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Volume Author/Editor: Ilse Mintz

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Chapter Author: Ilse Mintz

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Chapter 3

GEOGRAPHIC SHIFTS IN FOREIGN LOANS

Classification of foreign loans by the geographic location of debtor countries tests the diffusion of the process of credit deterioration and helps to interpret it. We now examine changes in the quality of foreign loans in geographic groups of debtor countries and shifts of foreign loans between such groups. Variations in the general default index are viewed as the resultants of these changes and shifts.

Only a minor part of the variation in the default index can be attributed to changes in loan quality within individual borrowing countries. This does not mean that loans issued at different times by public authorities in any particular country were equally sound. On the contrary, in several cases the first loans granted to a country appear to have been cautious and well secured, but were followed by ill advised credits. With few exceptions, however, either all of the foreign loans of the governments in a country went into default or none. Thus, differences that may have existed between loans of the same country disappeared. Only in the few countries where some loans were defaulted while the obligations on others were met may changes in quality be ascertained. These 'mixed' countries are Argentina, Cuba, and Panama (Table 8).¹ Each of the three series of default indexes rises sharply during the later years. This small sample too substantiates our previous results.

The defaulted loans of Argentina, Cuba, and Panama, constituting only about 5 percent of all the defaulted loans in our record, are too insignificant to account materially for the variations in the aggregate default index. The greater part of these variations was not due to changes within but to shifts between individual borrowing countries; or rather, as a glance at the location of 'good' and 'bad' countries will show, to shifts between major geographic areas. 'Good' and 'bad' debtor countries, far from being

¹ Also Canada, which will be discussed below among the larger geographic areas. Outside these countries only one defaulted loan was issued by a public authority in a country that otherwise did not default: a small issue (\$1.5 million) by the City of Carlsbad, Czechoslovakia.

Table 8
Annual Default Index: Argentina, Cuba, Panama
(percentages)

	Argentina	Cuba	Panama
1920	....	....	....
1921	0	....	....
1922	0	0	....
1923	....	0	0
1924	0	....	....
1925	18	....	....
1926	56	....	0
1927	22	0	33
1928	47	100	100
1929	....	100	0

distributed evenly over the map of the world, form large clusters; the 'bad' debtors are in Latin America and in central and eastern Europe (referred to hereafter as 'eastern Europe'); 'good' borrowers in northern and western Europe (referred to hereafter as 'western Europe'), the Far East, and Canada. In this grouping 'eastern Europe' is made up of Germany, Danzig, Estonia, Poland, Czechoslovakia, Austria, Hungary, Yugoslavia, Greece, Bulgaria, and Rumania; 'western Europe' of Great Britain, Ireland, France, Italy, Switzerland, Belgium, the Netherlands, Scandinavia, and Finland. Far Eastern debtor countries include Australia, the Netherlands Indies, Japan, and Palestine.

Table 9 shows the great difference between the two 'bad' and the three 'good' areas with respect to the quality of their loans. It also shows the changes that occurred within these groups over the period. The countries of 'western Europe' and the Far East remained entirely free from default. Canada is an exception; its default index was higher for the early period (4.7 percent) than for the later period (3.5 percent). But Canadian defaults were few. The default indexes for the 'bad' areas varied more. The default index for eastern Europe rose from 75 percent in the early

Table 9
Default Index, 5 Geographic Areas

	Western Europe	Far East	Canada	Eastern Europe	Latin America	Total
1920-24	0.0	0.0	4.7	74.8	55.2	17.5
1925-29	0.0	0.0	3.5	91.9	79.4	49.5

to 92 percent in the late period; that for Latin America from 55 to 79 percent. The upward movement of the general default index is repeated in both these subdivisions.

But the change in loan quality within the 5 areas accounts for only a minor part of the total decline. If the share of each of the 5 areas in total borrowing had remained in 1925-29 what it was in 1920-24, the change within the areas would have raised the default index for all loans only from 18 percent for the early to 23 percent for the late period. The difference between 23 percent and the actual rate, 50 percent, is due to shifts in the proportion of loans taken by different areas.

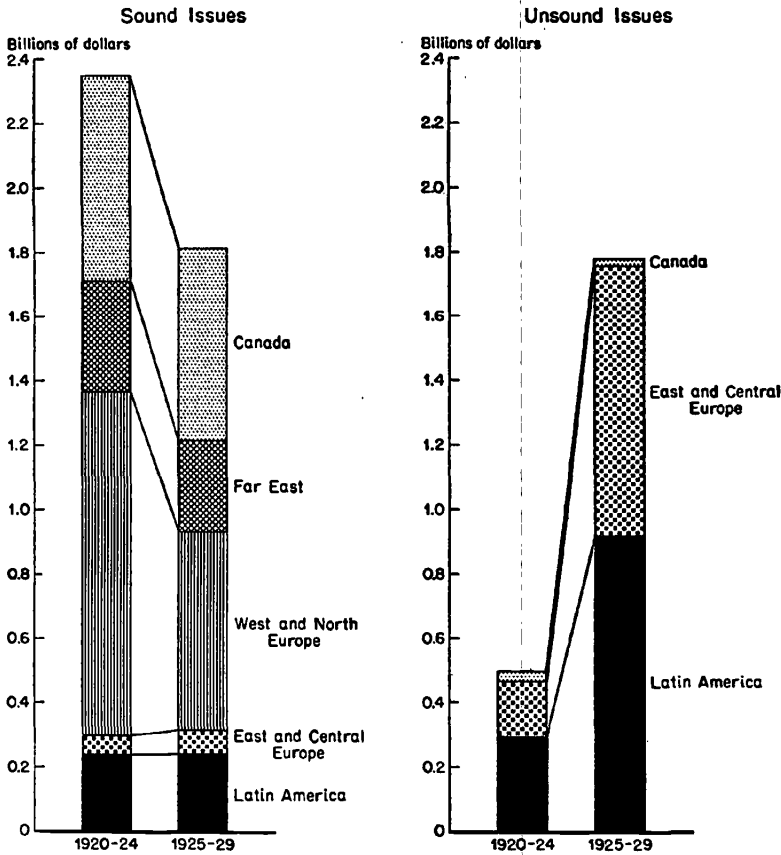
As Table 10 shows, both 'bad areas' took a much larger part of total lending in the late than in the early period, whereas the share of each of the three 'good areas' declined. It is noteworthy that the latter (western Europe, Far East, and Canada) borrowed not only relatively but even absolutely less from the United States in the later period, despite the boom in American foreign lending.

Table 10
Distribution by Geographic Areas
Foreign Government Bonds Issued in the United States

	AMOUNT (\$ mil.)		PERCENTAGE SHARE	
	1920-24	1925-29	1920-24	1925-29
Western Europe	1,073	620	37.7	17.3
Far East	343	284	12.1	7.9
Canada	669	617	23.5	17.2
Eastern Europe	233	912	8.1	25.4
Latin America	529	1,158	18.6	32.2
Total	2,847	3,591	100.0	100.0

In sum, the rise in the general default index may be viewed as the result both of the decline in loan quality within 'bad' debtor areas and of shifts of lending from 'good' to 'bad' areas. This diffusion of the process of credit deterioration is an important factor in its evaluation and interpretation. If, for example, the rise in the default index was due solely to mistaken judgment about a single country, this would, of course, have a different meaning from the actual case where loans to many countries that subsequently defaulted increased *and* loans to areas that remained solvent declined.

Chart 8
 Foreign Government Bonds Issued in the United States,
 by Geographic Areas, 1920-24 and 1925-29



Appendix Table 17.

Chart 8 portrays the changes both within and between areas. It is noteworthy that the unsound loans issued in 1925-29 were about evenly distributed between Europe and Latin America. The increase in both these groups of unsound loans and the relative, and in the three major groups even absolute, decline in each sub-division of sound loans, also stand out clearly.²

² Annual data summarized in Chart 8 and presented in detail in Appendix Table 17 show that the contrast between the two periods is not due to the loans of any single year but reflects a continuous process.