall into place.

KAPUR: Do you see a parallel between Argentina and Morocco in the sense that the right person at the right time is what made all the difference?

BOTTELIER: Yes, but the Argentina case is more extreme. There's never been this kind of drama, fireworks, in Morocco. As I mentioned to you last time, the appointment of Berrada in '86, Morocco's new Finance Minister, was a major factor. Like Gonzalez in Argentina, he was a powerful figure, not an elitist sophisticate but someone who in his guts knew very well what's right and what's wrong. Sourrouille is a typical example of a Buenos Aires sophisticate; he was in the end not terribly effective.

WEBB: Too much Harvard.

BOTTELIER: Too much Harvard, yeah.

WEBB: Same as Mario [Brodersohn].

BOTTELIER: Yeah, Mario was just full of [inaudible]

WEBB: Maybe it's all my fault because I sold him a secondhand car once. [Laughter]

BOTTELIER: Really? You sold Mario a secondhand car? You must be worse than him!

I've never met anybody more cynical than Brodersohn. But he was also a good man. He was a sophisticated economist but didn't have the gutsy instincts and power needed to counter vested interest groups. Although Mario did some very useful things. He negotiated a good pact with the provinces by twisting their arms. But it wasn't until Menem came with Erman Gonzalez that the Argentine government began to tackle the industrial union and the labor unions. They split up the labor unions and that was key.

So, I agree with the thrust of Shahid's letter that Polak's characterization of the Argentine episode is really a joke. His facts appear to support the story, but his facts are incomplete and very superficial--they don't reflect the truth at all.

WEBB: What strikes me about your story is that the Bank has an image of itself as a “partner in development”—an appropriate term for a book. The Bank actually has that kind of long-run relationship with a lot of countries. But when we look at this story, we see this great big stumble. It’s painted in the Fund’s story as a disaster, but is more accurately described as a “stumble” in an otherwise constructive long-term relationship. The Fund’s relations with Latin America are generally not intimate or continuous.

BOTTELIER: Yeah. I like that. It’s an effective way of putting it.

KAPUR: More [inaudible] rather than more continuous.

BOTTELIER: Yeah. We felt we had a stake in Argentina’s success. We weren’t playing politics. We worked with the Argentine agencies and knew that there were good people out there who, with the right kind of support, would be able to turn things around. We also knew that failure of the Fund’s program, for whatever reason, might undermine our efforts. In the Argentine case, we felt terribly frustrated.

WEBB: Were you particularly influenced by someone in your staff on this who had maybe been working in Argentina before? Did you have much of a team? Was this important to the way this thing worked out? Was there a lot of interaction among one, two, three people?

BOTTELIER: There wasn’t any scheming going on. One of the key actors in Suman Bery’s division was Luca Barbone.

WEBB: Barbone?

BOTTELIER: Luca Barbone, an Italian economist who had just come to us from the OECD in Paris, was very active on Argentina; he was absolutely first rate.

KAPUR: Is he still here?

BOTTELIER: Yeah. He’s now working on Poland. You might ask him, talk to him, because he is the one who really alerted us to this key problem of Argentina’s quasi-fiscal deficit. His work gave us the intellectual stimulation and credibility to go much deeper in the fiscal issues than we might have done otherwise.

WEBB: Who was the chief economist?

BOTTELIER: Selowsky. Marcelo.

WEBB: And was he involved? Did he have views on this?

BOTTELIER: Yes, very much so, but behind the scenes. He is a Chilean and didn’t want to be seen playing a prominent role in this.

WEBB: And for the country?

BOTTELIER: Suman [Bery] was the COD chief. Suman is a very good economist himself. Suman was definitely very much involved. But the key analysts were really three: Luca Barbone, Richard Newfarmer, and a third fellow whose name slipped my mind. And, of course, we had consultants, but the core team was all in the COD.

WEBB: Beckerman, was it?

BOTTELIER: Yes, of course, Paul Beckerman was very much involved in this and he is also first rate.

WEBB: I knew him at Princeton. He was a student.

KAPUR: I don't know him.

BOTTELIER: A very modest person but a first-rate economist/analyst.

WEBB: He was the one who told me about Yeo the first time. Y-E-O, Yeo.

BOTTELIER: Oh, I see.

KAPUR: Was he the one you called "a pigeon"? I couldn't understand.

WEBB: He described Yeo as a . . .

BOTTELIER: He was a messenger, who traveled . . .

KAPUR: Or also like a pigeon stool.

WEBB: Stool pigeon.

KAPUR: Stool pigeon, I'm sorry.

WEBB: Yeah, he described Yeo as essentially a Volcker man, that's why I am surprised by your story, because he painted him as Volcker's tool. He's the man that Volcker sent to Brazil, also, earlier on.

BOTTELIER: Yes. Yeah, well, it was either Volcker or Corrigan--maybe in some sense both. He was clearly the Fed's agent. By that time Volcker, of course, had already retired.

KAPUR: But Corrigan himself was a Volcker man at the New York Fed.

BOTTELIER: Yeah. But that doesn't come out well either, in the Polak story. After the Bank's bloody nose on Argentina, the quality of the interaction between Fund staff and Bank staff became much better. It seemed that our demise had saved the Fund's face. And there is some sentence in Polak's chapter which comes close to actually saying that. Polak says somewhere

that the Bank's bloody nose salvaged the Fund's position, or words to that effect. When we had egg on our face, it became possible for the Fund to be gracious again. [Laughter]

KAPUR: I see.

BOTTELIER: The quality of the interaction between the two staffs became much better for Argentina's benefit, I think, thereafter.

KAPUR: And then they finally did accept the fiscal, the quasi-fiscal deficit, the definition as well as how to . . .

BOTTELIER: You should talk to Luca about what happened. The Argentina case is extreme; normally central bank loans are assets, but in Argentina case that was not always the case and the Fund missed that point.

WEBB: I can see that outline. There was some of that in Peru.

BOTTELIER: It was only after we became aware of the magnitude of that quasi-fiscal problem and realized that Argentina's central bank didn't even have a system for collecting on overdraft loans to the provinces that we began to formulate an alternative approach to solving that country's macroeconomic problems. Luca wrote a very interesting article on the definition of the quasi-fiscal deficit. I don't remember where it appeared.

KAPUR: These guys—who's the Fund fiscal man?

WEBB: Vito [Tanzi]?

KAPUR: Vito had a piece on the definition of fiscal deficits in the *Journal of Economic Literature*--remember? The one I brought a few months back.

WEBB: I ought to ask Tanzi about what he remembers about this episode.

BOTTELIER: Yeah, well, Tanzi became involved later. We actually made a joint Bank/Fund effort (after the Bank's bloody nose) to strengthen Argentina's fiscal and central bank administration. Vito Tanzi became the head of their fiscal department, succeeding a lady, whose name I can't remember, Montenegro or something.

WEBB: Yes. Milka . . .

BOTTELIER: Milka. Yeah, that's her first name.

WEBB: Milka Casanegra.

BOTTELIER: Something like that.

WEBB: Yeah, that's right. She came and did a study in Peru about '86, '87.

BOTTELIER: I was very surprised and pleased to hear that Camarasa, in his farewell speech to the Board, while reflecting on the Bank-Argentina relationship, actually acknowledged the role that some individuals had played.

KAPUR: Yes, he mentioned Qureshi by name, and also Shahid Husain.

BOTTELIER: He mentioned me also.

KAPUR: Three of the key actors, which is rare for a Board member.

BOTTELIER: Yeah, it was a very nice gesture. We indeed worked like crazy at that time. There were many instances that I haven't even mentioned that add color to the story. After we announced to the Board that the deal was off, that there would be no further tranche releases, all we could do was wait for the elections in Argentina.

KAPUR: That was in '89.

BOTTELIER: Yeah, '89, of course. With Menem coming in. He was asked to assume office almost immediately, because hyperinflation had broken out. One of the first things that Menem did was to ask the Bank back and to resume the structural program. But then his first Finance Minister—I can't remember his name; he was a Bunge y Born man . .

WEBB: Yeah, that's right.

BOTTELIER: . . died. And the second Finance Minister was also a Bunge y Born man.

KAPUR: What's that [Bunge y Born]?

WEBB: It's a company.

BOTTELIER: It's one of the few Argentine international companies. It's a large grain marketing company with industrial holdings in Argentina, Brazil and the United States.

WEBB: It's interesting because—well, my father worked for their branch in Peru, La Fabril, at one time. I don't know what was the origin of this, but they held an alternative, a heterodox view of how to manage an economy. I don't know what the association was, but it was part of what Danny [Daniel] Schydrowsky was involved in.

BOTTELIER: Oh, yes.

WEBB: And Marcelo Diamand.

BOTTELIER: I don't know him.

WEBB: He's an Argentine. He wrote a book about all this. In fact, I reviewed his book once.

BOTTELIER: Is that the big book to which Schydlowsky contributed?

WEBB: Diamand was the author. I don't know who else contributed.

BOTTELIER: There is another book on the heterodox approach to managing economic adjustment that Schydlowsky and this Argentine economist wrote. One of those later began to advise Garcia.

WEBB: Yeah. Was it [Daniel] Carbonetto?

BOTTELIER: Carbonetto contributed to Schydlowsky's book..

WEBB: That's a different book, then.

BOTTELIER: The approach that Sourrouille and later Menem's first Finance Minister took to reform was not without at least some theoretical foundation. That was the so-called "heterodox approach": you make a big adjustment and then freeze all prices for three months and hang on to your exchange rate as the anchor in the system, hoping that that will drive inflationary expectations out of the system and then you are all right. Then you can make further adjustments without a massive contraction of GDP. According to this "heterodox approach," the painful deflationary aspects of major structural adjustment are thus removed. It's superficially very attractive. It could work if you can make the financial and fiscal adjustments within the short time window you buy through the price freeze. That was the plan of [Franz Josef] Strauss, essentially.

That was also the first plan of the first Finance Minister under Menem. I can't remember his name. It was not that there was no theoretical foundation for what they were trying to do, but they didn't make the fiscal adjustments within the window of time; the massive nature of the problems in Argentina made that virtually impossible. It wasn't Gonzalez, the third Finance Minister under Menem, who disregarded the heterodox approach and began a more conventional approach; it was Cavallo.

KAPUR: The Cruzado Plan was also sort of orthodox?

WEBB: There was also Garcia's plan.

BOTTELIER: It was Carbonetto and Garcia's, yeah.

WEBB: It's basically the same as what Cavallo has done now.

BOTTELIER: Well, no, Cavallo's plan was to take the wind out of the internal debt burden.

WEBB: But he's only frozen one price, but it's the essential price.

BOTTELIER: Yeah, okay. Yes.

KAPUR: You mean the exchange rate? He's frozen the exchange rate?

BOTTELIER: Yeah. But they're not out of the woods, even though a lot of progress has been made on the structural side. The exchange rate is now becoming their new structural problem and I don't know how they will get out of it.

Allow me--while you were talking I was reminded of an episode which could be of interest. I mentioned that after the Bank's bloody nose on Argentina, Bank-Fund relations became more relaxed and constructive, but there was one occasion where our relationship threatened to explode again. It was in January '90.

On the first of January, on New Year's Day, just after I came back from church, I got a phone call from Argentina, asking me to come to Buenos Aires urgently and catch a plane the same day, if possible. I had no idea what it was for but went anyway, asking Richard Newfarmer to come along. On the way down to Buenos Aires, I phoned Shahid that we had to [inaudible]

To our great surprise, on the plane to Miami that evening we found two of our Fund colleagues. They had received the same request. They didn't know either what was up. In Miami they called some news agency or people in Washington to get the story.

Apparently, the Argentine cabinet had been meeting in a retreat in La Rioja to discuss Cavallo's dollarization plan, which was then rejected. Cavallo recommended dollarization and freezing short-term deposit accounts to eliminate hyper-inflation and incessant speculation against the currency. His plan was rejected by the Cabinet because it amounted to de facto confiscation. But Menem wanted international opinion on Cavallo's plan.

KAPUR: That was the core of the policy argument?

BOTTELIER: Yeah, the core of the policy argument was always to restore financial stability. Argentines [inaudible]

So, the Fund staff knew in Miami that this was the thing for which we had been called to Buenos Aires. They were totally upset: "Oh, oh, oh, oh, this is the latest disaster! We have to insist that they roll it back. The Fund cannot willingly allow a member country to confiscate assets [inaudible]. You're talking about millions of dollars in [inaudible]."

I overheard their conversation and said, "I don't understand the responsibility of the Fund." If I had been in their shoes I might have reacted the same way, but I realized that the Argentines were desperate to overcome hyper-inflation. They had to do something drastic quickly; the Menem administration had already lost six months.

I was confused. I told my colleagues from the Fund (at Miami airport), "Listen, the Cavallo plan is bad, but the alternative is worse. What we should do is support the plan but tell the Argentines that this is their last chance; now they are on their own."

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

So, we fought on the strategy in Miami airport. “They have to roll it back,” our Fund colleagues said, and we argued that dollarization was one of the few positive things they could do. A complicating factor was that Cavallo was still foreign minister then. At the time of the retreat in La Rioja, Gonzalez was the Finance Minister and he may not have fully understood the economics behind Cavallo’s plan.

So, we landed early next morning in Buenos Aires. A government representative collected us from the airport and took us to the hotel. We showered and went to the Finance Ministry where we didn’t see our Fund colleagues. I was very curious what was happening. At a roundtable meeting with the Minister and senior people from the Ministry, Gonzalez explained to us that the government was going to announce later that day a reform of the financial system. I think that our Fund colleagues had pre-knowledge of this and, therefore, had had some chance to think it through [inaudible]. And that . .

[End of Tape 2, Side A]

[End of session]

Session 3
January 19, 1993
Washington, D.C.

[Begin Tape 1, Side A]

BOTTELIER: You know Barend DeVries, also known as Bob DeVries? He also wrote a book about this: *Remaking the World Bank*.

WEBB: I haven't read it.

KAPUR: In fact, the only favorite thing I've seen to his senior management is to take this page—he Xeroxed this page out of Stanley Please's book.

BOTTELIER: Ernie Stern?

KAPUR: No, Stanley Please, which has this thing on policy reform and the way you could do it is having a knowledge and expertise within the countries and be the role of a diplomat. There's a page—did you find that, Richard?

WEBB: I remember that, yeah.

KAPUR: And you know it's a very—and, you know, there's this note from Ernie to, I forget, at one of those senior staff retreats or one of those things, where he sort of insists that, look, this is the way, you know—you know, let this be a sort of watchword and so on and so forth.

BOTTELIER: I see.

KAPUR: I'll send you a copy of that. It's very interesting . .

BOTTELIER: Of that particular page?

KAPUR: Right . .

BOTTELIER: Please do. I won't have time to read the whole book, but . . .

KAPUR: . . because it sort of--what he seems to imply in that . .

BOTTELIER: When did he do that?

KAPUR: It was around '84, '85. That "Look, that there is no substitute for good country expertise if you want to around with policy reform and that country expertise is not simply a matter of knowing economic variables, because dialogue, et cetera, the way you do it you should know about," you know, I guess, "the nuances and the norms and values of the society, also." And I was quite surprised to see it from Ernie.

BOTTELIER: I'd be interested in that. I know Stanley quite well.

KAPUR: No, perhaps it wasn't Stanley. Who wrote this book in '64 on the Bank? A Canadian. Richard, who wrote the other book on the Bank in '64?

BOTTELIER: A Canadian.

KAPUR: Escott Reid, maybe. Yes, Escott Reid. Sorry. Escott Reid; I was actually quoting Escott Reid. But I know that Ernie sent this out, and Escott Reid had written this, on how you do—the only way you do around policy reform.

BOTTELIER: I have great respect for Ernie, so if he singled something out, I'd like to know it.

KAPUR: Well, I could send you his chron file. Take the rest of the month off. [Laughter]

BOTTELIER: Well, we were going to talk a bit about Mexico, right?

KAPUR: Yes.

BOTTELIER: But I have not so much time now and the story is quite complicated.

WEBB: Okay. It really concerns the initiation of reform there.

BOTTELIER: The period '83 - '87 is the one that I remember best because of my personal involvement then. I may be able to say a few things that are not common knowledge.

Coming from Jakarta and switching from an economic staff job to a Division Chief function, I was brought on the Mexico scene in the middle of '83 when the country's debt crisis was in full swing. I was asked to replace D.B. Dutt as Division Chief for Mexico. D.B. was going to be the Division Chief for Malaysia, I believe. I was told that the Bank was looking for someone with some knowledge of oil economies. Since I has been working on Nigeria and then Indonesia, I was apparently thought to be a good candidate for the Mexico job.

But I was out of my depth: I didn't know Latin America, spoke no Spanish and had never been in a line function. Moreover, there was no agreement in the Bank on what had caused the Mexican debt crisis and what it meant for the Mexican economy and for the Bank.

The Bank's economic report on Mexico of early '82 had downplayed the risk of the over-indebtedness. [Alden W.] Clausen, who was then the Bank's president, visited Mexico in the first half of '82, endorsed the main line of that economic report. He said that everything was going well, that Mexico could look forward to a high growth rate, 6 percent or more. Mexico just had to watch out for a few things, including debt, he said. There was no sense then that the country's debt situation was about to explode. But in August of that year Finance Minister [Jesus] Silva Herzog had to announce that Mexico was unable to service all its commercial bank debts.

KAPUR: D. B. Dutt, in a note of early '82 or late '81, had written that a debt problem was looming, but, as you said, the briefing for Clausen in '82 was quite sanguine.

BOTTELIER: The briefing certainly did not highlight the debt problem, yeah. Let me recount the history of that report, as I know it, and then go to the main subject of our discussion here.



This is relevant to the story, because Jorge Garcia-Mujica, who is still in the Bank and now a respected economist, was the only economist who correctly anticipated the Mexican crisis. He was member of an economic mission to Mexico in '81 that was led by a Frenchman whose name slipped my mind. He died in the meantime.

WEBB: [Alexander] Nowicki?

BOTTELIER: Nowicki, yeah. You know Nowicki?

WEBB: I remember him very well, yeah.

BOTTELIER: Nowicki was indeed the leader of that mission to Mexico. Garcia-Mujica was in charge of the quantitative macro work and economic modeling for that mission. He concluded that the debt situation was getting very serious and that a crisis would be hard to avoid. He suggested that that should be scenario number one for the economic report. Nowicki and some other Bank people disagreed. They felt that the debt problem was manageable. Nowicki was willing to keep Garcia-Mujica's concerns in the economic report, but only in one of the less important scenarios, which attracted no attention.

WEBB: Was Guy Pfeffermann the chief economist then?

BOTTELIER: Yes.

WEBB: Did he agree or disagree with the report?

BOTTELIER: He was in a sense responsible. Nowicki was the mission leader, but Pfeffermann was the departmental (or regional) chief economist. But the person who, more accurately than anybody else, understood what was going on, wrote about it and modeled Mexico's debt problem predicting the crisis and its dire consequences, was Garcia-Mujica, the Chilean economist.

It so happened that the writing of this economic report in '81 coincided with an unprecedented boom in Bank lending to Mexico. That year the Bank lent \$1.1 billion or thereabout to Mexico, more than ever before. Mexico had become one of the largest borrowers in the Bank. The view that the Mexican economy was about to derail wasn't exactly consistent with the Bank's lending policy.

KAPUR: But it was also inconsistent, because the Bank was talking of Mexico graduating.

BOTTELIER: Really?

KAPUR: Yeah. I mean . .

BOTTELIER: That I didn't know that. That's interesting.

KAPUR: There were graduation talks going on. When that happens, the Bank normally begins to decrease lending to the country in question.

BOTTELIER: Yeah. Coming in later and not having participated in those discussions, I concluded that the Bank's behavior had not been substantially different from that of the commercial banks. Like them, we had been riding on this assumed sea of creditworthiness, pushing out projects that the Bank might not have pushed in normal circumstances.

The view that Mexico's economy was about to explode was obviously inconsistent with the profile of and volume of our lending to the country. This was probably a factor in the suppression of a pessimistic perspective on the Mexican situation. Garcia-Mujica nonetheless persisted in his views and wrote a minority economic report in the form of a memo to files. It became a hardly noticed 25-page minority economic report, copied at the bottom on page 25 to [Eugenio F.] Lari, Dutt and Nowicki.

KAPUR: Lari?

BOTTELIER: Lari was the department director at that time.

KAPUR: Oh, Eugenio Lari.

BOTTELIER: Yeah, before Reiner Steckhan came.

WEBB: Eugenio Lari.



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I am telling you this story because it has a bearing on the work environment I found when I became the Division Chief. There was confusion among our experts as to whether Mexico was facing liquidity problems or a more profound solvency crisis. That issue was at the bottom of the Mexico problem.

I began to work on it seriously in August. I was fully charged, but blessed with a minimum of knowledge of how you do my new job. In my naiveté, and with the Indonesia experience behind me, a country where we had an excellent quality dialogue and a parallel track approach, I wrote a paper on how I saw the Mexico situation in September or October. After having obtained clearance from my seniors in the Bank--Reiner Steckhan and [Nicolas] Ardito-Barletta, the regional VP at that time--I proposed promoting a high quality macro policy dialogue with the Mexicans on two or three key problem areas, linked to the prospect that we would construct large policy loans around remedying those problems.

As you know, those were the early days of policy lending; institutionally, the Bank wasn't fully geared up for this kind of lending. We had no name for these loans. In the Mexico Division, we called them "DPLs," Development Policy Loans. I proposed a series of DPLs for Mexico. In fact, the term "DPL" still is part of the jargon in Mexico.

WEBB: Is that right?

BOTTELIER: At least a few years ago it was the case. The term "DPL" may have disappeared now. We were later told by Ernie that the term didn't appear in his lexicon; we had to call them SALs or sectoral SALs instead.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

The paper in which I proposed a new kind of relationship with Mexico--dialogue on key macro policy issues combined with some large, quick disbursing loans--was well received in the Bank and became the subject of intense debate within Mexico. I later found out that the paper had been hotly resisted in Mexico, in particular by Nafinsa [Nacional Financiera], our main borrower there. The head of Nafinsa, [Gustavo] Petricioli, a later ambassador to the U.S and successor to Finance Minister Silva Herzog, resisted the idea of giving the Bank much influence on policy making. He, encouraged by his own senior staff, submitted a 17-page memorandum to Silva Herzog explaining why Mexico, as a proud and independent country, could not possibly accept the World Bank in the role we proposed.

KAPUR: And this is '82 fall or '83?

BOTTELIER: No, '83. I was confidentially shown Petricioli's memorandum to Silva Herzog by officials of the Ministry of Finance, who explained to me that our proposal was a non-starter because Nafinsa blocked it.

Meanwhile, of course, Mexico's debt problems were building up. Silva Herzog was caught. The banking community in New York pushed international agencies such as the World Bank in a more prominent role to protect their own backs and create excuses for not further lending. Silva Herzog saw that very well and overruled Petricioli. He decided a few months later that the proposal by the World Bank, contrary to what his own internal colleagues were recommending, was constructive; he wanted to have the Bank in that role. It must have been December '83 or so.

Incidentally, the IMF was out of the picture at that time. We were doing all the development talking. Mexico was mad at the IMF for reasons I don't remember. It would be at least another two years before they brought the IMF back in, partly at our urging.

KAPUR: Now at this time one also sees that the Bank's quick disbursing loans became very controversial. I saw an OED [Operations Evaluation Department] review of the ag credit loan to Mexico. OED said quite categorically that the only reason for SAL-type loans to Mexico was to get the money out quickly.

BOTTELIER: Yeah. Well, let me explain what I remember. When I became the Mexico Division Chief in the Bank, I found that our portfolio contained no fewer than sixteen lines of credit to various on-lending institutions, all channeled through Nafinsa. The loans were for agriculture (both commercial and subsidized), SMEs [small- and medium-scale enterprises] in the industrial sector and other things.

KAPUR: Nafinsa is the . . .

BOTTELIER: Nafinsa--Nacional Financiera--has a different name now. It was constitutionally designated as the government's borrower for external funds, so everything had to be negotiated with Nafinsa. That's why Petricioli and his people, including Raul [Obregon] were so important to us.

WEBB: I didn't know that, that they were the only borrower.

BOTTELIER: Yes, constitutionally designated.

KAPUR: Didn't PEMEX [Petróleos Mexicanos] also borrow a lot?

BOTTELIER: Not from us. The Bank never lent to PEMEX.

WEBB: So, Nafinsa was the DFC [development finance corporation], the financial intermediary.

BOTTELIER: You can call it that, but Nafinsa was also the government's holding company.

WEBB: And it on-lent to . . .

BOTTELIER: Nafinsa on-lent to its customers directly and through banks. Earlier, we also lent to Banco Rural [Banco Nacional de Crédito Rural], which was basically the government's subsidy window for poor farmers.

WEBB: I was going to ask you why it had so much power.

BOTTELIER: Nafinsa had tremendous power because of the Mexican Constitution and its pivotal role in the economy. After the Finance Minister, the head of Nafinsa was the most powerful man in the country. And PEMEX was, of course, also very important, but that is a different story.

Raul Obregon [REDACTED] was Nafinsa's official counterpart for the World Bank, but Petricioli was the president.

Now let me try and to weave the story as where we came to where we are now, together in a very abbreviated sketch. Our attempt to pursue a new relationship with Mexico, a policy dialogue role, which was not only new for Mexico, but also for us, ran into some problems, at least initially. The main problem concerned interest rates. As I mentioned, we had sixteen different credit lines while inflation in Mexico was heating up. Nominal interest rates, which were all controlled by the government, had all fallen below current inflation rates and had therefore become negative in real terms. This was a violation of loan covenants in most cases.

I asked our people to make a study of all these covenants and found to my surprises that all sixteen were different. Some said that we had to have consultations on the level of interest rates every six months. Others said that interest rates had to be positive in real terms or had to exceed the cost of funds by X percentage points. The relevant covenants had been negotiated project by project without any overall sense of financial sector policy. This was perhaps not very unusual or surprising. Mexico's macro conditions had traditionally been rather stable. Inflation had not in the preceding twenty years been a major problem. But in '83, when everything went haywire in Mexico, those covenants became a major problem. Something had to be done about them, if only for our own credibility as a macro policy dialogue partner.

Pieter P. Bottelier

January 7, 11, and 19, 1993 – Final edited

I wondered if we could negotiate an umbrella interest rate agreement with the Mexicans to substitute for the interest rate covenants in individual loan agreements. The idea was a novelty, both for the Mexicans and in the Bank, at that time. My Bank colleagues didn't give it much chance. They thought that the Mexicans would never accept it. But we pursued it nonetheless, and were successful. Well before the end of '84 we had a legal agreement covering interest rates under all sixteen lines of credit. It became known as the GIRA, General Interest Rate Agreement. It provided for a six-monthly review of all nominal on-lending rates with the objective to keep them all above the current level of consumer price inflation, except for poor farmers.

This was an important agreement, which set the tone for the new Bank-Mexico relationship we were aiming at. The agreement covered not only Bank loans but all external loans, including IDB [Inter-American Development Bank] loans (they were rather miffed at us for that).

At first the Mexicans did not take GIRA seriously. Already by the end of '84 they failed to comply with the agreement. Presumably they had not expected that it would have any consequences, but we decided that this was a make-or-break point. But before going to formal suspension, with legal department involvement, we decided to try informal suspension, asking the Mexicans by telephone not to submit any disbursement applications under any of the sixteen loans. Since those loans constituted more than half of the Bank's loan portfolio in Mexico, our so-called "informal suspension" of disbursements was not a minor thing.

I remember that telephone conversation with my counterpart in Mexico vividly. They were not a little surprised. They were furious. They had never thought that the Bank would take GIRA seriously. To my great relief and to many colleagues' surprise, within a few weeks after that the phone call, the required interest rate adjustments were made and GIRA survived. For political and social reasons, Mexico's poor farmers were exempted, however.

WEBB: Do you think the mechanics inside Mexico were useful to someone . . .

BOTTELIER: Well, I think that the key figure who helped us in this and helped Mexico in the process was Angel Gurria, who was director of the Crédito Público. You must know him, Angel.

WEBB: Yeah.

BOTTELIER: Angel worked for Francisco Suarez, who was the deputy Finance Minister under Silva Herzog. Angel Gurria, more than anybody else, knew the realities of the banking world in New York, and he knew that Mexico had to take relations with the World Bank seriously. Angel is a very smart guy—he argued internally that agreements with the World Bank had to be taken seriously, if only because Mexico still had to negotiate debt reductions with the commercial bank creditors in New York. Perhaps Silva Herzog himself didn't need much persuasion.

WEBB: Was [Miguel] Mancera in there?

BOTTELIER: Yeah, he was already central bank governor, but I did not know him so well at that time. I think that he supported interest rate adjustments in the right direction.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

WEBB: In this sort of thing, did the Mexican decision makers meet regularly and function as a team?

BOTTELIER: I'm not sure I can answer that. I had great respect for Mancera, who, as we now know, outlasted all of them. He was a real gentleman and an excellent economist. I was not privy to their interactions. I simply don't know the answer to your question. Do you?

WEBB: No, I don't. I know them individually, but I've never seen them collectively in Mexico.

BOTTELIER: My guess is that professionally Mancera and Silva Herzog were on the same wavelength, but given the insular characteristics of Mexican government agencies, they probably operated more or less alone. Mexican ministries were like islands, with big walls around them. I don't think that cabinet-level coordination was strong in Mexico at that time.

WEBB: I have a sense that they are less of a team.

BOTTELIER: Insular characteristics. Not at all like Indonesia.

WEBB: But nonetheless on the same wavelength.

BOTTELIER: I think Mancera and Silva Herzog, both excellent professionals and patriots, were.

WEBB: Both were also central bankers, weren't they?

BOTTELIER: Yeah, Silva Herzog had worked in the central bank before he became Finance Minister. I'd forgotten that.

WEBB: It matters.

BOTTELIER: Yes, it matters.

WEBB: It's a brotherhood. Petricioli wasn't part of it, I think.

KAPUR: Central bankers are sometimes like a cult. [Laughter]

BOTTELIER: I don't know the background.

WEBB: I'm not sure about that, actually. I'm not sure.

BOTTELIER: I don't know what his background was. In any case . . .

KAPUR: One thing is clear. When you gave them that informal ultimatum, things actually moved . . .

BOTTELIER: Yeah. But nothing in writing.

KAPUR: Not in writing.

BOTTELIER: It was very important not to put it in writing.

KAPUR: I have observed in other country situations that informal threats can be more effective than formal ones. Clearly the Mexicans paid attention.

BOTTELIER: But not all did. Some Mexican policy makers preferred to play their “American card,” often through Paul Volcker and his chief economist—what was his name again? He was a good friend of Angel Gurría. But that part of the story comes later.

So, the new relationship with Mexico we had proposed became a reality in the next twelve months. The interest rate agreement (GIRA), which is now largely forgotten, was a watershed instrument in that relationship change.

While implementing GIRA, we began to work on the first SAL, which we proposed to focus on trade liberalization and related public policies. We had started work on a possible trade loan around the middle of '84, shooting for even bigger game than interest rates. Mexico's trade policies were very protectionist and “inward looking”; they needed major adjustment, in our opinion. To enhance the quality of our policy dialogue, I proposed to the Mexicans that we have serious, structured consultations twice a year, once in Washington and once in Mexico City. We would prepare a 10-page paper on the macroeconomic situation as we saw it and a parallel paper on the implementation of ongoing projects and the future cooperation program. I understand from my colleagues that such structured consultations are still going on. We referred to this system of cooperation--structured policy dialogue linked to policy loans--as the “parallel track” approach. The 10-page paper was confidential and rigorously limited in length. Ten pages, we thought, was the maximum readable length for senior officials. In those papers we concentrated linkages between Mexico's fiscal problems, trade policy and the performance of public enterprises. In the discussion of public enterprise performance, we stressed the potential benefits of privatization. Mexico's state enterprises were generally not efficient and required increasingly heavy trade protection and/or fiscal subsidies. We thus established links between the various major policy areas we wanted to focus on: trade, fiscal and state enterprises.

Based on the themes developed in those short papers, we proposed a big (\$500 million) trade loan, which would support trade liberalization, while reducing the fiscal deficit through the reform (including privatization) of state enterprises.

KAPUR: So the strategy was to use the entrée of trade and leverage it into public works.

BOTTELIER: Exactly. We decided to use trade as the policy lever. It was quite popular to do that during those days, the heydays of Anne Krueger as the World Bank's Chief Economist, as we discussed on a previous occasion. So we had ready acceptance within the Bank of our parallel track approach to Mexico. But it would take a long time before our trade loan to Mexico materialized. I don't remember the exact dates, but what we started in '84 did not become a

Board-approved loan until '86. Negotiating the loan was very difficult, partly because of a lack of agreement within the Mexican government on future economic policy. For example, Commerce Secretary Hector Hernandez and his deputy were opposed to trade liberalization, whereas Silva Herzog and the central bank were in favor. Another problem was that some Mexican negotiators wanted a much larger loan amount than the \$500 million the Bank was willing to consider. (They wanted \$5 billion to do all the things the World Bank thought they had to do.) Another complication was a major earthquake hitting Mexico City while several of our negotiators were there, trapped in a downtown hotel.

To break the policy deadlock on the direction of Mexico's future economic management, we organized a seminar in Mexico City where we invited Anne Krueger and other speakers from various parts of the world. The seminar was well attended and greatly appreciated by the Mexicans.

But what really led to a breakthrough, I think, was Silva Herzog's awareness that without a World Bank policy loan of the kind we were discussing, he would have even greater difficulties with the commercial banks on debt rescheduling. It was in August '85 that Mexico finally completed negotiations with its commercial bank creditors on a major debt restructuring package. This was going to be the largest financial deal in history. The agreement in principle covered Mexico's entire commercial bank debt, including previously rescheduled debt--over \$70 billion. However, the deal (with some 500 commercial bank creditors) was linked to a major economic restructuring program to be supported by the World Bank. That gave us a lot of leverage and headaches as we would find out later.

WEBB: There was still no Fund involvement?

BOTTELIER: No, but that was about to happen. The preparation of our first Mexico DPL, as we continued to call the operation, was enormously complicated, partly because there was no IMF program at that time. I don't remember exactly why the Fund was not in the picture. It came later. We would have been able and willing to draft a IMF-style short-term macro stabilization program for Mexico. Our Mexico division was very well-staffed; we had five or six excellent economists, including Garcia-Mujica and Fred [Frederick E.] Berger, the lead economist. Fred Berger, a Danish-Uruguayan, knew Mexico well and was fluent in Spanish. (I studied Spanish while I was working in LAC, but never made it beyond level 4, which is actually very good for a foreigner.)

WEBB: I don't know Fred Berger.

BOTTELIER: Fred played a key role in the Mexico-Bank relationship in those years. He and [Vahram] Nercissiantz (loan officer) negotiated the interest rate agreement (GIRA) to which I referred earlier. Tragically, Fred died of a brain tumor a few years later.

WEBB: Is that right?

BOTTELIER: Yeah. Fred became a good friend. He was a first-rate economist and he was very persuasive. Without him the Mexico program would not have succeeded in the way it did. He had an Uruguayan father and a Danish mother. He was raised in Argentina and Uruguay.

KAPUR: Now--I'm sorry. Around this time, according to his chron files, Ernie (Stern) seems to have been resisting the proposed Mexico operation.

BOTTELIER: Really?

KAPUR: Right. He apparently asked Reiner Steckhan what this was all about. But I'm not sure I really understood why.

BOTTELIER: That's new to me; the proposal for the Mexico DPL had been cleared by Ardito-Barletta. I didn't interact with Ernie in those days and was never told that he had reservations about the proposed DPL.

KAPUR: Barletta had left in '83, right?

BOTTELIER: He left late '83 and his successor was David Knox.

KAPUR: So the Mexico DPL actually went under David Knox.

BOTTELIER: Yeah, that's right. But we had the initial blessings from Ardito-Barletta; this was the Bank's first policy loan of this kind. If Ernie was opposed, he must have changed his mind later; he became a champion of the parallel track approach we were pioneering in Mexico, especially when Mexico had negotiated the terms of a monster financial deal with commercial bank creditors that was linked to Bank operations in Mexico. I remember the proposed deal well; I attended a reception in New York (together with Reiner Steckhan) to celebrate the conclusion of negotiations between Mexico and the banks. We (the Bank) served as a kind of "overseer" of that deal through our involvement in Mexico's economic restructuring plan. On the way back from that reception, I had an accident on Park Avenue and broke my hip, which landed me in a hospital in New York.

The Mexicans realized that to make the deal with their commercial bank creditors effective, they needed a trade loan from the World Bank. We had prepared for this for two years and were ready to negotiate. I cannot remember exactly when that loan went to the Board, but I do remember that the final negotiating stages were very difficult; there was a lot of arm-twisting.

At one point, it must have been late '85, with David Knox's permission, I gave a copy of our proposed policy/disbursement matrix to the Mexicans so that they would fully understand how the proposed loan would work (how disbursements would be linked to policy changes by the Mexican government). Those policy adjustments had been discussed, but not yet been formally agreed in negotiations.

A few days later, around 6 PM, I was called into the office of David Knox, who was very angry at me for having shared the policy/disbursement matrix with the Mexicans. I was puzzled,

because had done that with David's knowledge and permission. Exactly what had happened, I still don't know. It seemed to me that David was under pressure to kill the DPL. Later I learned that the Mexicans had complained about our proposed policy conditionality to the U.S. government, accusing us of neo-imperialism. They had apparently decided to play their "America card." I surmise that the U.S. government complained to Ernie or Clausen, who then called David Knox. (Incidentally, this may explain why Ernie expressed reservations about our proposed DPL for Mexico in his chron file.)

David Knox was very angry; he had apparently forgotten that I had given the matrix to the Mexicans with his permission. He shouted, "Somebody's head has to fall!" Mexico was, of course, very important to the Bank, and David could not risk a serious breakdown in our relations with that country.

I was rather shaken by this experience. When I mentioned to David that he had authorized me to share the matrix with the Mexicans on a personal basis, he denied it; he had obviously forgotten or had not seriously focused on the issue. In retrospect, however, it was a good thing that I had shared the matrix, because by then the Mexicans knew exactly what it was that we had in mind. We had been talking about this policy loan in polite memos and letters, but this was the first time they realized that this was serious business.

[End Tape 1, Side A]

[Begin Tape 1, Side B]

BOTTELIER: Mexico needed an agreement with the Bank of this kind, and Silva Herzog realized that more than anybody else, encouraged in this direction, of course, by Angel Gurria.

In the final stages of the negotiations of this loan, David Knox had to come into the act himself. I traveled with him to Mexico—again, I don't remember the exact dates but it must have been late '85 or early '86. We had reached the breaking point on that loan.

Hector Hernandez was adamantly opposed to a program of trade liberalization. Silva Herzog wanted it, but Hector Hernandez, who was in charge of industry and external trade, didn't. In a meeting between him, David Knox and myself in his office, he said, "I'm not going to let the World Bank tell me what I have to do on trade policy. Full stop."

And David Knox, who has a volatile character--you may have known him, or not?

WEBB: Not in that way. I've talked to him a couple of times . .

KAPUR: He's been writing to us a lot.

BOTTELIER: He has been writing?

KAPUR: Yeah.

BOTTELIER: Oh, he has.

WEBB: And I also dealt with him in an official capacity, around that time, '84.

BOTTELIER: He's a very competent economist, but not known for subtlety. He would lose his horses.

KAPUR: I would never have guessed that.

WEBB: No, me, either.

BOTTELIER: Oh, he can be so angry. When we had that episode over the matrix I mentioned he literally had foam on his mouth in anger. And I expected, after Hector Hernandez told him that he wouldn't have the World Bank tell him what to do, I expected David to lose it again, but fortunately he was just sitting there composed and, you know, almost unlike himself, totally in control of the situation. And he said very kindly, "Mr. Minister, I understand your position, but you must also understand my position. I am not under any obligation to lend you \$500 million." That sort of restored the balance.

Hector Hernandez left the room, leaving us alone. He came back 10, 15 minutes later, after (we guessed) discussing the situation with others, probably including president [Miguel] de la Madrid. He came back with a deal. So it was, in the end, David Knox himself who negotiated the final stages of that loan with the man who had most opposed it. I don't know if he has mentioned that to you.

KAPUR: No. We'll ask him.

BOTTELIER: I give him enormous credit for that. Without his personal intervention at the right time the whole deal with Mexico might have gone off the track. After the episode with Hector Hernandez, we could proceed with the details of the loan in formal negotiations in Washington.

It is important to note, I think, that all the important breakthroughs with Mexico--on the interest rate, financial policy, fiscal policy, trade policy, and the beginnings of public enterprise reform--were made under President de la Madrid, not under his predecessor [Carlos] Salinas. Contrary to popular opinion in the United States (where Salinas was seen as the reform agent), it was in fact de la Madrid who made the difficult economic reform decisions. And what is not well-known either is that the World Bank was the critical external partner in this. Our 10-page notes were very important.

That's more or less how the Mexico-Bank relationship took shape in those difficult years. But things could have turned out differently; there were several occasions where I feared that our new-style relationship with Mexico could go off the track. The fact that it landed so well and that the program blossomed on all sides is due to several people and some chance factors. On the Mexican side, Mancera (who worked mostly behind the scene), Silva Herzog, his deputy Francisco Suarez and, perhaps most importantly, their director for public credit Angel Gurria were the most important positive agents.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

WEBB: Was de la Madrid ever in any meetings?

BOTTELIER: No. But de la Madrid met with Clausen twice in those times; both meetings were here in Washington, am I right? Gee, I wish my memory was a bit better. De la Madrid was very interested in the World Bank link. You remember that before he became President he had been head of the planning office, like Salinas. Under de la Madrid that function became extremely important. Pedro Aspe, who had been head of statistics, became the principal planning expert and head of that office. We had a good relationship with him. When he was in charge of statistics we helped him design a questionnaire on consumer behavior. We had good relations with the whole Madrid group before he became president. De la Madrid, I think, supported Silva Herzog on relations with the World Bank, but we could only guess that. As I mentioned, the Nafinsa group was opposed to granting the World Bank so much importance in the policy dialogue; they might have won had it not been for the fact that Mexico needed us for the debt rescheduling with their commercial bank creditors.

At that time Ernie became very active in the Bank's relations with Mexico. Mexico was the first major country where this new role of the Bank, which was supported by Baker, had been tested. Ernie wanted this to be a success case. He was personally involved in the commercial bank debt negotiations, where the Bank served as a kind of guarantor of sound economic restructuring policies. Since everything had to move very quickly, we couldn't always follow the normal bureaucratic processes in the Bank. I was a mere Division Chief at that time, but after the successful trade loan negotiations, I was in touch with Ernie quite a lot. I briefed him almost on a daily basis on the status of our trade loan and disbursement projections. The loan did indeed become the catalyst for Mexico's much larger deal with commercial bank creditors and may have contributed to the even larger "Baker Plan" (for solving Latin American debt problems) later.

KAPUR: There are some who say that Ernie was in fact the Bank's loan officer for Mexico. What do you have to say on that?

BOTTELIER: Well, Ernie was in touch with Bill [William R.] Rhodes all the time. Bill Rhodes did the running for Citi as lead bank of the steering group for Mexico. Having seen the two interact, it was clear to me that Ernie ran the show. Ernie told Bill Rhodes what could and what could not go. [REDACTED]

And when we had to make presentations to the banks in New York about how we saw the Mexico situation and the status of our lending program, it was Ernie who did it. I traveled with him to New York, so the interaction was very much between the Division Chief and Ernie, which occasionally created difficult situations for me. Because of the speed of all these transactions, I was sometimes forced to bypass my director and the vice president, David Knox.

WEBB: The director was Steckhan then?

BOTTELIER: Yes.

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

A little known story is that we in the Mexico division became increasingly convinced that mere debt rescheduling was not enough for Mexico and that at some point debt reduction had to become part of the deal. We were trembling even to mention the words “debt reduction” in the Bank or put it on paper, because we knew that was a nonstarter.

KAPUR: Why?

BOTTELIER: Well, there was still a belief at that time that the World Bank could not be an agent for debt reduction without jeopardizing its own position as privileged creditor.

KAPUR: Preferred creditor?

BOTTELIER: Preferred creditor in the capital markets and preferred creditor in the relationship with Bank borrowers. You couldn’t speak the words “debt reduction.” The first time we openly did was in a briefing for Clausen sometime in the course of ’87 when, in the final paragraph of a briefing note we said, “In our opinion Mexico can’t climb out of the hole without some debt reduction.”

KAPUR: If that was ’87, it must have been Conable.

BOTTELIER: No, I was talking about a briefing in ’85, the first time we dared to put the words “debt reduction” on paper. This came to haunt us later when we were accused by everybody of not playing a positive role in finding solutions for Mexico’s debt problems. Part of our problem was that by that time the new MD [Managing Director] of the IMF, [Jacques] de Larosiere, had become the international leadsman in cementing deals with commercial creditors.

What we did, which few people knew about at that time, was to engage Don [Donald R.] Lessard as a consultant on debt issues. He was at Stanford, I believe, at that time.

KAPUR: He’s at MIT now. Don Lessard is the one who invited me to that talk at the [inaudible]

BOTTELIER: Now, Don, if you know him, can tell you that more clearly what happened. Incidentally, Don was a contact of Fred Berger, the fellow I mentioned earlier. We asked Don to explore how the World Bank might be able to contribute to negotiated debt reduction. He produced a number of internal think pieces for the Mexico Division long before the [Nicholas F.] Brady Plan.

WEBB: Was [Frederick Z.] Jaspersen the author of any of those . . .

BOTTELIER: No, no. He wasn’t.

WEBB: That was separate, huh?

BOTTELIER: Yeah, that came much later. It was clearly the Mexico Division at that time that was the lead agent inside the Bank. Jaspersen worked for Pfeffermann, the regional chief economist at that time. They did very useful work, but it came later.

KAPUR: Also OPS [Operations Policy Staff] was doing something on debt.

BOTTELIER: Who?

KAPUR: Under Shahid Husain . . .

BOTTELIER: That's right. Yeah, Shahid was head of the OPS and encouraged me in this direction.

KAPUR: But nothing had been done in Jean Baneth's debt group?

BOTTELIER: I don't know.

KAPUR: Nick [Nicholas C.] Hope and . .

BOTTELIER: No. On debt reduction and financial engineering, including the possibility of using "zeroes" and debt conversion aimed at a reduction in principal, the first one to work out detailed proposals was our consultant Don Lessard. We were afraid that his papers might leak in the Bank, because at that time you couldn't openly talk about debt reduction. The idea of using "zeroes" and conversion, "zeroes" that would be underwritten by the U.S. government as part of a negotiated debt reduction scheme, was worked out in the Mexico Division.

Angel Gurria knew perfectly well what was going on; he was in frequent touch with us and had access to some of our internal think pieces. I sometimes thought that Angel, having decided that the World Bank was of no use to him on debt reduction, took those papers to New York and shopped around for an agent who could engineer a debt reduction scheme on the basis of "zeroes" and conversions. And he found J.P. Morgan prepared to do it. You may remember--it was late '86 or was it early '87?

KAPUR: I don't know. [inaudible]

BOTTELIER: When this tremendous deal was offered, Paul Volcker and others asked, "Where is the World Bank? Why didn't anybody think of this.?" The whole thing had in fact been cooked up in the World Bank, but very few people knew about it. I would love for this story to come out some day.

WEBB: See if Gurria would admit to it now.

BOTTELIER: See if Gurria would subscribe to this perspective. I could not talk to him about it, but knew that he had access to some of our internal working papers. He knew that we had engaged Don Lessard, which few people in the Bank knew. You can call Angel. He is at Bancomex now.

WEBB: Oh, really? I didn't know that.

BOTTELIER: Yeah, Francisco Suarez became head of Bancomer [Banco de Comercio] and Angel Gurria became head of Bacomex.

WEBB: I can also talk to Mancera; he might know.

BOTTELIER: I'm not sure. He might. But if anybody really knows, it was Angel Gurria. He had his finger in every pie, in the World Bank, in New York and, of course, at home in Mexico City.

And so I always found it interesting when the Bank was accused of falling behind, of not providing leadership on the Latin America debt problems, which in fact we did in the Mexico Division but couldn't openly talk about because of internal constraints.



KAPUR: But did you have a sense that Ernie was strongly opposed, or was it perhaps [Eugene H.] Rotberg? He was close to the U.S. Treasury where key people were very concerned. But Rotberg was not as powerful in the Bank as Ernie.

BOTTELIER: Who? Garcia?

KAPUR: No, Rotberg, saying, "Look, you can't talk about this." I mean, it had to come from up high.

WEBB: The question is who was the policeman in the Bank.

BOTTELIER: Ernie.

KAPUR: I mean, were the issues and choices made clear by him at some point, implicitly, explicitly?

Pieter P. Bottelier
January 7, 11, and 19, 1993 – Final edited

BOTTELIER: I wasn't close enough to the top to know that.

KAPUR: But how did you get the signal? Through David Knox?

BOTTELIER: Yeah, it must have been David Knox.

KAPUR: [inaudible]

BOTTELIER: It must have been David Knox, although I have no positive recollection of that.

KAPUR: You just had a palpable sense that that was . . .

BOTTELIER: Oh, definitely. And I always thought that it came from Ernie, with Rotberg's total support. Ernie was the kingpin in the Bank. I respected him enormously. Without Ernie, the Brady Plan might not have come about.

KAPUR: Was it your sense that Ernie thought there was a conflict between the interests of the World Bank and those of the commercial banks?

BOTTELIER: I don't know, but it was only after the famous speech by Brady that the Bank could play a pro-active role on debt reduction. The speech provided political cover to us. Talk to David Knox about it and Gene Rotberg, who is still in Washington somewhere. I see him regularly on walks.

WEBB: Oh, yeah?

BOTTELIER: Yeah. He does not know me well. He was a "god" in the Bank at that time.

WEBB: That is a marvelously useful story. There're a lot of things to follow up.

BOTTELIER: Yeah. I think it could be useful, because Mexico became such a success story later and few people know how the Bank was involved in the Mexico story. But then, things might have gone wrong.

WEBB: Yeah. It's as fascinating as the Joseph Kraft story; the rescue, the first . .

BOTTELIER: Oh, yeah?

WEBB: . . which is also a dramatic and fascinating story. It has a lot to do with the respective roles of the Bank-Fund and the Fund. The public image is that the Fund ran the show, but the reality was different.

BOTTELIER: Yes, very different. In fact, in '84, when we began to work on that DPL for Mexico, the Fund was totally out of the picture; Mexico didn't want the Fund in. We kept arguing with the Mexicans they had to get the Fund involved. We had no choice. Our game plan was to design our DPL as part of a comprehensive structural reform plan, including a Fund-

supported stabilization program, as we later did with Argentina. In the course of '85 Mexico decided to drop its objections and bring the IMF in. I sighed with relief, because we could drop our efforts to include short-term macro stuff in the proposed trade loan.

I have got to excuse myself.

[End of Tape 1, Side B]

[End of interview]