

ALTERNATIVE OUTCOMES OF THE
LATIN AMERICAN DEBT CRISIS:
Lessons from the Past*

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Will the denouement of the current Latin American debt crisis be unilateral default or preemptive concessionary write-downs of the debt? If either outcome occurs, what are the implications for the U.S.-centered world trade and financial system and, in particular, for the trade and financial links between Latin America and the United States? The crisis containment strategy instituted by the United States in 1982 presumed a negative answer to the first question, thereby ruling out the second as irrelevant. But by 1986, fading confidence in that strategy has reopened both questions.

This article culls two earlier Latin American debt crises for clues to answering these questions. The first part will review the Argentine-Uruguayan debt crisis of 1890, dubbed the Baring Crisis in the financial centers of Europe. The second part will survey the 1930s debt crisis, when about two-thirds of the Latin American countries defaulted on their foreign debt. The third part will pull together inferences from the past that appear relevant for assessing the outcome of the current Latin American debt crisis and its longer-run international repercussions.

Historical analogies, like metaphors in general, are imprecise modes of analysis. But for understanding unsteady states of the world, they can be useful checks on other metaphoric modes of analysis, such as econometric models, with their penchant for playing down discontinuities in order to facilitate quantifying, or theoretical models of economists purporting to explain after the fact what they had failed to anticipate, while sticking with the same theoretical premises that had dulled their anticipatory sensibilities. The earlier debt crisis illustrates a successful return to domestic and international normalcy; the later one,

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a denouement involving important shifts in Latin American development strategy and permanent alterations of Latin America's links with the financial centers of the capitalist world. Awareness of the diverging factors that seem to have accounted for these opposite outcomes could perhaps improve both types of formal modeling by broadening the prior perceptions of the modelers about debt crises.

THE BARING CRISIS: SUCCESSFUL CRISIS MANAGEMENT

The crisis broke out in 1890, when Argentina and Uruguay suspended payments on their sterling debts. By November the suspension had pushed Baring Brothers, Britain's leading merchant and acceptance bank (and "Europe's sixth power" to its admirers), toward imminent bankruptcy. Given the size and international distribution of Baring's liabilities, the incipient run on the deposits and acceptances of the stricken firm threatened to exhaust quickly Britain's gold reserves and ignite a global financial panic.

Of the three facets of the crisis, the third was adroitly contained by fast "lender of last resort" actions by the Bank of England and the British Treasury. To the bank's historians, its handling of the threatened global crisis was its finest hour (Andreades 1909; Clapham 1958). Nurturing a chastened Baring Brothers back to financial health took longer, over four years. Bringing Argentina and Uruguay back to normal debt servicing took still longer, about eleven years, and involved permanent capital losses to some of the debt holders.

The crisis and its delayed liquidation helped dampen for a time Britain's ardor for overseas investment. Capital exports in the 1890s were half the volume of the 1880s. But by 1903, the pace revived, new Argentine issues could again be floated on the London market, and the general revival culminated in Britain's peak decade of capital exporting, 1904 to 1913. The Baring Crisis and its aftermath proved to be merely a prolonged parenthesis in Britain's transformation from leading industrial workshop to leading international banker of the capitalist world before World War I.

What led up to the suspension of debt payments and the outbreak of the crisis? Some of the precipitating factors are familiar because they show up again in the 1930s and in the current crisis.

One is that in each case the debt payment suspensions followed hard on the decision by lenders to reverse a prolonged acceleration of lending. In the Baring Crisis, new River Plate issues, which were heavily favored by the London capital market in the 1880s, had become unmarketable by 1890. The abruptness of the turnaround caught Baring Brothers, the leading underwriter of such securities, with a disastrously large inventory of Argentine securities that it could unload only at dis-

stress prices. Knowledge of Baring's financial embarrassment led, in turn, to the run on the bank.

That a supply reversal should quickly lead in each case to the suspension of debt servicing implies that the preceding run-up of debt had brought the debtor country to a parlous state in which its ability to service existing debt had come to depend on an increasing inflow of new loans. That is, in the last phase of the debt buildup, the market for international loans behaves perversely in that increases in the interest charge on new loans pressure the heavy debtors to increase borrowing while deterring suppliers from increasing lending. Rising interest rates augment, rather than reduce, excess demand. To halt the exploding debt spiral, lenders have to curtail the flow of new credits, higher interest rates notwithstanding.

Risking a debtor default can be dangerous to the financial health of the more heavily exposed lenders, however. When the latter are banks, the added danger exists of setting off bank runs and a cascading crisis of confidence in the banking systems of the creditor countries. Interventions by the monetary authorities, particularly of the dominant creditor country, may therefore be needed to prevent euphoric lending booms from plunging international financial markets into a destabilizing mode. When precrisis interventions are lacking or ineffective, "lender of last resort" actions are required to contain cascading repercussions from the resulting debt crisis. From this perspective, the outbreak of debt crises derives primarily from endogenous tendencies of capitalist financial markets, when left unregulated, to carry lending booms to excess. A mere subsidiary causal role is attributed to "exogenous shocks." They spark a crisis only when the financial markets have already been brought to a fragile state by the endogenous tendencies. This view of capitalist financial markets equips one to anticipate crises, but at the cost of occasionally underestimating the self-correcting capabilities of such markets.

The alternative view plays down the importance of endogenous destabilizing tendencies. Financial markets are held to be efficiently self-correcting when allowed to operate freely. Debt crises are viewed as adventitious events, caused by exogenous shocks of unusual magnitude or inopportune interventions by the monetary authorities. While ill-suited for anticipating crises, this view has dominated the *ex post facto* explanations of the outbreak of the 1930s, and of the current crisis. To be sure, what is exogenous or endogenous depends on the scope of the explanatory model. But in the 1930s and the current crises, plausible candidates for exogenous shocks can be cited: sharply falling terms of trade for the debtors preceding the 1930s defaults and oil price shocks preceding the 1980s debt crisis. The virtue of studying the Baring Crisis is that neither plausible shock candidates nor ill-timed inter-

ventions by creditor monetary authorities can be found to account for that crisis. It thus strengthens the case for viewing endogenous destabilizing propensities as crucial conditioning factors in the genesis of other debt crises as well.

Argentine capital imports during the 1880s are summarized in table 1.¹ As can be seen, around 85 percent of the inflow occurred during the last four years of the decade. Most of the inflow was portfolio capital. Even the substantial investment in British-owned railroad companies was largely financed by the sale of mortgage bonds and debentures in London.

The high proportion of public sector borrowing shown in table 1 is misleading. A small part of that borrowing directly financed government public works. A larger share was used in lieu of taxes to fund current fiscal expenditures, part of which were payments pursuant to official guarantees to private railroad concessionaires of a minimum yield of between 6 and 7 percent on their construction costs. The largest share of public sector borrowing was contracted by national and provincial government banks to finance private rural and urban land acquisitions, residential and commercial construction, the purchase of farm stock and equipment, and working capital, as well as consumption expenditures of the burgeoning landed and commercial elite. In sum, government borrowing was mainly recycled to finance a private sector boom.

In contrast to the explosive rise of foreign borrowing was the moderate expansion of exports, whose growth in gold pesos averaged 6 percent per annum over the decade, with no acceleration in the second half. Import growth, on the other hand, averaged 13 percent per annum and accelerated in the second half of the decade. Hence the balance of trade deficit, which averaged 16 percent of exports in 1881–1885, rose to 49 percent in 1886–1890. The ratio of foreign interest payments to exports, already 0.25 in 1876, also rose to 0.38 in 1886 and 0.66 in 1889 (Williams 1920, 46, 104–6). Foreign borrowing was clearly reaching unsustainable levels.

Why did borrowers and lenders carry matters this far? The answer seems to be that the lending was based initially on strongly favorable fundamentals, to use Wall Street jargon, but degenerated into a speculative boom self-propelled by myopic euphoria.

On the Argentine side, the borrowing spree was set off by a favorable conjuncture of political and economic fundamentals. The latter include the rich agricultural potential of the Pampas, advances in railroad technology for solving the problem of moving bulk produce to port at moderate cost in a region deficient in fluvial alternatives, and innovations in shipping and communications that were reducing ocean freight rates, passenger fares, and travel time. The key political funda-

TABLE 1 Argentine Capital Inflows in the 1880s Valued in Gold Pesos

	<i>Public Sector Account</i>	<i>Private Sector Account</i>
1880–1885	105,000,000	44,300,000
1886–1889	465,500,000	425,400,000

Source: Computed from Williams 1920, 43, 85–101.

Note: The Argentine gold peso equaled 0.2 pound sterling, or about 97 cents U.S.

mental was the replacement of the insular Rosas dictatorship by “outward-oriented” regimes committed to modified free trade, foreign investment, and mass European immigration to supply manual labor as well as managerial and technical cadres for exploiting the agricultural potential.² Adding to Argentina’s appeal to foreign capital was the “enrichiez-vous, messieurs” twist given the strategy after the 1870s.

Initially, a slight possibility had existed of an egalitarian tilt. President Domingo Sarmiento (1868–1874) envisioned replicating the northern U.S. pattern of family farms, literate farmers, and agriculturally linked small industrial firms in Argentina by promoting immigrant colonies of owner-operated farms and a comprehensive network of primary and technical schools.³ Sharing some of that vision, his successor, Nicolás Avellaneda, put through an American-style homesteading act. Had the vision been actualized, the more equitable distribution of property and human capital would probably have forced populist modifications of the outward-oriented strategy that might have dampened Argentina’s appeal to foreign capital. That danger was aborted when the successful Indian wars of the late 1870s opened up the southern and western pampas to safe exploitation. In an orgy of land grabbing by the affluent, the senior military, and the politically well-connected, the new lands were carved up into large holdings. Supplying the financial, labor, and transport requirements for capitalizing underdeveloped latifundia dominated Argentine economic policy during the 1880s.

The Argentine fundamentals meshed with those in Britain. These fundamentals included Britain’s commitment to free trade and the secular drop of domestic profit and interest rates after the mid-1870s that, on the heels of a quarter-century of high returns on capital, perplexed Britishers dubbed the Great Depression. Economic historians now view it as merely the climacteric of an aging industrial Britain, the slipping away of its industrial preeminence. But with the yield on British Consols falling to 2.5 or 3.0 percent (Edelstein 1982), British rentiers were primed for the purchase of gold-backed Argentine securities yielding 6 to 8 percent.

The British community of Buenos Aires and the London investment banks were poised to promote the securities. Since Argentine in-

dependence, British merchants and bankers had probed its markets, drawn by the country's potential but frustrated by its insular policies and disorderly finances (Ferns 1960). Baring Brothers had underwritten the first Argentine foreign loan in 1824. It soon went into a default that was settled only with some write-down on the accrued interest in 1857. Cleaning up old debts, part of the effort by the early post-Rosas regimes to implement the outward-oriented economic strategy, evoked a favorable response in the British capital market. Between 1862 and 1875, Argentine securities, mostly government issues and government-guaranteed railroad company bonds, were sold in London on a fairly substantial scale. Defaults in 1876 terminated this boomlet, but this time arrears were made up in four or five years with no write-downs, clearing the decks for the 1880s lending boom.

The overheating that brought that boom to its crisis reflected two basic flaws that tend to bring down capitalistic booms. One is the inability of markets to signal accurately the limits to the viable pace at which favorable fundamentals can be exploited. Initially promising results raise expected future payoffs, which get capitalized in rising asset values that collateralize further borrowing, often producing a "trees can grow to the sky" freneticism in the later stages of the boom. The second flaw is the imbalance between insider and outsider information. Project promoters and security brokers, who may come to suspect that the market has been overcapitalizing expected returns, are also positioned to gull outsiders into continuing to feed the boom in asset values. Under the bludgeoning of temptation, fiduciary responsibility tends to give way to *caveat emptor*.

The 1880s boom was deeply marred by both flaws. Railroad trackage rose from twenty-eight hundred miles in 1885 to seventy-two hundred miles in 1891, with thousands of additional miles under construction when the debt crisis exploded, yet freight tonnage rose only 28 percent. The overbuilding, moreover, was not an unavoidable consequence of the need to connect widely separated population nodes. The trackage, fanning out from the ports of Buenos Aires and Rosario, was constructed incrementally, *pari passu* with the advancing pampean agricultural frontier, by twenty-four separate railroad companies, twenty-one of them private (Ferns 1960, 402–21). The promoters usually had objectives over and above profits from railroad operations. Landowners seeking quick capital gains from land sales engineered the lavish dissemination of the 6 to 7 percent government-guaranteed yields on railroad construction outlays. British railway equipment firms seeking captive sales and British merchants seeking better access to interior Argentine markets also promoted the railroad companies. British rentiers buying the railroad securities may have been swept along by naive

overoptimism about railroad profits; the promoters had more solid, if furtive, grounds for pushing the securities.

Warnings of the general fragility of the Argentine boom began circulating in British business journals by 1888, but they were countered by reassuring statements from principals engaged in promoting Argentine securities. Thus the chairman of the Buenos Aires and Great Southern Railway pronounced at the 1888 meeting of stockholders:

No doubt the pace is rapid, and no doubt the country's engagements and indebtedness are increasing to an enormous amount, but on the other hand, recollect that you are dealing with a country possessed of enormous resources of national wealth. . . . So far we may say that the Argentine credit has stood the test in the London market, and although some of us older ones may question the practical utility of some of the projects . . . , still I may say . . . that any English investor exercising a proper amount of judgement and discretion will find ample means in the Argentine for investing his money to advantage. (Ferns 1960, 437–38)

The optimists were more persuasive than the Cassandras. About 40 percent of the decade's Argentine placements were made in 1888–89, and around 40 percent of all foreign placements in London during those two years were Argentine.⁴ Only at the end of 1889 did Argentine issues encounter increasing market resistance, to the near fatal embarrassment of Baring and some lesser underwriting banks (*Economic Journal* 1891; Presnell 1968; Ferns 1960, 464).

The boom in mortgage credit was equally explosive. Two government land banks, one provincial and the other national, supplied most of the mortgage finance. Loans were made in the form of *cédulas*, bearer bonds that were obligations of the lending bank and residually of the respective governments. Borrowers sold the *cédulas*, usually at a discount, in the local money market to raise cash. Most *cédulas* carried no gold clause, but their high nominal interest rates of 7 to 8 percent and their discounted prices, which moved inversely with the gold premium on the peso, made them interesting speculations abroad. About 90 percent of the *cédulas* were bought by British financial houses for resale in Britain and Europe. The boom in *cédulas* between 1886 and 1889 coincided with that in Argentine railroad securities, and equivalent gold peso amounts were invested in each (Williams 1920, 82–84, 90–91; Ferns 1960, 398). The *cédulas* financed a phenomenal rise in rural and urban real estate values, which went far beyond any reasonable expected yields on the properties.⁵

The premium of the gold over the paper peso was a key indicator to Europeans of the state of Argentina's creditworthiness. The premium emerged when Argentina, having gone on the gold standard in 1883, was forced by a rapidly rising import surplus and gold drain to suspend

convertibility “temporarily” early in 1885. The suspension lasted until 1899, when convertibility was restored with a 56 percent drop in the peso’s gold content. During the inconvertible years, the domestic market for gold remained open except for a brief shutdown in 1890. It was fed by gold obtained from exports and foreign loans and drained by imports and foreign debt servicing. The 1883–84 gold peso, no longer minted, served as the unit of account in the gold market; its market price in paper pesos minus one being the gold premium. As sterling was convertible at virtually a fixed gold price, the changes in the gold premium closely tracked the movements of the floating peso-sterling exchange rate.

The premium was the focus of conflicting pressures. On the one hand, Argentine agricultural exporters wanted a rising premium because a depreciating exchange rate lowered the ratio of debt and wage payments to their export receipts. Their political clout kept taxes low and forced a rapid expansion of peso emissions by the government banks to help finance the fiscal deficits and provide easy bank credit to the private sector. On the other hand, the boom in “real” consumption and investment required rising imports, forcing the government and its banks to augment foreign borrowing to finance the growing import surplus. This development required stabilizing the gold premium in order to maintain the salability of Argentine securities abroad. The loans, in turn, became essential for sustaining the inflow of gold needed to stabilize the premium (Ford 1956). British financial houses peddling *cédulas* and underwriting Argentine gold-backed securities aided this circular effort. Toward the end of the boom period, when the gold premium was edging upward, they engaged in short-term “salting” operations, shipping gold to the thin Buenos Aires gold market to force back the rising premium long enough to allow them to sell their Argentine paper profitably (Williams 1920, 62–63; Joslin 1963, 121). Apparently, Baring participated in these shady maneuvers, to the shocked disapproval of the City (Gregory 1929, 2:194–99; Lawson 1890, 932–45).

Between 1885 and 1887, the gold premium held relatively stable at around 36 percent. It rose moderately in 1888, more rapidly in 1889 as new Argentine flotations encountered growing market resistance, and precipitately in 1890–91, when access to new “voluntary” foreign loans was cut off. The premium peaked at 364 percent in October 1891, a 70 percent depreciation of the peso between 1889 and 1891 (Williams 1920, 111–13).

The 1890–91 crisis produced domestic financial repercussions in many countries linked to the London-centered international trading and financial network, but the most severely affected were Argentina and Uruguay. Most provincially owned banks went under during the crisis years, including Argentina’s largest land bank and largest deposit

bank. The Banco Nacional, owned by the national government, also fell, as did some private banks, while the national land bank was barely salvaged by emergency injections of federal funds. Precipitating the banking crisis was the enormous rise of nonperforming loans, reflecting a wave of urban and rural bankruptcies and collapsing real estate values. On sales of 901 foreclosed properties, the national land bank was able to recapture only 8 percent of its loans against these properties (Williams 1920, 119–22), implying a 96 percent fall in real estate values.⁶

The “real” consequence of the financial crisis was a disastrous decline of output and employment. Many half-completed railroad and public utility projects were suspended, and urban building virtually ceased. Imports fell 59 percent between 1889 and 1891 (Williams 1920, 104). Net immigration dropped from +224,000 in 1889 to -30,000 in 1891, in relation to a national labor force of 1.4 million (Díaz Alejandro 1970, app. tpls. 20, 24, 30). Contemporary accounts tell of railroad and urban unemployed workers flooding the countryside seeking farm jobs (Ferns 1960, 448; Williams 1920, 198–99).

In London, prices of Argentine securities dropped rapidly after mid-1890: *cédulas* because of the depreciating peso and the bankruptcy of the land bank of Buenos Aires province; gold-backed government securities because of suspension of debt service; and railroads and other public utilities because of falling profits and growing payment arrears on the government’s railroad guaranties (Williams 1920, 122). Security prices in London and other financial centers followed the Argentine securities downward. The international repercussions from the Argentine crisis were magnified because of its timing. Financial shocks in 1889—for example, the collapse of De Lesseps’s Panama Canal company and the near bankruptcy of the Comptoir d’Escompte, a leading French deposit bank—had set off tremors in European financial markets. The Comptoir had heavily financed an unsuccessful effort to corner the world copper market and was saved from bankruptcy by a hastily organized syndicate of French banks that guaranteed its liabilities. Thus when the Argentine crisis first broke in 1890, nervous British and French financial houses, some holding unsalable inventories of Latin American securities, unloaded U.S. securities to build up their liquidity. The fall of U.S. security prices sparked an 1890 financial panic in the United States via the close links between the securities markets, the call loan market, New York city banks, and the country banks in that pre-Federal Reserve era. Baring’s troubles intensified the rush to liquidity, closing the London and Paris markets to virtually all new foreign issues, which set off financial turbulence between 1891 and 1894 in less overextended borrowers, such as Australia, Brazil, and Chile (Kindleberger 1984; Morgenstern 1959).

But the financial crisis affected the “real” economies of lenders

and borrowers asymmetrically. The impact on Argentina and Uruguay was immediate, deep, and prolonged, and the first half of the 1890s was economically depressed for other borrowing countries as well: Australia, New Zealand, Brazil, Chile, Peru, even the United States, which by then was a much less dependent economy. But for Britain, the depression of output and employment was delayed, brief, and mild. British GNP in constant prices rose steadily until 1892. It then fell slightly but regained its upward momentum in 1894. The financial crisis also had a temporary egalitarian impact. The property income share of British GNP fell nearly 8 percent between 1888 and 1892, whereas real weekly labor earnings rose over 9 percent in that interval. The unemployment rate dropped below the 1880s average between 1889 and 1891, before rising above that average in 1892–1894 (Feinstein 1972, tbls. 1, 7, 57, 65). The mild British recession of 1892–93 seems to have been a delayed reflex of the depression among the borrowing countries, transmitted through a fall in demand for British exports between 1891 and 1893 (Ford 1968).

The asymmetry reflected two key mechanisms protecting the British economy. One was the sustained improvement in the British commodity terms of trade from 1889 until 1900, so that cheapened wage goods and raw materials allowed real wages to rise without depressing profit margins.⁷ The other was the sharp decline of British capital exporting during the 1890s. Between 1888–1890 and 1892–1894, portfolio investment fell two-thirds; in 1898–1900, it was still only 57 percent of the 1888–1890 volume. Loans to South America fell more precipitately: to 14 percent of the 1888–89 volume in 1892–1894, recovering to only 24 percent of that volume in 1898–1900 (Simon 1968, 48–50). British direct foreign investment to all regions apparently fell less steeply but more continuously during the 1890s than did portfolio investment.⁸ Domestic fixed investment, in contrast, rose from around 6.5 percent of British GNP in the 1880s to over 8 percent in the 1890s (Feinstein 1972, t. 5).

The asymmetrical distribution of the real effects helps explain why the British-centered international trading and financial system rode out the 1890s crisis fairly easily. This distribution offset an opposite asymmetry between the capacities of the ruling elites of the lending and the borrowing economies to preserve the *laissez-faire* policies on which the system depended, in the face of the recurring bouts of economic adversity to which the system was prone.

In late-nineteenth-century Britain, that capacity was being narrowed by the growing political mobilization and radicalization of the working classes and by a resurgence of protectionist sentiment among British industrialists confronting rising foreign competition. Had the real economy not been cushioned during the 1890 financial crisis and had the adverse impact fallen on British workers rather than rentiers, it

is doubtful that the financial establishment would have been allowed to handle the financial crisis and its aftermath *en camera*, with no parliamentary meddling, and with so little lasting damage to the firms whose behavior had helped bring on the crisis. The policy conflicts between the city and the productive sectors, visible in the 1920s, would have shown up much sooner.

The ruling elites of the harder-hit borrowers had greater scope to tough it out without defecting from “outward-oriented” strategies, primarily because neither the “social question” (that euphemism for working-class militancy) nor industrial protectionism was yet on the political agenda. In Argentina, street fighting in July 1890 forced President Juárez Celman to resign in favor of his vice-president, and in the province of Santa Fe, agitation broke out against foreign ownership of utility companies and the political dominance of the provincial latifundistas (Jones, Jones, and Greenhill 1977, 83–94). Significantly, Santa Fe, the main locale of the European colonization schemes, was the only pampean province with a sizable core of family farms, supporting the conjecture that a broader implementation of Sarmiento’s vision would have dampened the foreign-lending boom. The unrest was cited by Argentine negotiators bargaining over refunding terms with European creditors,⁹ but real wages, already falling during the inflation of the late 1880s, fell further in the aftermath of the financial crisis. The unemployed were thrown on their own resources, and the agitation against foreign capital left no imprint on public policy (Ford 1956, 131; Williams 1920, chap. 13).

Reaching an accord within the Argentine elite on the sharing of the adjustment burden was more of a stumbling block. The first refunding agreement, concluded in January 1891, tripped over it. Made with a consortium of London banks organized by the Bank of England and headed by the Rothschilds, the agreement provided for a three-year fifteen-million-pound loan at 6 percent secured against Argentine customs receipts. The loan was to be used to resume debt servicing and to pay off arrears on the railroad guarantees. Concurrently, Argentina was to reduce its money stock by 15 million pesos in each of the three years. By the end of the period, it was expected that full debt servicing, including repayments of the refunding loan, could be resumed from ordinary export receipts. The IMF-style agreement fell apart because the severe drop in imports drastically reduced the Argentine government’s chief source of fiscal revenue—import duties—and new taxes to fill the gap were politically unacceptable. The fiscal deficit rose, and so did monetary emissions to finance the deficit, contrary to the terms of the agreement. The deficit, however, stemmed the economic downturn. Imports that in 1891 had fallen to 41 percent of their 1889 peak recovered to 57 percent of that peak in 1892–93. But export earnings re-

mained flat, so that the trade surpluses in 1892–93 covered only about two-thirds of the annual debt service (Williams 1920, 127, 183).

In 1893 a new refunding agreement, the *Arreglo Romero*, allowed Argentina to suspend 30 percent of its annual interest service for five years and all amortization payments for eight years. Thanks to rising export volume and prices in the latter half of the 1890s, these new targets were met. In the early 1900s, the boom in beef exporting further strengthened Argentina's balance of payments, and its securities regained easy acceptability in the European capital markets.

THE 1930S DEBT CRISIS

This crisis also followed a strong decadal flow of foreign lending, mainly from the United States, which had displaced Britain as chief capital exporter. Over seventeen hundred bond issues totaling \$11.3 billion were floated in the United States during the 1920s, of which \$9.6 billion was new debt and the rest refunded old debt (Madden, Nadler, and Sauvain 1937, 69). Another \$3 billion represented direct investment by U.S. enterprises, mainly in Canada and Latin America.

British capital exports remained substantial, but the annual flow, despite the higher postwar price level, averaged 11 percent below that between 1910 and 1913, the zenith of Britain's trajectory as capital exporter. Foreign issues during the 1920s, excluding refunding, totaled \$6.4 billion, around two-thirds bonds and the rest equities (Royal Institute 1937, 134). France, which had been second to Britain in the prewar era, withdrew from long-term lending until 1927, then resumed on a small scale, lending mainly to its colonies and East European allies. But while the United States and Britain virtually ceased lending after 1930, French issues rose to an annual rate of \$250 million between 1931 and 1933, before plunging toward zero with the onset of France's gold crisis of the mid-thirties (Royal Institute 1937, 214). Germany was enmeshed in the triangle of reparations, war debts, and foreign borrowing that helped transform it from the third largest prewar lender into the largest debtor of the 1920s. In all, the \$14 billion of long-term international lending between 1920 and 1930 emanated almost entirely from the United States and Britain in a ratio of about two to one.

As in the 1890s crisis, cessation preceded default. British and U.S. capital markets abruptly closed to new overseas flotations in the second half of 1930, and the parade of defaults began in 1931, with Latin America in the vanguard. By mid-1932 twelve Latin American countries had partially or fully suspended debt servicing. They were joined by nine Central and Eastern European countries in 1932 and by Germany in 1933. In 1934 and 1935, there followed additional recruits and a broadening of debt suspension among the defaulting countries.

By the end of 1935, fourteen Latin American countries, thirteen European countries, China, and Canada were in partial to full default.¹⁰

A default wave was no novelty. It had occurred in the 1870s debt crisis, with Latin American countries also in the vanguard, and was only avoided with difficulty during the 1890s crisis. But in virtually all past defaults, debt servicing was resumed after lapses of varying duration, and with the aid of refunding loans, interest arrears were usually made up with only moderate to negligible write-offs by the creditors. Initial analyses, made while the default wave was still rising, therefore tended to stress either or both of two causal strands that had run through the earlier crises: falling terms of trade for primary producers, and financial mismanagement by lenders and borrowers.¹¹ The crisis was seen as a virulent repeat of the periodic instability to which the multilateral system of trade and payments was subject rather than as presaging the collapse of that system. Thus in 1935, the authors of a prominent treatise on international finance wrote: “. . . it will undoubtedly be some years before the capital market of this country [the United States] will be receptive to new foreign loans on any very large scale. The experience of other creditor countries, however, indicates that when economic conditions are favorable, foreign lending is invariably resumed after a period of depression and default” (Madden and Nadler 1935, 81).

Later analysis of the collapse, written amidst the rubble, included in the causal story the worsened plight of the primary producing countries resulting from the absence of new lending. The lesson drawn was that restoring the multilateral system of trade and finance was a *sine qua non* for sustained economic revival of the primary exporting periphery because only in that context could the security markets of the industrial center resume their former importance in financing investment in the periphery (Royal Institute 1937; Madden, Nadler, and Sauvain 1937; Buchanan 1945). The analysis became the guiding principle for the U.S. international economic strategy after World War II until the present debt crisis. It suffered, however, from a misconception and a faulty anticipation. Many of the defaulting economies had actually revived fairly well during the 1930s, despite inability to borrow abroad, and restoring the multilateral trading and payments system after World War II did not revive international bond floating in private capital markets by the peripheral countries. Long memories of prolonged defaults and debt write-downs had been fatal to that mode. The resuscitated multilateral system had to devise alternate channels of long-term lending to the LDCs: governmental loans under various institutional guises during the first two decades and, when these began faltering, commercial bank lending.

Speculative excesses were present in abundance during the

buildup to the 1930s debt crisis, but poorer fundamentals explain why that crisis destroyed key financial ties binding the peripheral debtors to capitalist center countries—ties that had survived the 1890s crisis. The poorer fundamentals reflected structural changes, both economic and political, that weakened the ability of the center of the multilateral system to hold, and of the peripheral debtors to regain debt-servicing capability through economic growth.

The “real” core of the multilateral system had been the exchange of industrial goods from the center countries for raw and semiprocessed food and materials from the primary exporting countries. In 1914 half the world’s industrial exports went to primary exporting countries and half the world’s primary exports went to four industrial countries—Britain, Germany, France, and Belgium—70 percent when Italy, Japan, the United States, and Austria-Hungary are added to the industrial list (Hilgerdt 1945, 166–67; Maizels 1963, t. 4.4). The core distinctly diverged from the Heckscher-Ohlin model for two basic reasons. One was that the flows of the “factors of production” did not fit that model.¹² European capital flowed primarily to peripheral countries that were also importing European labor, implying that Europe was relatively more abundant in both “factors.” In 1914 Europeans owned 92 percent of the \$44 billion world stock of foreign investment, and over 50 percent of the stock were assets in or claims on the United States, the British dominions, Argentina, and Brazil, the destination of virtually all of nineteenth-century European overseas migrants (Woodruff 1966, t. 4.3). Second, complete trade specialization of most of the receiving countries in primary production appeared *ab initio*; little reallocation of resources along the production possibility surface was required of them to exploit trading opportunities under the Pax Britannica system. These features distinguish the Pax Britannica from the current Pax Americana version of the multilateral trading system, in which the “factor” flows and reallocation pressures conform to the Heckscher-Ohlin model. Until eroded by structural changes, these features helped give the Pax Britannica version a firmer base of political support for riding out crisis periods than the Pax Americana version has had.

The financial requirements for holding together Pax Britannica multilateralism through periodic boom and bust, according to Kindleberger, came down to a hegemonic international financial center that could and would meet three requirements: first, keep an open market for primary products during periods of oversupply and falling prices; second, provide countercyclical long-term lending, that is, lend more overseas when the home economy is in recession and expand home lending, investment, and hence the demand for primary imports when the periphery is depressed; and third, discount in crisis, that is to say, act as lender of last resort to prevent international bank runs and finan-

cial breakdowns during cyclical downturns (Kindleberger 1973, 291–94).

Disagreement exists over how faithfully Britain adhered to the second and third requirements during the heyday of Pax Britannica.¹³ Its response as lender of last resort to the 1890 crisis was limited to bailing out Baring and the British banking system, leaving Argentina's banking crisis to run its course. The Pax Britannica system in fact depended on a fourth requisite: political power constellations in Britain and in the peripheral countries that accepted as normal an asymmetrical international and domestic distribution of economic costs during the periodic crises. The dominance of the Argentine *agroexportador* elite, touched on earlier, was mirrored in the other peripheral countries. In prewar Britain, the informal management of Pax Britannica was also narrowly based. Feis observed:

. . . financial power was united with political power, and held mainly the same ideas. Partners of the important issue houses sat in the House of Commons or among the Lords, where they were in easy touch with the Ministry. In clubs, country weekends, shooting parties, Sir Ernest Cassel, Lord Rothschild, or Lord Revelstoke [who headed Baring Brothers during its 1890 crisis] could learn the official mind and reveal their own: there was ample opportunity to discuss the wisdom or needs of the moment. The smallness of England, the concentration in the same circle of those possessing influence or prestige, the responsiveness to group opinion which ruled, the personal honesty and discretion of English officialdom, the acceptance by the financial world of a high standard of honor—all combined to make it easier to understand the freedom left to private judgement. (Feis 1930, 87)

The rise of net property income from abroad, from 7 percent of British property income between 1855 and 1864 to 21 percent between 1905 and 1913, and of the share of foreign assets in total British wealth from 12 percent in 1860 to 33 percent in 1913, sustained the political base for this arrangement (Edelstein 1982, tbls. 2.5, 8.3). As Edelstein noted, “. . . ownership of overseas assets was so broadly based among the wealthy and politically powerful classes of Great Britain by the late nineteenth century that to suggest that this ownership did not influence the structure, goals and policies of imperial trends amounts to arguing that the extensive land holdings of the British aristocracy in the early modern era had little to do with the structure of Tudor-Stuart political life” (1982, 309).

Britain did adhere resolutely to the first requirement, free trade, during the prewar era, although other major industrial powers did not. But because Britain was losing its share of world industrial production and exports to its protectionist rivals, its function as open market for distressed primary goods was eroding. Whether the British-centered multilateral system would have adapted successfully to the secular shift of world productive power had it not been battered by World War I is a counterfactual question with no definitive answer. In the event, the

requisites for sustaining the system under either old British or new American management disappeared in the 1920s. Britain no longer had the economic power to manage the system through crises like that building up to 1929, and the United States, which had the economic power, lacked the political consensus to reshape its trade and financial policies for the management role.

By the late 1920s, Britain's share of world industrial production had declined to 9.5 percent, below Germany's 11.5 percent and far below the 42.5 percent share of the United States (Hilgerdt 1945, 128, 157–58). Britain maintained the largest share of world industrial exports, 21.5 percent, but much of it was under severe competitive pressure—cotton textiles from new textile exporters and coal from new substitutes. Its industrial output and exports were further depressed when Britain returned to the gold standard in 1925 at the prewar exchange rate, a controversial choice made at the behest of the City against the criticism that the prewar rate then represented a 10 to 12 percent overvaluation of sterling. This rate kept interest rates high, the British economy in the doldrums, and forced the adoption of moderate industrial tariff protection to ease discontent (Moggridge 1972).

Overvaluation also helped shrink Britain's current account surplus. High interest rates, however, drew substantial short-term funds from continental Europe, which enabled Britain to accelerate long-term lending between 1926 and 1928. Borrowing short to lend long was a dangerous deviation from the prewar pattern in which Britain had lent on long-term only part of its then-sizable current account surpluses while maintaining positive balances on short-term capital account. To mitigate risk, British monetary authorities in the 1920s intervened to limit foreign bond issues and steer them toward the dominions and the colonial authorities (Royal Institute 1937, 76–77, 135). Seventy-eight percent of all overseas government bonds floated in Britain during the 1920s were by imperial units: about 7 percent were Argentine and Brazilian, and the rest were European (Schedvin 1970, t. 15). Overall British overseas investment was less concentrated. The imperial share in 1930 was 59 percent as compared with 47 percent in 1913, but the Latin American share also rose slightly, around 22 percent of British capital exports in the 1920s going to Latin America, mainly to Argentina and Brazil (Royal Institute 1937, 121, 142).

The war, on the other hand, accelerated the transformation of the United States from net international debtor to creditor. Until 1917 the European allies had financed enlarged import surpluses by liquidating part of their private foreign assets, running up short-term dollar debts, and in the case of Britain and France, floating bonds in New York. These measures sufficed to convert the United States into a net creditor, quite apart from the war loans with which Washington fi-

nanced the import surpluses of the Allies when it joined the conflict. After the war, the United States, with comfortable trade and current account surpluses, took over as chief peacetime capital exporter.

U.S. lending accelerated in the course of the 1920s and altered its geographic composition. Between 1920 and 1924, about 61 percent of the foreign bonds floated in the United States were West European (not including German) and Canadian, with premier investment houses such as Morgan and Kuhn-Loeb handling most of the underwriting. Annual bond lending was much higher from 1925 to 1930, and its distribution shifted, Latin American issues making up 32 percent and German and East European bonds around 25 percent of the total (Mintz 1951, t. 10). These issues were mainly underwritten by lesser Wall Street investment houses attracted to the high underwriting spreads on the lower-rated bonds.

The U.S. investment banks plunged into foreign lending with characteristic American brio. Bonds underwritten by smaller Wall Street firms usually passed through one or two layers of underwriting syndicates before being retailed, each layer taking its underwriting cut. Large New York banks bypassed anti-branch-banking laws by organizing "security affiliates" to retail domestic and foreign bonds. The marketing procedures created gross spreads of up to 14 percent between the nominal bond price and the amount actually received by the foreign borrower. To keep the supply of bonds flowing through these marketing systems, foreign borrowers were pursued aggressively. Overseas agents, finders fees, direct bribes of officials of borrowing governments, and deceptive prospectuses became standard operating procedure, according to U.S. Senate hearings held after the collapse (Royal Institute 1937, 167–71; U.S. Senate 1932).

Final placements were generally in small blocks (Morrow 1927). A substantial share of the 1920s dollar bonds was taken up by foreign buyers, much less by U.S. banks, representing in 1929 merely 1 percent of total U.S. bank assets (Madden, Nadler, and Sauvain 1937, 83, 93–95). The defaults of the 1930s depressed household wealth but contributed negligibly to the bank failures of 1931–32.

Foreign bonds were purchased more for short-term speculation than for long-term investments. They carried higher nominal interest rates than domestic bonds, including until 1929 BAA-rated industrial bonds, and were retailed at a discount. The leverage effect of a general decline of long-term rates on resale price would thus be higher on foreign bonds than on domestic, unless offset by an upward perception of their riskiness. U.S. long-term interest rates fell between 1920 and 1925 on all grades of domestic and foreign bonds, but when domestic bond yields leveled from 1926 to 1929, those on foreign bonds kept falling, so that by 1929 their yield was below that of BAA bonds (Madden, Nadler,

and Sauvain 1937, 14, 97). Clearly, the perceived risk premia on foreign bonds were declining, generating capital gains on well-timed transactions.

Buyers alternated between foreign bonds and domestic equities as speculative instruments, with stock turnover moving procyclically and the volume of new foreign issues countercyclically. This sine-cosine pattern was particularly pronounced between 1927 and 1930 (Mintz 1951, chap. 1), the volume of foreign issues falling off from mid-1928 until late 1929, then picking up. But in mid-1930, belated awareness that the balance of payments of most of the borrowing countries was deteriorating rapidly brought new flotations to a screeching halt (Fleisig 1972).

The foreign bond spree after 1925 was part of the “New Era” euphoria, “manifested in a general tendency to minimize business risks and to discount future prosperity” (Madden, Nadler, and Sauvain 1937, 66; see also Davis 1975, chaps. 4, 6, 7). Parallel speculative booms took place in real estate, corporate debt financing, and stock-market shares, in the course of which the “quality” of the various debt instruments deteriorated. Mintz shows that the foreign bond defaults of the 1930s were mainly concentrated in bonds issued after 1925 and that this default concentration was also true of dollar bonds from each major geographic region (Mintz 1951, chaps. 2–3). A similar deterioration showed up for U.S. corporation bonds, whose default percentage was highest for issues between 1927 and 1929 (Edwards 1933), and for urban mortgages, whose foreclosure rate was highest for issues between 1925 and 1929 (Saulnier 1950). There were, to be sure, Cassandra warnings about foreign bond overlending, including discreet ones in the late 1920s from faceless bureaucrats of the U.S. Department of Commerce about overlending to various Latin American countries (U.S. Senate 1932, 748–825). But Panglossian fatuities, illustrated by the following quotation, had the greater influence:

The dollar exchange created by the new loans takes care of the old loans and finances new American exports. . . . This expansion, the English tell us, is dangerous to the United States. But I’ve yet to hear any sensible reason advanced why it is dangerous or why it cannot go on indefinitely to levels scarcely yet dreamed of

It seems to me that, on the evidence, we may safely conclude that those who have feared that the debts . . . cannot be paid because the debtor countries will not have an export surplus, have been unnecessarily concerned. For so long as the debtor countries have no export surplus, they will be in the market for new foreign loans, and the debts will be paid by new loans. (Auld 1928, 13)

The reckless aspect of the U.S. lending spree in the late 1920s contributed to, but was not the *causa prima* of, the general collapse of foreign lending in 1930 and the subsequent defaults. In the first place,

British lending of the late 1920s was relatively conservative (except to Australia), and its overseas lending mainly terminated for reasons other than loss of confidence in the creditworthiness of the borrowers. Second, the defaults of the 1930s encompassed conservative as well as rash borrowers. Third, some of the rash borrowers did not default, or did so only marginally. These outcomes imply additional causal factors, to which I now turn.

In contrast to the United States, British lending was done in by its deteriorating balance of payments. The riskiness of borrowing short to lend long first hit home toward the end of 1928, when the booming U.S. stock market began pulling U.S. speculative funds from foreign issues to domestic shares, reducing the outward flow of dollars. Concurrently, the stock market drew speculative funds from Europe, which augmented the international demand for dollars. The demand was met by Europeans selling short-term sterling assets for gold to be shipped to the United States. To halt the gold drain, the British monetary authorities raised short-term interest rates and informally discouraged the floating of new foreign bonds, particularly to Australia, which was judged to be overborrowed (Kindleberger 1973, 103–7; Schedvin 1970, 70–74).

The October 1929 stock-market crash temporarily eased the pressure on sterling, as U.S. interest in foreign bond issues revived and European enthusiasm for U.S. shares evaporated. But by mid-1930, falling output in the United States and Germany and declining exports of the periphery were enmeshed in their downward spiral. When U.S. foreign lending also halted, bankruptcies and bank failures broke out on the continent, and in the ensuing scramble for liquidity, a new run began on sterling, judged weakest of the major creditor currencies. To stanch the run, the British monetary authorities tightened restrictions on new foreign issues and borrowed short-term from the Bank of France and the Federal Reserve. When these efforts proved inadequate, Britain went off gold in September 1931, and the pound was allowed to float downward. In the summer of 1932, a complete embargo was put on overseas flotations. The embargo was eased toward the end of 1932 for imperial issues and in 1934 to allow a refunding loan to Argentina. Loans, mainly for refunding, were also made to Australia and some other imperial units during the 1930s. These were more than offset by liquidations of nonimperial overseas assets, so that Britain's stock of foreign assets declined between 1930 and the outbreak of World War II.

The outbreak of defaults between 1931 and 1933 reflected risky debt accumulations by the borrowing countries during the late 1920s as well as the severity of the external shocks that reduced their foreign exchange receipts from exporting and borrowing after 1928. Germany's balance of payments crisis started in 1929, when the decline of U.S.

TABLE 2 Trends in Wheat Exports and Imports by Major Region, in Millions of Tons

Region	1909–13	1925–29	1934–38
<i>Net European Imports to:</i>			
Western Continental Europe	16.4	17.7	10.5
United Kingdom and Ireland	9.9	9.1	10.4
Total	26.3	26.8	20.9
<i>Net Exports from:</i>			
Eastern Continental Europe	2.7	0.6	2.0
Russia	10.5	0.8	1.2
North America	6.4	15.1	5.4
Southern Hemisphere	7.5	13.6	13.9
Total	27.1	30.1	22.5

Source: Schedvin 1970, 24–25.

lending began unraveling the U.S. loans–reparations payments–war debts triangle. Neither reduced reparation quotas combined with a three-hundred-million-dollar loan under the Young Plan nor the Hoover Moratorium of July 1931, which suspended reparations and war debt payments, sufficed to relieve the run on the *deutsche mark*, which the successive Weimar governments were also trying to stanch by short-term borrowing and by the “classical remedy” of deflation and unemployment. The deep German depression failed to halt the run on the mark, but it brought Hitler to power, who promptly repudiated reparations and restricted access to foreign exchange for servicing Germany’s other foreign debts. Because Germany was a major importer of primary products, its depression helped worsen payment difficulties in the periphery. But the origin of these difficulties lay elsewhere: in deteriorating market conditions for most primary exports that had been papered over by the excessive borrowing of the late 1920s.

The deterioration originated in structural changes. On the demand side was the diminishing importance of Britain as an open market for primary imports and the rising agricultural protectionism and import substitution in primary goods after 1925 by industrial Europe and the United States. Even Britain joined in by subsidizing its domestic sugar beet industry. On the supply side was the “exhaustion of the easy phase” of output expansion for grains and meat of the Cono Sur and Australia, requiring a shift to capital-intensive and land-economizing methods that were costlier and more import-intensive. Prior to 1925, the recovery and restocking of the Western European economies supported a run-up of the price and volume of most primary exports. The postwar *bailes de millones*, the brief export bonanzas enjoyed by some Latin American countries, were mainly early 1920s fiestas. The

TABLE 3 *Composite Price and Stock Trends of Agricultural Products, 1923–1932*
(1923–1925 = 100)

<i>December</i>	<i>Price^a</i>	<i>Stocks^a</i>
1923	108.4	95
1924	98.3	106
1925	102.2	119
1926	77.8	138
1927	82.4	147
1928	71.2	165
1929	64.5	194
1930	38.9	235
1931	27.9	277
1932	24.4	264

Source: Timoshenko 1933, appendix table 10.

^aWeighted index of cotton (31 percent), wheat (21 percent), sugar (21 percent), rubber (10 percent), silk (7 percent), coffee (7 percent), tea (3 percent).

dances ended, usually crashingly, when prices began sagging after 1925. The prices of grains and cotton held up longer, primarily because Russian competition remained far below prerevolutionary levels during the 1920s, but began falling in 1928. Stocks of the major primary products accumulated rapidly after the mid-1920s, as the governments of many primary exporters resorted to price-support schemes. Financing them became a major motive for foreign borrowing by the peripheral countries during the late 1920s.

Table 2 shows the changing demand pattern for wheat. Note the stagnating volume of wheat imports by industrial Europe prior to its depression and the failure of the volume to return to that level in the recovery years of the 1930s. Note also that the opening for export from North America (the United States and Canada) and the Southern Hemisphere (Australia and Argentina) created by Russian and Eastern European withdrawal from wheat exporting in the 1920s was offset in the 1930s by the intensification of Western European import substitution.

Table 3 summarizes price and stock trends of seven key agricultural exports. Using the years 1923–1925 as a base, prices had fallen over one-third and stocks had risen 94 percent by 1929. With the deepening world depression, prices declined another 57 percent during the next two years while stocks rose another 43 percent. Wool, not included in these indices, followed the trends shown in table 3 fairly closely (Timoshenko 1933). The pattern was more mixed for minerals. The prices of tin and natural nitrates sagged during the later 1920s, but prices for petroleum and nonferrous metals held up into 1929. Mineral prices and output, however, fell even more precipitately than agricul-

tural products between 1930 and 1933, as the world industrial depression deepened.¹⁴

While foreign borrowing by the peripheral economies in the pre-war era had been primarily aimed at expanding their capacity to export, their borrowing after 1925 was more defensive: to slow the decline of export prices and to avoid painful structural adjustments required by stagnating trade prospects. Many of the loans financed price-support schemes, fiscal deficits, and in the late 1920s, debt service on accumulating foreign debts (Timoshenko 1933, 619–22). By 1928 the aggregate foreign-debt service of the twelve leading agricultural exporters excluding the United States was three times Germany's annual reparations bill and well above the value of foreign bonds floated in the United States that year (Timoshenko 1933, 595–97; Madden, Nadler, and Sauvain 1937, t. 7).

Had U.S. lending in the late 1920s been less ebullient, agricultural prices would probably have declined faster during the 1920s and the agricultural depression begun sooner, although with less defaulting. The falling prices would also have intensified agrarian pressures in the industrial countries for tariff protection, however, and in the primary exporters, the political upheavals and shifts of the 1930s to import-substituting industrialization might have come sooner. U.S. over-lending slowed these trends, but for 1920s-style multilateralism to have survived, the deteriorating fundamentals would have had to be reversed. A major reversal of U.S. trade policy from protectionism toward free trade and the willingness of the United States to use its economic clout to impose a similar reversal on the other industrial powers would have helped, but the political conditions for such a policy reorientation were clearly lacking. The Hoover administration's response to sagging agricultural prices was the Smoot-Hawley tariff, and during the international financial crisis, the Congress and U.S. public were preoccupied with collecting the Allied war debts. In general, the United States in the 1920s wanted to be the premier international capital exporter while protecting its export surplus. The temporary resolution of this contradiction was accelerating capital exporting, which had its own fatal contradictions, however. But overborrowing and the relative fall of export earnings leave unexplained part of the incidence of default among the primary exporters, as shown by table 4, which covers defaults of dollar bonds.

The inability of the countries enumerated in the top row of table 4 to continue servicing their foreign debt needs no elaboration, nor does the *au courant* status of two of the nondefaulters in the row for 60 to 70 percent decline of export earnings. One (Ireland) had a negligible dollar debt of \$1.3 million, while U.S. officials controlled the customs of the other (Haiti) under an arrangement carried over from the headier

TABLE 4 *Percentage Decline of Export Earnings of Primary Exporting Countries and Service Status of Their Dollar Bonds*

<i>Percentage Decline of Export Earnings, 1928–29 to 1932–33</i>	<i>Service Status of Dollar Bonds^a</i>		
	<i>Fully Serviced</i>	<i>Under 50% of Bonds in Default</i>	<i>50 to 100% of Bonds in Default</i>
70–90	0	0	6
60–70	3	2	9
50–60	2	1	4
40–50	1	0	1
Total	6	3	20

Source: Computed from Triantis 1967, table 7; and Madden, Nadler, and Sauvain 1937, Appendix Table 2.

^aAs of 31 Dec. 1935.

days of dollar imperialism. A third nondefaulter (Norway) was at the low end of the 40–50 percent scale and under less strain from falling exports than the rest. Moreover, two of the three moderate defaulters were only negligibly in default: Canada in the 60–70 percent row on only 3 percent of its U.S. dollar debt and Denmark in the 50–60 percent row on only 1 percent of its dollar bonds. Thus the interesting set contains three heavily indebted nondefaulters, two negligible defaulters, one moderate defaulter (Argentina), and the fourteen major defaulters of the lower three rows. Of the latter, twelve were in default on all their foreign bonds—sterling and franc (Swiss and French) as well as dollars—while two (Cuba and Panama) were in default on about 80 percent of their foreign bonds. What explains the distribution within the set?

Country-specific factors helped Canada and Australia, which was in the 50–60 percent row, to avoid default. As gold-mining countries, they benefited substantially from the windfall to gold earnings resulting from the depreciation of the pound and the dollar against gold (export data in table 4 exclude gold shipments). Canada's net tourist receipts, 10 percent of its current account earnings, held up better than exports during the economic downturn, thanks mainly to U.S. Prohibition. Its banks had built up large secondary reserves in the New York money market, and its citizenry had accumulated large stocks of foreign securities during the 1920s. Partial liquidation of these holdings also helped sustain Canada's international liquidity through the depression (Marcus 1954, 2, 74, 99, 135). Australia, more industrialized than the other primary exporters, recouped in lower costs of industrial raw material some of its export loss from depressed world prices for primary products (Schedvin 1970, 154–55, 301–10).

In addition, one overriding factor divided nondefaulters from defaulters—the trading orbit in which they were positioned when the depression hit. Those still exporting predominantly to Britain during the 1920s generally did not default; those who had slipped into the dollar or deutsche mark trading orbits generally did.

The overall default record on sterling bonds was only moderately better than on dollar bonds, 35 percent in 1935 compared to 40 percent (Royal Institute 1937, 22–24), but this figure is misleading. The sterling defaults were overwhelmingly by primary exporters whose chief trade partner was the United States or Germany. In Latin America, where 59 percent of sterling bonds were in default in 1935, the main defaulters were Brazil, Chile, Colombia, Mexico, and Peru, whose chief supplier and customer in the 1920s was the United States. Their sterling bonds were prewar issues or refundings of older issues; only Brazil had been able to float substantial new sterling issues in the 1920s. All were equal opportunity defaulters in the 1930s, however; they did not discriminate between foreign issues. On the other hand, 80 percent of Latin American dollar bonds were in default in 1935, with Argentina mainly accounting for the difference. Argentina had been Britain's prime Latin American debtor prior to World War I but had borrowed heavily in dollars as well as sterling during the 1920s, although Britain remained its chief export market. During the depression, Argentina was a discriminating defaulter, maintaining full service on its larger sterling debt but defaulting on 27 percent of its dollar bonds (UN ECLA 1965, t. 24; Madden, Nadler, and Sauvain 1937, app. t. 2).

Britain's advantage derived from the skillful way it regrouped after the 1931 sterling crisis. From the collapsing multilateral trading and financial system, it molded a reduced version that encompassed the imperial dominions and colonies, the Baltic countries, and Argentina. For the countries within the sterling bloc, Britain adhered on a limited scale to Kindleberger's three requirements of an international financial center. The peripheral members were required, in turn, to favor British exports, hold their international reserves in sterling, and honor their sterling debts (Tasca 1939). Despite the heavy burden of the last requirement for some of the members, such as Argentina and Australia, defaulting and giving up the security of the bloc seemed a worse alternative to their reigning elites, given the dim prospects for primary exports outside the system and their unwillingness to embark on radical adventures in self-sufficiency (Salera 1941, 89–90; Schedvin 1970, 253–55).

Britain's main instruments for carving out the bloc were preferential tariffs and quotas, discriminatory access to the British capital market, and an economy that enjoyed an earlier and more sustained recovery from the depression than the other major industrial powers, with

TABLE 5 Selected Data on the British Economic Recovery in the 1930s

	<i>Shares of GNP</i>				<i>Wage-Salary Share of National Income</i>
	<i>Gross Fixed Investment</i>	<i>Net Foreign Investment</i>	<i>Industrial Production^a</i>	<i>National Income per Head^a</i>	
1925–1929	8.8	2.1	107.0	97.0	59.7
1930–1934	8.1	–0.6	109.8	98.0	62.0 ^b
1935–1939	10.6	–1.2	142.3	115.0	62.0 ^b

Source: Pollard and Crossley 1969, 249, 253, 258, 259.

^a1913–14 equals 100.

^bDecade average.

the partial exception of Germany, whose recovery from a much deeper depression came later but moved faster. Emergency tariffs were introduced late in 1931 and systematized in formal imperial preference arrangements in 1932. Nonimperial members of the sterling bloc obtained tariff and quota preferences on a bilateral basis. Access to the British capital market was perhaps the least important of the instruments, as it was granted sparingly. The expanding British economy was a more important inducement to primary exporters with otherwise collapsing exports. Table 5 shows Britain in the 1930s doing a replay of the 1890s, cutting back on capital exporting but augmenting home investment, national income, and the wage income share, that is to say, carrying out Kindleberger's second requirement in a reduced international arena. Baltic and Canadian lumber exports were especially favored by the upsurge in home building that led the rise of British domestic investment. Canada, which moved in the dollar orbit during the 1920s, returned to the sterling trading orbit in the 1930s, as exports to Britain and the empire overtook Canadian exports to the United States. Canada also benefited from branch-plant investment by U.S. firms hopping over the Canadian tariff wall in order to operate within the imperial preference system (Marcus 1954, 26, 110, 124, 161–63). Britain's overall import coefficient fell, mainly because of a very favorable shift in its terms of trade, but trade diversion helped compensate countries within the sterling bloc. In 1938 Britain obtained 55 percent of its imports from the bloc compared to 42 percent in 1929 (Kindleberger 1972, 282).

Britain also used its import surpluses to extract debt servicing from nonimperial debtors who had adopted exchange controls. Under threat of reduced British import quotas, the bilateral Anglo-German trade agreements required Germany to service British loans from its

sterling exchange surplus (Harris 1935). Argentina came to similar terms under the Roca-Runciman agreements of 1933 and 1936. Under those agreements, Argentina also gave preferential tariff treatment to British goods, which enabled Britain in the 1930s to regain its former position as chief Argentine supplier at the expense of the United States. In return, Britain granted Argentina a reduced, but assured, import quota on chilled beef and a forty-million-dollar loan in 1934 to fund Argentina's short-term debts with Britain.¹⁵ But Britain lacked similar leverage to avert Brazil's default on its sterling debts, despite intense negotiations, because it ran a large export surplus with Brazil (Paiva Abreu 1984). Had the British been coffee rather than tea drinkers, the effort might have succeeded.

Eastern European debtors in the German trading orbit had poorer alternatives to defaulting, but they found a safe haven against retribution in the closed German trading bloc. Their exports were badly hurt by the deep German depression of 1930–1933. German exchange controls, introduced in 1933, remunerated Eastern European exports to Germany with nontransferable marks, which left these countries with even less free exchange for servicing sterling and dollar debts. After they defaulted, expanding trade with the rapidly recovering German economy also reduced their motivation to resume debt servicing (Rau-pach 1972).

The Latin American debtors in the dollar orbit, cast adrift by a United States preoccupied with its own domestic disasters, had neither a British- nor a German-type haven. The Smoot-Hawley tariff was an instrument for protecting the shrinking U.S. market from all competitors, not for salvaging a dollar trading bloc. The closing of the U.S. bond market to Latin American issues invoked no offsetting financial assistance from either the U.S. commercial banks or the Federal Reserve to ease the credit crunch. With more serious fissures than prospective Latin American defaults opening up in the U.S. financial structure, Bolivia's petition to New York banks in the fall of 1930 for emergency credits was rejected out of hand by the preoccupied banks. On 1 January 1931, Bolivia regretfully announced "that the Republic is not in a position at this time to meet the interest obligations which became due on its external debts on January 1," and the default wave began (Kaletsky 1983).

The regret was genuine. The Latin American elites presiding over the initial defaults were true believers in the multilateral trading and financial system that had nurtured their wealth. The initial expectation was that the suspensions and the accompanying devaluations and exchange controls were merely temporary aberrations from orthodoxy. As earnest of their good intentions, they set aside counterpart funds in local currency for the delinquent debt service. In December 1931, a con-

ference of central bankers from Bolivia, Chile, Colombia, Ecuador and Peru "affirmed its adherence to the gold standard" (Baster 1935, 215). The crystal ball of bankers from the creditor countries was no clearer. One month before Brazil defaulted in August 1931, Sir Otto Niemeyer, the Bank of England's international troubleshooter, announced "that Brazil had all but turned the corner on her difficulties" (Kaletsky 1983). On 18 December 1931, the International Committee of Bankers on Mexico, having reached a draft settlement with Mexico's president on the long-defaulted debt, announced that Mexico could now expect "a period of rehabilitation which will compare favorably with the other major countries." The prognosis was inadvertently prescient; the downward spiral of some of the major countries did last as long as that of Mexico, whose upturn began within a year after the Mexican Congress in January 1932 rejected the draft settlement. In September 1933, Mexico's president ratified the rejection by announcing that "the present and future financial policy of the Government does not permit of any idea of renewing service on the foreign debt" (Kaletsky 1983; Bazant 1968, 210–13).

Mexico's change of heart merely reaffirmed a long-standing default; elsewhere in Latin America, it harbingered a newly relaxed attitude in which temporary suspension became a quasi-permanent arrangement. The shifting attitude evolved as the economies and debt-servicing capacity of the defaulting countries were reviving. It reflected rather a decline in the benefit-cost ratio of payment resumption, with three main factors entering the metaphoric calculations.

One was belated recognition that the new world of semiclosed trading blocs would persist, dimming the expected benefits to the orphaned Latin American debtors from resuming the predepression strategy of export-led growth and foreign borrowing. With international capital markets reluctant to lend even to nondefaulters, the capital inflow was not likely to match the considerable costs of clearing up payment arrears.

Second, payment suspension provided much-needed financial space for the expansionary monetary and fiscal measures that were propelling economic revival in the larger debtor countries. Hampered by large debt payments, devaluation and exchange controls would have been much less a stimulus to the import-substituting industrialization underway in these countries. By forcing tighter monetary-fiscal policies, the payments would also have weakened the other major stimulus, which was expanding public works.

Third, awareness arose that the United States was also relaxed about the dollar defaults. The U.S. Bondholders Protection Council, organized in 1933 for collecting foreign debts, was originally intended to have official status. But State Department objection to drawing the

U.S. government into conflicts with the debtor governments resulted in the council forming as a private organization (Madden, Nadler, and Sauvain 1937, 278–97). Its negotiating clout proved minimal; the percentage of Latin American bonds in default rose to a peak of 85 percent in 1937. Thereafter, the percentage gradually fell, primarily because some of the governments were repurchasing their dollar bonds in the open market at 20 to 30 percent of par (UN ECLA 1965, t. 26; UN 1955).

The many interacting variables and limited data make assessments of the contribution of the defaults to economic recovery highly judgmental. Table 6 provides some material for judgment. It shows that the capacity to import fell more for the five total defaulting countries than for partially defaulting Argentina, but that the reverse was true of export volume. Because the capacity to import is export volume times the terms of trade, it is apparent that the terms of trade remained more depressed between 1929 and 1939 for the five defaulters than for Argentina. Yet table 6 also shows that after 1933 their imports recovered faster than the capacity to import, and faster than Argentina's imports. The inference is that defaulting allowed the five to offset their disadvantage in terms of trade relative to Argentina.¹⁶

The extra boost to imports contributed to the relatively good macroeconomic performance of some of the defaulters during the 1930s. The GDP growth rates of Brazil, Colombia, and Mexico, as well as Argentina, surpassed those of the United States, France, and Canada between 1929 and 1939. The comparison is less favorable in GNP terms because of the opposing impact of the movements of terms of trade after 1929 on industrial and primary exporting countries, although Brazil's GNP growth rate was probably higher than those of the United States and France. In addition, the GDP and industrial growth rates after 1932 of Brazil, Chile, Colombia, and Mexico each exceeded Argentina's (Díaz Alejandro 1984; Ocampo 1984; Paiva Abreu 1984; O'Connell 1984; Maddison 1985, t. A1).

Why was the United States relatively tolerant of the Latin American defaults? Initially, it reacted thus because the defaults did not threaten to set off major chain reactions, as was feared in the Baring Crisis. Foreign bonds were a negligible item in the portfolio of the U.S. commercial banks, which were collapsing in the early 1930s for other reasons. Despite the defaults, U.S. gold reserves were still more than enough to cover Federal Reserve liabilities without forcing monetary contraction. Congress and the public could therefore safely turn their wrath on the investment bankers for callously and irresponsibly victimizing the speculating bondholders and the naive Latin American borrowers.

With the New Deal came official antipathy to dollar imperialism and a desire for gentler relations with Latin America. The Reciprocal

TABLE 6 *Trade Volume and Capacity to Import of Argentina and Five Major Defaulting Countries during the 1930s*

	<u>Vol. of Exports</u>		<u>Vol. of Imports</u>		<u>Cap. to Import</u>		<u>Import Volume ÷ Cap. to Import</u>	
	Five Def. ^a		Five Def. ^a		Five Def. ^a		(3) ÷ (5)	(4) ÷ (6)
	Arg. (1)	(2)	Arg. (3)	(4)	Arg. (5)	(6)	(7)	(8)
1928–1929	100	100	100	100	100	100	1.00	1.00
1930–1931	83	91	76	59	65	60	1.17	0.98
1932–1933	85	70	50	38	59	41	0.85	0.93
1934–1935	89	97	55	48	73	61	0.75	0.79
1936–1937	89	112	61	72	96	69	0.64	1.04
1938–1939	70	98	79	71	69	62	1.14	1.16

Source: UN CEPAL 1976.

^aWeighted average of Brazil, Chile, Colombia, Mexico, and Peru.

Trade Agreement Act of 1934 initiated a turn to trade expansion as economic stimulus. Attempts by bondholders to include resumption of interest payments in the agreements with the Latin American countries were rejected by the State Department. The Act was followed in 1936 by the reorganization of the Export-Import Bank to supply intermediate-term foreign loans tied to the purchase of U.S. capital goods and other export-promoting objectives, such as funding accumulated short-term trade debts owed to U.S. banks. When Export-Import loans were extended to Brazil, Mexico, and other countries still in default on dollar bonds, it became even more obvious that trade expansion for the United States took precedence over debt collection. As war clouds gathered toward the end of the decade, collecting old debts took an even more distant backseat to strengthening diplomatic and military ties with Latin America, while Export-Import loans to defaulters also began to be used as an instrument of diplomacy (Paiva Abreu 1984, 146–56).

During the war, Latin American countries used part of their accumulating foreign exchange to reduce their defaulted debts further by open-market repurchases. Another portion was used to repurchase foreign-owned enterprises, mainly railroads and utilities. Argentina even emerged from the war as a large creditor of Britain. But the assets were inconvertible sterling paper, which Argentina liquidated at British urging by purchasing the British-owned Argentine railroads.¹⁷ Nevertheless, 62 percent of the dollar debt in default in 1935 was still in default in 1945 (United Nations 1965, t. 26).

When the United States embarked after the war on reconstructing a liberalized multilateral trade and financial system, its position

hardened toward the remaining defaults. The motivation apparently was to resuscitate the U.S. capital market's role as key supplier of loan capital to Latin America by restoring the credit standing of the defaulting countries. Access to loans of the Export-Import Bank and of the newly created International Bank for Reconstruction and Development were made contingent on satisfactory debt settlements with the Bondholders Protective Council.

The ploy was only partly successful. Between 1945 and 1953, all Latin American countries with dollar and sterling bonds in default settled on generous terms: major write-offs of accrued interest and long-term refunding loans at low interest and amortization rates (UN 1955). The terms were probably also generous to the current bondholders, by now a second or third layer of speculators who had bought the bonds at small fractions of par. But despite this clearing of the decks, the U.S. foreign bond market remained virtually closed to Latin American issues. The defaults had lasted too long and the write-downs were too generous. Pressured by its Pax Americana responsibilities, the United States had to turn to official lending as a substitute for an unresurrectible private bond market for Latin American bonds.

INFERENCES FOR THE CURRENT DEBT CRISIS: SUMMATION AND ASSESSMENT

One clear lesson is that because of imperfect ability to appraise risk, financial markets are prone to excesses and subsequent breakdowns. Despite differences in institutional specifics—seasoned merchant bankers in the 1890s crisis, brash U.S. underwriting banks in the 1930s crisis, sophisticated international commercial banks in the current crisis—an abrupt upward reassessment of lending risk in each case cut short a prolonged lending boom, to be followed quickly by the debt crisis.¹⁸ In the current one, new bank loans to all LDCs dropped 55 percent between 1981 and 1983. To Latin America, the drop (including “involuntary” lending) was 80 percent, with further declines in 1984 and 1985.

Inferences concerning the outcome for Latin America of today's crisis are less clear-cut. The U.S.-led containment strategy resembles Britain's effective intervention in the Baring Crisis and contrasts favorably with the fumbling joint efforts of the United States, British, and French financial authorities to contain the 1930s crisis. But does the presence of the United States as hegemonic lender of last resort, poised to intervene quickly, also ensure that the strategy is adequate, that it will restore normal debt servicing and bring center-periphery economic relations back to precrisis normalcy? The case for optimism, as put forth in various official and unofficial crisis analyses, comes down to four key propositions (IMF 1984, chap. 4, supp. n. 7; Cline 1983, 1984; Morgan

Guarantee 1983; Leven and Roberts 1983). One, the debtor countries are illiquid, not insolvent, meaning that refinancing, but no write-down, of their debts is required. Two, a three-to-five-year time frame, during which official aid and "involuntary" bank loans are needed to keep the debtors current on their interest payments, will suffice to complete the structural adjustments for returning the debtor countries to precrisis normalcy. Normalcy is both the attainment of full capacity to service the debt from growing exports—specifically, an export growth rate greater than the debt interest rate—and the approximate restoration of precrisis GNP and import growth rates. Three, with normalcy restored, voluntary bank lending, albeit at a more measured pace, will resume its precrisis role as the major source of development lending to the debtor countries. Four, by using divide and conquer tactics, the managers of the debt crisis strategy should be able to prevent debtor coalitions from exacting major debt write-downs (a proposition that appears only between the lines of the published analyses by creditor agencies).

As of 1986, four years into the adjustment period, only proposition four has been realized. But failure to attain "normalcy" in that interval is not in itself disastrous. The three-to-five-year time frame projected for the structural adjustments seems to have been partly based on guesses about the maximum duration of political tolerance in debtor countries undergoing the rigors of the adjustments, and it could well underestimate the tolerance. In the Baring Crisis, it took eleven years, rather than the three initially assumed by the crisis managers, before normalcy was restored. Much more damaging is the failure of the adjustment process to generate sustained movement toward "normalcy" (IDB 1985, chaps. 1–4). Export growth rates continue to lag behind interest rates on the debt, so that the meager improvements in debt-servicing capability have come mainly from depressing imports. Attempts to regain "normal" GNP growth have self-destructed, as rising import demand worsened the debt payment shortfall, and it is now apparent that a return to normalcy by debtors would not touch off a vigorous renewal of voluntary long-term bank lending. Latin American loans are merely the leading specie of an expanding genus of bad bank assets. Shaky energy, agricultural, and real estate loans are also contributing to the near insolvency of many of the U.S. lending banks, which now have to undergo painful adjustments of their own to restore healthy balance sheets (*Business Week* 1984). That and long memories of the debt crisis will remove them as an important source of medium- to long-term loans to Latin America for many years to come (BIS 1985a, 133–39). The strained political tolerance of the Latin American debtors has lost much of its original purpose.

Do parallels with the 1930s therefore dominate those with the 1890s? The answer is a qualified yes. In most aspects, the evolution of

the 1930s debt crisis is the more relevant for understanding the dynamics of today's crisis, although two important current features that are *sui generis* qualify the answer.

The first set of parallels concerns the "fundamentals" motivating the 1970s borrowing spree. As in the 1920s, it was not for the purpose of fueling prolonged export bonanzas but for minimizing adjustments to a darkening international trading environment while keeping up economic growth rates. Oil exporters such as Mexico, Venezuela, Ecuador, and Peru were only partial exceptions, for offsetting the extremely favorable oil prices of the 1970s were the declining terms of trade of most of their other exports. The latter reinforced domestic pressures to borrow heavily. The defensive motives for the 1970s borrowing spree were well recognized at the time, and as was the case in the 1920s, the wisdom of steering through a turbulent trading environment with debt-fueled economic growth was lauded by many international experts prior to the outbreak of the debt crisis (World Bank 1981; Bruno 1984). After the outbreak, the postmortem critiques fingered similar mistakes: excessive borrowing, reluctance to adjust, and misuse of the borrowed funds (Makin 1984; Enders and Mattione 1984, 6–23; Felix 1986). If, as now appears likely, the terms of trade of most of the debtors remain depressed through the rest of the 1980s, it will establish yet another parallel with the 1930s.

Two other analogues with the 1930s are also illuminating. The unwillingness of commercial banks to resume long-term lending to Latin American countries is a replay of the permanent closing of the international bond market to them in the aftermath of the 1930s debt crisis. Concurrently, the United States in the 1980s is, like Britain of the interwar period, a fading international financial hegemon. It is no longer capable of stepping in freely with substitute modes of large-scale capital exporting to the peripheral countries as it did in the early post-war decades. Britain in the 1920s sought to supplement its shrunken current account surpluses with short-term borrowing in an unsuccessful effort to regain its prewar eminence as international lender. The United States since the mid-1970s has ventured beyond that: borrowing short- and long-term to finance its growing current account deficits plus capital exports. As a result, by 1984 "America was back" to its nineteenth-century status of net international debtor. Estimates of U.S. net international indebtedness as of the end of 1985 range from \$197 billion, the combined debt of Brazil and Mexico, to \$350 billion, or almost the entire Latin American foreign debt, with the exclusion or inclusion of the "errors and omissions" item in the U.S. balance of payments accounting for the difference (Triffin 1986). Under the most optimistic of scenarios, U.S. indebtedness will continue rising at least through the rest of the 1980s, according to a recent Morgan Guaranty study (Triffin

1986). In the banking sphere, the financial slippage shows itself in the decline of the U.S. share of international bank assets to third place in 1985, below the shares of the Japanese and the European Economic Community banks (BIS 1985b).

With its growing international liabilities still largely dollar-denominated, the United States is not in imminent payment trouble, but its ability to step in with new modes of long-term lending to the peripheral countries is now hostage to the willingness of its creditors to fund the accumulating U.S. current account deficits by accumulating more and more dollar assets. Throwing money at geopolitical problems, as the United States was able to do freely in the first two postwar decades, now depends on the forbearance of its creditors because the United States would, in effect, be recycling internationally borrowed funds. To keep the forbearance from weakening, and thereby augmenting instability in the dollar exchange rate and accelerating the erosion of the dollar as the premiere reserve currency in international transactions, the United States will have to ration its capital exporting as Britain had to do in the interwar period.

The elements for a 1930s-style breakup into competing currency blocs are thus present. But their interaction is affected today by two features whose intensity levels are unique to the present crisis: massive capital exporting by many of the debtors and the influence of ideological concerns on the management of debt crisis. The phenomenon of capital flight from the debtors is a major reason why the current strategy of crisis management is probably headed for breakdown, while the ideological factor should influence the timing as well as what happens after the breakdown.

The capital flight phenomenon has stock and flow dimensions, each of which can only be roughly estimated. These dimensions indicate that for at least some major Latin American debtors (notably Argentina, Mexico, and Venezuela), the stocks of private foreign assets in 1984 equaled or exceeded their respective foreign debts. Foreign assets were smaller, but substantial, fractions of the foreign debt of most of the other major Latin American debtors, with Brazil near the bottom of the ranking (Felix 1985). The indexing of deposits and government bonds, which helped keep Brazilian capital at home, was abolished, however, as of March 1986, which should raise Brazil's future ranking. Reports on the foreign holdings of the recently deposed Philippine dictator and associates indicate that high ratios of foreign stock to foreign debt are not unique to Latin American debtors, but the region does dominate the rankings.

The high ratios are historically unique for Latin America, however. In the Baring Crisis, capital flight from Argentina either before or after the crisis did not merit mention in the *ex post facto* analyses.

Capital flight in 1929 did help force Argentina off the gold standard by the end of that year (O'Connell 1984, 194), but subsequent capital exodus from Argentina and other Latin American countries was aborted by the erosion of safe havens as the world depression deepened. "The lamentable state of banks in the USA and other industrial countries during the early 1930s made Latin Americans think twice about the wisdom of capital flight, increasing the potency of domestic monetary and tax policies" (Díaz Alejandro 1984, 48–49). In the late 1930s, some Latin American countries became safe havens for European capital, brought in by refugees from fascism or sent over as war scares in Europe mounted. Argentina even felt impelled to restrict the inflow of "hot money" for reasons of macroeconomic stability (Díaz Alejandro 1984, 28).

Immediately preceding the current debt crisis, capital outflows and inflows rose coterminously for most of the Latin American debtors. Outflows from Argentina, Mexico, and Venezuela were half or more of capital inflows between 1979 and 1982, the peak years of bank lending. After 1982 outflows fell off but have remained a high percentage of the shrunken capital inflows arranged for under the IMF adjustment programs. Indications also exist that capital outflow now moves inversely with the movements of the real GDP of the debtors (Felix 1985).

The IMF programs were supposed to promote capital repatriation, which was counted on to improve debt-servicing capability. Repatriation was to be induced by devaluing and raising domestic interest rates sufficiently to elevate exchange-deflated interest rates above those in foreign money centers. But capital also reacts to the state of investment prospects and political risk. The first has been depressed and the second exacerbated by the efforts to raise real interest rates high enough to draw back flight capital. Exchange devaluation lowers the liquidity and solvency of domestic banks and firms with large foreign debts, and raising interest rates does likewise to firms and households heavily loaded with domestic debts. Resulting bankruptcies and output cutbacks have induced those with liquid assets to invest abroad, and the governments to break their IMF commitments in order to expand credit, lower interest rates, and so halt the economic decline. But as output and investment opportunities revive and draw back some flight capital, imports also revive, causing the excess demand for foreign exchange and the reduced real interest rates to revive capital flight in anticipation of further devaluation.

With severely constrained capacities to import, the debtor countries have been whipsawed between capital fleeing to safety when the economy is headed downward and speculating on devaluation when the economy turns upward. Brazil's alternative, devaluation with indexing of wages and financial liabilities, managed to reduce the whipsaw-

ing, but at the price of accelerating three-digit inflation that forced the recent abandonment of indexing. Because of capital flight, only a fraction of the involuntary bank lending has been used for debt servicing and restructuring, a fact that creditor banks now cite to justify their resistance to more lending. The recycling of national debt into foreign assets and bank resistance to fueling it further symptomize the disintegration of the current strategy of debt containment.

Disintegration in the 1930s would probably have produced "everyman for himself" reactions from the respective creditor countries. Today this response is less likely, not merely because memories of trade and financial disorders of the 1930s persist but also because the elites of the major capitalist economies are now more self-consciously linked by shared ideological tenets and fears of system-threatening consequences from economic disorder (Kaletsky 1985, 4–6). But will heightened capitalist solidarity also enable a financially weakened United States to transfer to its creditors a growing share of the financial burden of handling the Latin American debt crisis and of supplying portfolio financing over the longer term? The current minueting around the Baker Plan, as well as general perceptions about the limits of international solidarity, suggest a modified no.

Announced with considerable fanfare by the United States in October 1985, the Baker Plan is intended to shore up the current strategy of debt containment. It calls for new loans of twenty-nine billion dollars to fifteen major LDC debtors, ten of them Latin American, to be made between 1986 and 1988. Twenty billion would be involuntary bank loans while the rest would come from the World Bank and the Inter-American Development Bank, who would raise their planned lending over the three-year period by half for that purpose. Juxtaposed with the net capital outflow from Latin America—about twenty-nine billion dollars in 1984 alone (90 percent to help service the foreign debt and the rest as capital flight, according to IDB 1985, 155–56)—the three-year loan target is exiguous. Not so the requirements for getting a Baker Plan loan. To qualify, the debtor country will have to accept IMF-type monetary and fiscal supervision and will also be expected to adopt free-market economic policies, details to be filled in later.

Six months later, these and other details were still in negotiation. The two official banks had obediently signed on, some debtor countries had begun queueing up for the loans, but implementation was stalled by creditor disagreements. These differences of opinion have concerned not the ideological thrust of the Baker Plan but burden sharing. Banks outside the United States and the less exposed of the U.S. banks, both of whom could weather defaults, object to increasing their exposure by more involuntary lending. This approach would put more of the lending burden on the heavily exposed U.S. money-center banks, most of

whom could not handle defaults without official help. They therefore favor the plan but are apparently holding out for a government guarantee of the new loans, whereas the U.S. negotiators, cognizant of the unpopularity of such loan guarantees, have hastened to deny to suspicious congressional committees that such guarantees are even contemplated. Other creditor countries, who see the plan as a stopgap rather than a solution to the debt crisis, suspect that it is also part of a U.S. strategy to saddle them with more of the financial burden of crisis management. Their combined capital contributions to the IMF and the World Bank now dwarf that of the United States, yet the Baker Plan would divert the resources of these two agencies disproportionately to handling what is now viewed as largely a U.S. problem originating mainly in Latin America, a region that economically and geopolitically is very much in the U.S. orbit.

Obeisance to the United States as "Leader of the Free World" more or less assures that the negotiations will eventually produce a face-saving compromise, but the language of the agreement will probably leave the signatories uncommitted as regards lending over the longer term. Ideological solidarity cannot completely subordinate conflicting perceptions of national self-interest.

Assume the Baker Plan proves to be a mere stopgap and that the financially robust creditor countries direct their future lending primarily to peripheral regions of greater economic and geopolitical importance to them than Latin America. Ideology may in a limited way affect U.S. reactions to the Latin American debt crisis. It is unlikely to make politically palatable any of the schemes floated by bankers and academicians for a comprehensive takeover of the bank debt with write-downs for the debtors of principal or interest or both.¹⁹ Such proposals may be justified as cauterizing the wound to halt chronic bleeding, but politically they are anachronistic echoes from an earlier era when the economic cost to the United States of throwing money at international crises was less apparent. Today they clash with another recently heightened aspect of U.S. ideology, the belief that budget balancing and tax cutting will reverse the slippage of the international economic and financial power of the U.S. economy, a belief conducive to high estimates of the costs of the cauterizing schemes. U.S. ideological concerns, however, probably do lower the risk to Latin American debtors that "conciliatory defaulting" will evoke fearsome U.S. retaliation.

Conciliatory defaulting, to use Kaletsky's phrase, is defaulting in which the debtor acknowledges the debt but regretfully reneges on part of the payments (1985, 59–60). Bolivia and Peru are already practitioners, Bolivia by quietly suspending payments beginning in 1984, and Peru by announcing late in 1984 that it was limiting debt payments indefinitely to 10 percent of its exports. Thus far, well-timed dollops of

official and involuntary bank credits have dissuaded other Latin American debtors from following suit. But as the mirage of renewed voluntary lending fades and retaliation against Bolivia and Peru remains muted, the logic of diverting foreign exchange from debt servicing to financing economic recovery becomes more compelling.

The ideological basis for the reluctance of the United States to reverse that logic by vigorously retaliating is expressed succinctly in the following statements by two highly placed "Latin American hands" of the first Reagan administration:

In the so-called realistic scenario, the debtor countries accept a semi-permanent state of depression. The banks, meantime, continue to pay themselves interest while pushing off amortization into the never-never land of the 21st Century. . . . Even if such a situation could be sustained for several years, the result would be a Latin America with no private sector, no middle class and a resentment level ready to explode at any time in the face of our national security. (Norman Bailey, Senior Director, National Security Council from 1981 to 1983, as cited in Kaletsky 1985, 51.)

. . . it is easy to imagine resentment and frustration exploding against governments when they fail to persuade the U.S. and other industrial countries of the need for more generous terms. Not only would the current broad but weak trend toward democracy falter, but public order and national security would also be at risk. *And it is worth remembering that after a generation of often failed national security governments, military intervention may no longer be the plausible alternative it was in the 1960s and 1970s.* (Thomas Enders, U.S. Assistant Secretary of State for Latin American Affairs from 1981 to 1983, in Enders and Mattione 1984, 56. Emphasis added.)

Widespread conciliatory defaulting would saddle the United States with the task of salvaging its overexposed money center banks to avert a financial crisis. Contingency plans for such an eventuality are undoubtedly already on file, including coordinated steps with the monetary authorities of other major capitalist economies to control runs on the dollar. But the primacy of the United States as international financial center would no doubt be diminished further in the aftermath, even though U.S. exports would benefit from the augmented importing capacity of the defaulting debtors. Correcting major mistakes cannot be costless.

The defaulting debtors would also have to adjust their economic strategies to fit a greatly reduced access to external financing. In the 1930s, the large Latin American defaulters turned to import-substituting industrialization, but that turn was reinforced by depressed export markets. If this time they are not as depressed, more mixed economic strategies would be feasible.

But heightened ideological concerns may also be blocking from consideration the potentially superior solution to the debt crisis of combining capping of debt payments from exports with direct mobilization

of private foreign assets of the debtors to finance the rest. The precedent comes from a less stridently ideological era, that of *laissez-faire* capitalism. During World War I, Britain and France, the dominant capital exporters, assumed control of the foreign assets of their nationals with the right to sell them as needed to finance foreign expenditures, the owners to be compensated with local currency bonds (see Felix 1985 for details). Latin American politicians frequently use war economy and wartime sacrifices as metaphors to justify the cuts in wages and public services they impose to keep up debt payments, but mobilization of private foreign assets as a war measure has thus far gone unmentioned.

Impracticality is not a sufficient explanation of the lacuna. The limited power of Latin American governments to enforce compliance could be strengthened by eliciting the aid of creditor banks and governments in identifying foreign asset holdings. Combining a large cut in debt servicing from exports with mobilization of foreign assets to be escrowed solely for additional debt servicing is a promising stick and carrot strategy for evoking such cooperation from the creditors (see Felix 1985 for details). Even if refused, the mobilization gesture, by signaling the debtor's high commitment to honoring the debt, would further strengthen defenses against strong creditor retaliation against the other half of the package—partial default. In fact, the benefit-cost calculus strongly favors cooperation. The escrow account would collateralize the existing bank debt, thus greatly strengthening bank balance sheets. Exports to the revived debtors would be stimulated, while discouraging safe-haven capital flight would improve the efficiency of the exchange rate as a regulator of commodity trade. Effective mobilization, by raising transaction costs of future capital flight, would give the debtor governments more scope to pursue recuperative monetary-fiscal policies, while equalizing the sharing of the adjustment burden would yield political dividends.

If serious consideration seems unlikely, the reasons are probably class obtuseness in the debtors and heightened ideological sensitivities in the creditors. The affluent classes of Latin America have not been noted for tempering class power with *noblesse oblige*, and war metaphors are unlikely to alter that. The creditors who, given the bleak alternatives, should be quietly encouraging the intimidated debtor governments to try foreign asset mobilization, are deterred by inhibitions against tampering with private property rights. There is a double irony in this reluctance. The inhibitions were weaker in the era of *laissez-faire* than in today's era of expanded government. Second, altering property rights by socializing private debts has been a major feature of the current strategy of debt containment, as the Chilean government discovered when forced to take over the foreign debts of its delinquent private banks in order to qualify for IMF-crafted emergency assistance. The

inhibitions only apply to socializing private assets. This asymmetry is well recognized in banking circles. When the Argentine government was forced in 1985 to assume *ex post facto* the private foreign debts of the failed Banco de Italia, a foreign banker involved in the episode observed: "We foreign bankers are for the free market system when we are out to make a buck and believe in the state when we are about to lose a buck. This thing will come down to a matter of muscle" (Hatch 1985).

To summarize the answers to the questions posed at the beginning of this essay: First, unilateral, but "conciliatory," default as in the 1930s is the most likely denouement to the current Latin American debt crisis. Second, as in the 1930s, Latin America faces a prolonged period of meager access to foreign-loan capital markets, which as in the 1930s will force a turn to import substitution, although probably a more moderate turn. Third, preemptive debt write-downs by the creditors or conciliatory default offset by mobilization of foreign assets for debt servicing are superior solutions, with the latter probably dominating. Neither, however, appears politically feasible in today's ideological climate.

NOTES

1. The Uruguayan debt, which reached 16.8 million pounds in 1890, also had to be refunded in the 1890s (United Nations 1955, 139; Joslin 1963, 133–38).
2. Interprovincial tariffs were abolished, but a moderate external tariff was maintained for revenue, supplying over 60 percent of federal tax receipts until after 1900.
3. Sarmiento's "vision" is eloquently presented in his long, unsigned introduction to Argentina's first official population census in 1869.
4. These estimates are from Ferns and include *cédulas* and trade credits (Ferns 1960, 397–435). Argentine placements through the listed exchange market were only 20 percent of all listed issues in 1888–89 (Ford 1956, t. 4).
5. Ferns reports that land values in the province of Buenos Aires rose 1000 percent between 1880 and 1887. As the *cédula* boom peaked in 1889, land values probably rose another few hundred percent before collapsing in the 1890s (Ferns 1960, 422–24).
6. Loans could not exceed 50 percent of the value of the real estate being mortgaged.
7. British terms of trade rose 16.5 percent in 1889–1900 (Feinstein 1972, t. 57).
8. This generalization was deduced from comparing Simon's portfolio investment series with Imlah's series on total British capital exports reprinted in Simon (1968, 38–39).
9. Dr. Victorino de la Plaza, the chief Argentine negotiator, warned the Rothschild Committee that without a substantial alleviation of Argentine debt service, the rise of the gold premium "would make living unbearable except for the richer classes and might even cause a revolution" (Williams 1920, 125).
10. This group included Mexico, in default since 1914, and the Soviet Union, which had repudiated the czarist bonds in 1919. To trace the spread of defaults, compare the 1935 list from Madden, Nadler, and Sauvain (1937, app. t. 2) with the 1934 list in Royal Institute (1937, 24) and the 1933 list in Winkler (1933, 182–205).
11. Ohlin (1931) and Timoshenko (1933) emphasize the first strand. Winkler (1933) and U.S. Senate (1932) stress the second strand.
12. The Heckscher-Ohlin model is the canonical model of orthodox international trade

theory and policy. Output in the basic model is produced by two aggregated “factors of production”: labor, which encompasses all human contributions to production and distribution of commodities, and capital, which encompasses all nonhuman inputs. As in standard neoclassical theory, an inverse relationship is postulated between the ratio of the “quantities” of the two factors and the ratio of their marginal products. This inverse relationship implies that if the marginal product ratio favors labor in country A, then it must favor capital in the trading partner, country B. Hence both capital and labor migrating from A to B contradict the two-factor Heckscher-Ohlin model. Disaggregating “factors” into three or more categories can explain such joint flows, but it raises other logical problems for the disaggregated H-O model as an apparatus for explaining international trade patterns.

13. On the second requirement, Edelstein has persuasive evidence that the counter-cyclical pattern was dominated by a secular decline of British productivity growth and British profit rates from home investment, which pushed British savings from the mid-1880s increasingly into overseas securities (Edelstein 1982, chaps. 5, 6, 9, 13). For scepticism about the extent of British adherence to the third requirement, see Presnell (1982) and Moggridge (1982).
14. Copper stocks rose sharply in 1929, but copper prices did not break sharply until early in 1930. Between April 1929 and December 1932, they fell 80 percent despite a drop of nearly 50 percent in output over that interval. Yet stocks accumulated further as the copper cartel tried frantically to stabilize the situation (Richter 1931 and 1932).
15. Salera (1941) provides an indignant account of the British maneuvers from a pro-U.S. perspective. His indignation is shared by Argentine nationalists, for whom the Roca-Runciman agreements were an egregious case of *vendepatria* by the then-dominant *agroexportador* elite. Independently of patriotic embellishments, a strong case can be made that the agreements benefited the cattle growers at considerable cost to other economic sectors (Di Tella and Zymelman 1973; Fodor and O’Connell 1973).
16. Table 6 probably underestimates the “gain” from defaulting relative to Argentina because the sharp rise of Argentina’s import volume and of the ratio of that volume to the capacity to import in 1938–39 reflected the sizable inflow of European hot money that offset the drop of Argentine exports.
17. A recent study of the controversial railroad purchase based on British official correspondence and memoranda concludes that Argentina had no choice in British official eyes but to take the railroads. Britain had neither the capacity nor the intention to pay off its sterling debts to Argentina through normal channels (Fodor 1983).
18. This obvious lesson seemingly has to be relearned by the experts. In April 1982, a high-level task force reported to the IMF and World Bank Development Committee that the “pricing mechanism in international lending is functioning. . . . Developing country borrowers with adequate policies and reasonable growth prospects are not likely to be denied continued market access solely because exogenous factors—such as deterioration in their terms of trade or the adverse impact on debt service of high world interest rates—may have rendered their circumstances somewhat more problematic in the short run.” Task Force on Non-Concessional Flows, “Final Report to the Development Committee,” IMF/World Bank, 15 Apr. 1982, p. 19 (cited in Dale and Mattione 1983, 25).
19. For a summary of leading proposals in this genre, see Cline (1983, 113–19).

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