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2 Some Debt History

Prior to the Great Depression, Argentina was one of the ten wealthiest countries in the world.[1] In this chapter we will review, from the perspective of external debt, the growth in the late nineteenth and early twentieth century and the subsequent decline that begins with the depression and World War II and extends to the present. We will only discuss the latter period in broad terms, although it must be understood that the Peronist experience of 1946–55 and the Frondizi years of 1959–62 have fundamental importance for the structure and performance of Argentina even today. Episodes such as the attempt at modernization under Frondizi or the Krieger-Vasena stabilization of 1967–69 remain important events in Argentine economic history.

2.1 Debt and Long-Run Growth

In general terms, when did the economy of Argentina move ahead or fall behind? Table 2.1 shows a comparison of average growth rates of per capita income for several broad periods.

Argentina became a significant country in world trade around the turn of the century. By 1912 Argentina accounted for 5.5 percent of British imports from the main trading countries, 4.2 percent of German imports, and 4 percent of French imports. The strong growth in real per capita income and in exports was rooted in the development of an export-based agricultural economy. By 1913 exports accounted for 40 percent of GDP.[2]

The period of decline clearly began in the 1930s. The collapse of commodity prices and the trade restrictions implied stagnation in per capita income. In 1939 per capita GDP was still at the level of 1928, and the same was true, after intermittent fluctuations, in 1945. The period from 1945 to 1974 had growth rates of per capita income equal on average to 1.9 percent. Since then, per capita income has been falling at 1.4 percent per year. Thus, even though inflation and external balance performance has often been troublesome and growth performance falls far short of that in Korea or Brazil, the extreme difficulties stem from events of the past fifteen years.

Table 2.1 Average Per Capita Growth (percent per year)

Period	Argentina	Australia	Brazil	Canada	U.S.
1870–1913	1.9	0.6	n.a.	2.0	2.0
1900/04–1925/29	1.8	0.8	1.2	1.2	1.3
1925/29–1935/39	−0.3	0.3	1.0	−0.9	−0.2
1935/39–1980/84	1.3	2.6	3.3	3.2	2.3

Sources: Cavallo (1986), Maddison (1982), and Elias (1987).

n.a. = not available.

2.2 The Late Nineteenth Century

Argentine economic development in the nineteenth century was financed by borrowing in the world capital market. Peters (1934) reviews the history of Argentine debt in this period and documents the waves of lending and subsequent defaults. His estimates place debt in 1879–80 at 300 percent of GDP and at 360 percent in 1890–91. Speaking of the 1890s, Peters notes, "Within a decade exports had doubled, imports had tripled, and debt had quadrupled. In no single year was there a budget surplus" (35). Hyndman ([1892] 1967, 153–54) writes of this period:

> Buenos Ayres surpassed every other city in its luxury, extravagance, and wholesale squandering of wealth. There was literally no limit to the excesses of the wealthier classes. While money, luxuries, and material poured in on the one hand, crowds of immigrants from Italy and other countries flocked in to perpetuate the prosperity of the new Eldorado of the South. Railways, docks, tramways, water-works, gas-works, public building, mansions, all were being carried on at once in hot haste.

Debt service difficulties developed into a full-fledged debt crisis in 1890, spreading far beyond Argentina. Table 2.2 shows data on trade, the budget, and borrowing. Until 1890 large rates of capital inflow financed trade deficits and debt service. Ford ([1962] 1983, 140–41) observes:

> By 1890 this borrowing of 708 million gold pesos between 1885 and 1890 had increased the annual debt service charges to 60 million gold pesos (or 60 percent of export proceeds in 1890—a very heavy charge) of which the public sector's share amounted to 28 million gold pesos. . . . It is important to note that because of the nature of these loans the annual

Table 2.2 **Argentine Trade and Finance, 1885–93 (in millions of gold pesos)**

Year	Exports	Trade Deficit	Debt Service	Foreign Borrowing	Budget Surplus
1885	84	8	23	39	−13.9
1886	70	25	27	68	−8.8
1887	84	33	37	154	−10.0
1888	100	28	50	248	−16.7
1889	123	42	60	154	−17.6
1890	101	41	60	45	−9.0
1891	103	36	32	8	−14.1
1892	113	22	n.a.	n.a.	−6.1
1893	94	2	n.a.	n.a.	0.3
1894	102	−9	n.a.	n.a.	−5.9
1895	120	−25	38	17	−10.3
1896	117	−5	40	37	−36.0
1897	101	−4	44	38	−9.9

Sources: Ford ([1962] 1983) and Schaefer (1922).

Note: Foreign borrowing is calculated by date of debt issue.

n.a. = not available.

service charges incurred had a hard core contractually fixed and payable in gold or sterling. Once the flow of loans ceased, thereby diminishing foreign currency receipts, . . . these service charges would remain. . . . Thus as the boom progressed service charge payments formed a growing portion of foreign currency payments and remained more intractable, once loans diminished and incomes fell, than imports. It is not surprising then to find the public debt service repudiated in 1891, and a moratorium arranged until 1987, for the government would have had to add to the depressive forces to raise the necessary funds—an action politically impossible.

In fact, Argentina's failure to service its debt brought down Baring Brothers, the English banking house.[3] The initial debt rescheduling with the receivers of Baring Brothers (called the Rothschild Committee) was negotiated in 1890. Williams (1920, 125–28) notes two points of the deliberations that are highly relevant to present-day discussions. One is the insistence of the Argentine representative that "if the government had to buy bills of exchange in Europe, the premium on gold would probably go up so very considerably, which would make living standards unbearable, except for the richer classes, and might even cause revolution." The other notable point concerns differences of opinion within the committee. The German and French members wanted to make a temporary loan to Argentina, believing that the country might shortly be in a position to resume payments, "but the English members refused to accede to this, for they thought it probable that at the end of six months the Argentine government would be in exactly the same position as at present. The foreign representatives then withdrew from the committee."

The initial agreement reached provided for a new bond issue to provide the means for debt service over the following three years. In return for this loan the government undertook to cancel (through budget surpluses) at least 15 million pesos each year. But, again quoting from Williams (1920, 127):

The authors of it [the restructuring] had underestimated the gravity of the crisis, supposing that the temporary relief afforded by the loan would be sufficient to enable the government to assume the full burden of its foreign liabilities in 1894—a burden that would be augmented by the addition of the interest on the funding bonds to the previous obligations. The Funding Loan was at best a palliative, conceived in the spirit of the old policy which had brought Argentina to financial collapse, the policy of paying the interest on old loans with new ones.

Further debt service difficulties, however, led to a large rescheduling in 1893. Interest on the three principal long-term loans was reduced for a five-year period from 5–6 percent to only 1 percent. The bond holders committee also agreed, in the so-called Romero Settlement, to a simultaneous reduction of interest payments to only 60 percent of the stated coupon rate for the same five-year period on all other debts. Full debt service was to resume in defined stages between 1897 and 1901. As Peters (1934, 47) notes, "the arrangement was highly successful; interest payments were resumed in full a year before the stipulated time, and Argentine bonds rose to high quotations almost immediately, indicating small loss of prestige."

The very rapid pace of immigration and the accompanying large inflow of capital stabilized debts per capita and strengthened the balance of payments. By 1899 the currency was stabilized in the Tornquist reform with a return to the gold standard. Argentina entered the twentieth century with a clean slate.

2.3 The Great Depression

The sharp decline in commodity prices in 1921 brought renewed debt service problems for Argentina. Wheat prices fell by nearly 50 percent. The terms of trade which had been exceptionally favorable during World War I deteriorated by nearly 40 percent during 1925–31. The debt service problems did not last long. Recovery of the terms of trade and a wave of new lending, this time from the United States, masked the payments problems.

The price of Argentine bonds which traded in the 90s at the end of the war fell to only 70 in 1920–21, but by 1923 a recovery of confidence helped push up the price. By 1926–28 full confidence was restored and Argentina was borrowing extensively. Peters (1934, 167) reports that net capital inflows from all sources averaged more than 100 million dollars per year between 1923 and 1930, or about 10 percent of the public external debt.

Figure 2.1 shows net exports (in the GDP accounts) as a fraction of GDP and figure 2.2 shows the ratio of external *public* debt to GDP. Wartime surpluses and inflation helped reduce the debt ratio. Even with postwar

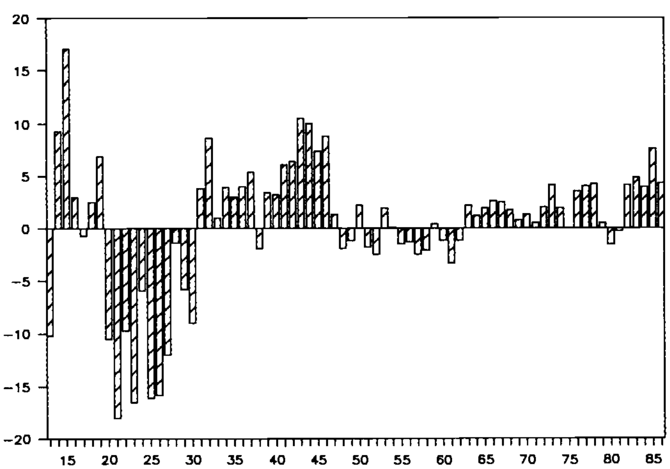

Fig. 2.1 Net exports: 1913–86 (percentage of GDP)

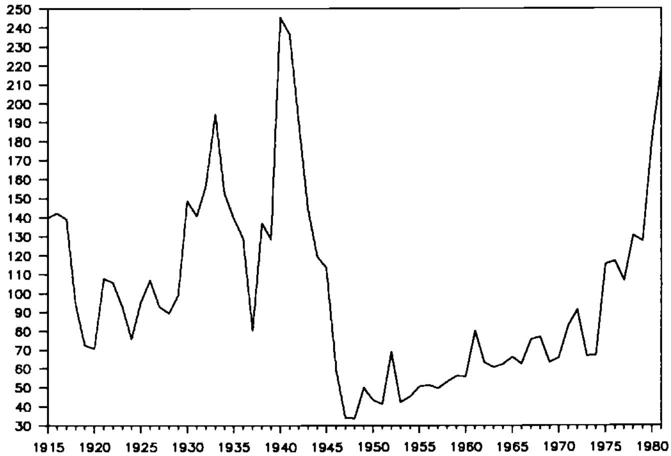

Fig. 2.2 Public external debt (percentage of exports)

deflation and the deficits, the 1930 ratio of debt to GDP was no higher than that prevailing on the eve of World War I.[4]

The 1928–33 period for Argentina represented an entirely traditional debt crisis: an adverse external shock coupled with a suspension of capital flows and trade restrictions. Kindleberger (1984, 317) notes that

> Latin America was hit—especially Argentina, Brazil and Colombia—by the abrupt halt in foreign lending in June 1928 when the New York market started its meteoric rise and interest rates tightened on the call money market. On this score a number of Latin American countries date the start of the Depression from the second half of 1928. . . . Whatever the merits of U.S. bankers in pushing foreign lending from 1925 to 1928, they were surely at fault in cutting it off abruptly in June of the latter year. Deflation is imposed by the Center on the Periphery, whenever the former suddenly stops lending, as in 1825, 1857, 1866, 1873, 1890 and 1907. First halting lending and then cutting way down on imports is a recipe for disaster.

Table 2.3 shows key macroeconomic variables during the late 1920s and the depression years.[5] Note first that the terms of trade and exports peak in 1928 and then suffer a dramatic decline. Real GDP reaches its lowest level in 1932, with a 13.5 percent decline. Just like Brazil, Argentina came out of the crisis rapidly and by 1938 had an output level 23.6 percent above the previous peak.

Maddison (1985) has compared the performance of various countries during the Great Depression. Some of his conclusions are summarized in table 2.4. First, note that the experience of Argentina is not very different from that of other Latin American countries with respect to the decline in output, the export loss, and the decline in the purchasing power of exports. In order to complete the comparison, the change in the real value of debt

Table 2.3 **Argentina During the Great Depression**

Year	GDP[a]	Agricultural GDP[b]	Terms of Trade[c]	Price Level[d]	Public Debt[e]	Exports[f]
1926	100	100	100	100	848	792
1927	107	103	98	98	940	1,009
1928	106	105	136	102	943	1,054
1929	119	104	123	100	926	934
1930	114	93	119	96	913	614
1931	106	96	89	82	901	646
1932	103	101	93	76	888	567
1933	107	101	88	80	859	493
1934	116	106	108	81	966	633
1935	121	121	108	83	965	691
1936	122	110	131	91	941	729
1937	131	114	151	100	818	1,017
1938	131	104	138	95	845	616

Sources: Vazquez-Presedo (1971) and *Estudios* (no. 39, July–September 1986).
[a]Index, real GDP.
[b]Index, real agricultural GDP.
[c]Index of the GDP deflator.
[d]The series was estimated from data in *Estudios* (1986).
[e]Public external debt, in millions of $U.S.
[f]Merchandise exports, in millions of $U.S.

Table 2.4 **Comparative Performance in the Great Depression**

	Peak-to-Trough Decline (%)				External Shock[a]	
	GDP	Export Volume	Import Volume	Purchasing Power of Exports	1929–32	1932–37
Argentina	−13.8	−35.8	−53.2	−41.9	−9.3	18.1
Latin America	−17.3	−40.0	−64.8	−53.7	−11.1	11.7
Asia	−6.4	−22.4	−30.0	−31.8	0.1	5.6
Industrial countries	−13.0	−37.5	−27.1	−30.1		

Source: Maddison (1985, tables 4, 6, and 7).
[a]The external shock is defined as the real income loss from export volume and terms of trade changes measured as a percentage of base year real GDP.

service would have to be added. Since Argentina had a very high ratio of debt to GDP, this factor might have made Argentina's experience appear to be particularly striking.

The external shock measure represents a calculation of the *real income* as opposed to the GDP cost of the external shock. An adjustment is made for the reduced purchasing power of exports as well as their volume decline. The interesting point here is that while the initial loss was extremely large, so was the recovery. The base years for the decline and recovery are not the same, but an adjustment for this point would reduce the gain in 1932–37 to 15.7 percent. Thus on balance there was an exceptionally strong recovery.

The reason for this is that partly as a result of several years of drought during the 1930s in the United States, Argentina experienced a major terms of trade improvement after 1933.

Argentina's response to the crisis, the terms of trade improvement notwithstanding, differs from that of other Latin American countries, notably Brazil. The Brazilian decline in real income in 1929–32 averaged only 0.4 percent versus 4.8 for Argentina; Brazil's recovery in 1932–37 averaged 7.5 percent per year versus 5.2 in Argentina. Active domestic industrialization policy using import substitution explains Brazil's superior performance because on the external side Brazil fared worse in 1932–37. Whereas Argentina in 1932–37 gained 18.2 percent in real income as a result of external forces, Brazil gained only 3.1 percent.

However, there was another important difference: Argentina faithfully continued debt service throughout the period of adverse shock; Brazil, by contrast, declared a moratorium and ultimately wrote down its obligations in 1943. Figure 2.3 shows the price of Argentine debt in the New York market. Until 1930 there was no sign of the impending crisis. Then, with the collapse of exports and widespread default by European and Latin American countries, the price of the debt fell to less than $50 per $100 face value. But with the sharp rise in wheat prices—they doubled between 1931 and 1937—debt returned to near par and held steady until the outbreak of World War II.

Unlike virtually all other Latin American countries, Argentina did not suspend debt service in the 1930s.[6] Countries like Brazil relied on domestic industrialization and sacrificed debt service to gain the necessary room in the external balance. Or else, where industrialization was not the avowed policy,

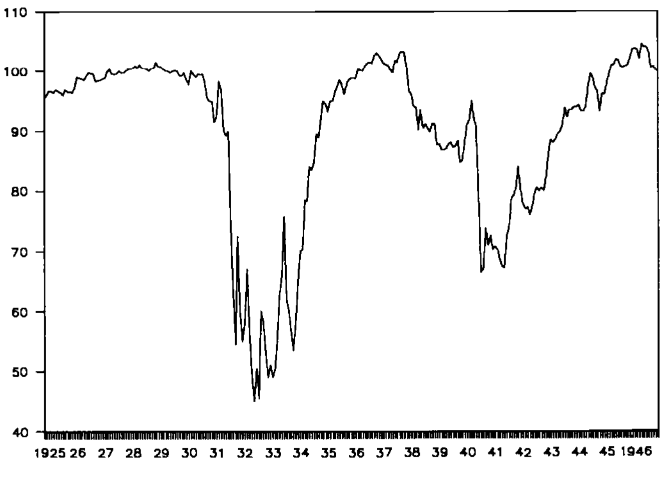

Fig. 2.3 The Argentine bond price in New York (price per $100 face value)

at least there was a vigorous attempt to stem the depression by fiscal policy. This was not the case in Argentina. Carlos Díaz Alejandro (1984, 33) writes explicitly about the tradeoff in Argentina between debt service and fiscal policies to fight recession:

> The counter-cyclical potency of Argentine fiscal policy during the 1930s was reduced by the increased share in total expenditures of debt-service payments, largely made to foreigners. All payments on the public debt reached 29% of expenditures in 1932; this may be compared with a meagre 5% devoted to public works.

In Argentina a conservative government favored the interests of the cattle industry. The government won the continuation of access to the British market by granting privileged exchange rate and tariff treatment of British goods and by pledging continued debt service. Abreu (1984, 158) summarizes the policy of the 1930s, embodied in the Roca-Runciman Agreement of 1933, in the following terms:

> Argentina's foreign economic policy in the 1930s was defined under the heavy constraints placed by British bilateralism. Given the political basis of the *Concordancia*, Argentine concessions tended to assume a shape which distinctly favored cattle interests to the detriment of the national interest. This policy had costs in the long run in terms of a slower growth of the economy—and particularly of industry—than would have been the case had it made less concessions towards British interests.

O'Connell (1984, 204) comments in particular on the conservative influence on policy. He writes that internationalism was a reflection of the favorable experience and the prosperity won in the past. That favorable experience in turn justified maintenance of that posture during a period of adversity:

> Insistence on maintaining the service of the external debt even when confronted with outright suggestions of suspension by the British authorities—in the context of the Anglo-Argentine Agreement negotiations of 1933—looks like a clear indication that such a set of ideas went beyond any external determination.

2.4 The Postwar Period through 1976

From figure 2.3 it was clear that Argentine bonds were trading near par by World War II. The improvement in the terms of trade at the end of the 1930s and the large trade surplus accumulated during the war, which is strikingly apparent from figure 2.1, gave Argentina the means to retire its external debt and to buy from an impoverished Britain its direct investment in Argentina, in particular the railroads. Blocked sterling deposits of the BCRA with the Bank of England were the means with which the purchases were financed.

Thus, by the late 1940s Argentina's bonded public external debt had been very substantially reduced.

The pace of redemption and the purchase of the railroads was too fast, however, and debt problems were again apparent by 1950. This time they concerned short-term credits. A refunding loan of $125 million from the Export-Import (Ex-Im) Bank helped pay off the arrears due American creditors. Most external borrowing in the 1950s, apart from short-term trade credit, took the form of lending by the Ex-Im Bank and by the World Bank.

By 1955 the bonded public external debt of Argentina stood at $575 million. The next refunding operation occurred in 1956, following the overthrow of the Peronist regime. At this time, Argentina joined the IMF and had its first Paris Club rescheduling of official debts. By 1962 debt had risen to $2.6 billion with an additional $1 billion in unguaranteed private debt.[7] Table 2.5 shows the very low ratio of public external debt service in the early 1950s and the rapid buildup, particularly in the form of amortization, toward the late 1950s.

Further rescheduling of debts occurred in 1962–63 and again in 1965. The 1962–63 rescheduling involved public sector principal payments, with a stretching of maturities into the late 1960s. But the rescheduling was not sufficient, so that in 1965 principal payments due in the five-year period following 1968 had to be refunded.

In the late 1960s, following the refunding agreement of 1965, there was a shift in financing from suppliers' credits and official agencies to the international capital market. Borrowing in the world capital market allowed the *automatic* rolling over of maturing principal payments. Funding crises of the 1950s and early 1960s had arisen from an inability to pay principal, which created a need to reschedule these payments. The world bond market made it possible to roll over these payments apparently indefinitely. Thus any increase in the debt/income ratio could be kept to low levels, as shown in figure 2.4. The external surpluses shown earlier in figure 1.4 on average paid at least part of the interest.

From the vantage point of 1970, this is how Bittermann (1973, 117–21) viewed the Argentine debt situation:

Table 2.5 **Ratio of Public Debt Service to Exports (in percentages)**

Period	Ratio	Period	Ratio	Period	Ratio
1926–29	9.3	1957	7.4	1960	23.5
1930–33	24.6	1958	12.5	1961	26.1
1953–56	2.0	1959	16.0	1962	22.8

Source: Avramovic (1966, 46).

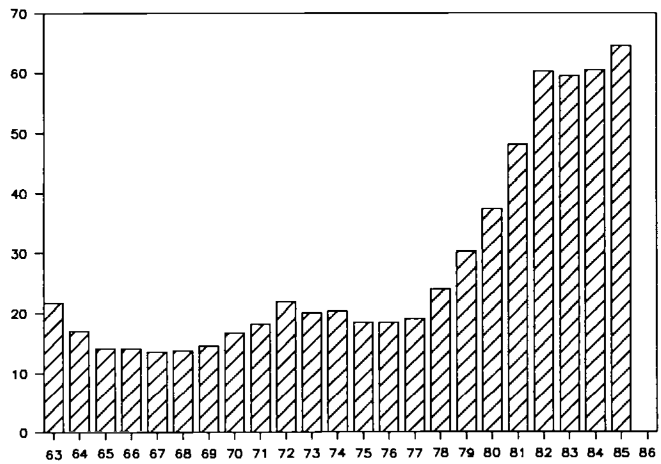

Fig. 2.4 The ratio of debt to GDP (percent)

> The outstanding public and private external debt, requiring heavy amortization in 1970, will constitute a crucial problem for the next few years. Obligations under the earlier refundings have been met and are scheduled to be paid off by 1972. . . . Without a renewal of bank loans and other credits, the contractual payment of the Argentine economy would be over a billion in 1970, compared with exports of $1.8 billion.
>
> In sum, the solvency of the Argentine economy depends on its ability to renew banking credits and issue securities. The formal refunding credits will have been paid off in 1972, but there will be continued service on the debt which has replaced them.

Why was there no debt crisis until the early 1980s? The primary explanation is that automatic rollover meant that as long as creditors were confident, the external debt basically had no set maturity and no limit! From 1970 to 1975 public and private external debt each doubled. New loans financed old loans. One might have thought that the Peronist experience of 1973–76 would have made operation in international capital markets difficult. But reserves were high and initially the world commodity boom made for very large trade surpluses. A massive current account deficit did emerge in 1975, but that was also the last year of the Peronist regime. The policies under Martinez de Hoz, which we will discuss in the next chapter, brought the economy rapidly around to muster unprecedented rates of capital inflow. By the late 1970s the vulnerability of the economy to external payments difficulties and, especially, to a halt of foreign lending, was far removed from daily experience and memory. The stage was thus set for a major debt crisis.