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RESOLVING DEBT CRISES: AN HISTORICAL PERSPECTIVE

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Resolving Debt Crises: An Historical Perspective

Abstract

Two general approaches have been offered for dealing with the developing country debt crisis: continued reliance on case-by-case negotiation, versus global plans for fundamentally restructuring the terms of international lending and repayment. Both approaches have precedents in earlier historical periods. In the 1930s, for instance, when some two thirds of foreign dollar bonds lapsed into default, several global schemes for resolving the crisis were considered even while individual debtor-creditor negotiations were underway. In the end no global plan was adopted and the debt crisis of the '30s was resolved by the "muddling-through" approach of case-by-case negotiation. This experience suggests two questions about the efficacy of the alternative approaches. First, what stumbling blocks stand in the way of the adoption of global schemes? Second, as a crisis drags on, how do the evolution of debtor and creditor strategies permit it to be resolved through bilateral negotiation? In this paper historical evidence from the interwar period is addressed to these questions.

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The developing-country debt crisis recently celebrated its fifth anniversary. That more than five years have passed since the Mexican crisis of 1982 is no cause for celebration. In the intervening years, the collapse of long-term lending and the policies of austerity adopted by the borrowers have combined with global economic imbalances to depress domestic investment and economic growth through much of the developing world. As the crisis drags on, prospects for renewed growth continue to be adversely affected. This recognition has occasioned a number of ambitious plans for resolving the crisis. These range from the Baker Plan to encourage concerted bank lending to developing countries, to the Kenen Plan which would have the IMF or another international entity buy up debt at a discount and pass along the benefits to the debtor countries, the Bradley and Sachs Plans which would have the banks directly forgive developing-country liabilities, and the Dornbusch Plan which permit countries to service their debt in domestic currency.1/ In contrast, Cline (1987) and Feldstein (1987) have criticized the global approach, urging instead reliance on the market to resolve the crisis through case-by-case negotiation.

This is not the first time that foreign lending has culminated in default or that default has reached crisis proportions. Nor is it the first time that ambitious proposals have been elicited by disarray in international capital markets. In the 1930s, when some two thirds of foreign dollar bonds lapsed into default, a number of global schemes for resolving the crisis were discussed. Some, like current proposals under which the World Bank or International Monetary Fund would adopt a leading role, relied on the newly-established Bank for International Settlements for mediation and liquidity. Others advocated instead the establishment of an independent facility controlled by the bankers. Some thought the solution lay in converting one asset into another, not through debt-equity swaps as today but by transforming short- and medium-term obligations into long-term liabilities. Others emphasized instead the need to index payments to macroeconomic indicators such as the price level or the value of exports, or to permit debt to be serviced in local currency with provision for reinvesting interest payments domestically when transfer was infeasible. Like today, there were those who argued the inefficacy of all global plans, insisting on the superiority of case-by-case negotiation.

In the end, no global plan was adopted. The debt crisis of the 1930s was resolved by the "muddling-through" approach of bilateral negotiation. This observation raises two questions. First, what stumbling blocks stood in the way of the adoption of global schemes? Second, as the crisis dragged on, how did the evolution of debtor and creditor strategies permit the crisis to be resolved through bilateral negotiation?

In this paper I analyze global and bilateral approaches to dealing with foreign default in the interwar years. Part I sketches the background to negotiations: the origins and characteristics of the debt crisis of the 1930s. Part II then describes the global schemes and bilateral negotiations. The conclusion suggests some implications for the current situation.

Part I: Into the Crisis

1. The Tapestry of Foreign Debts

The experience with foreign lending in the 1920s has been recounted on more than one occasion (viz, Fleisig, 1970; Eichengreen and Portes, 1986). The aspect of the episode relevant for present purposes is that the way countries got themselves into the debt crisis of the 1930s shaped their options for getting out. The nature of the shocks which pushed the borrowers into default conditioned debtor and creditor attitudes toward negotiations to restart debt service. The nature of the foreign debts incurred -- their magnitude, maturity and currency composition -- served as the initial conditions from which negotiations would commence. The institutional structures linking the small investor to the foreign government, notably issue houses, the secondary market for bonds, and bondholders' committees, comprised the framework within which those negotiations took place.

Frequently it is suggested that, compared to the current environment of gigantic bank syndicates, lengthy loan contracts, and complex regulatory restrictions, rescheduling in the 1930s was straightforward. The era of bond finance is portrayed as a simpler era, when bond covenants were transparent and negotiations had to surmount only the large numbers problem created by the multitude of small creditors, a hurdle which was successfully overcome with the creation of bondholders' reprentative committees. A central message of this section is that precisely the opposite was true. Progress in debt renegotiation in the 1930s was impeded by interlocking creditor-debtor relationships and by the proliferation of debt instruments ranging from short-term acceptances to long-term bonds, from war debts to reparations, from foreign commercial deposits to foreign exchange reserves. Freeing one thread from this tapestry without unraveling the fabric was the challenge for negotiators.

The first thread in the tapestry was made up of war debts, in Herbert Feis's evocative words, the "sludge left after the fires of the First World War had died down." The stance of the United States, the principal creditor, toward war debts shaped the attitudes of negotiators toward other obligations. Accounts of war debt negotiations traditionally emphasize U.S. intransigence, an emphasis that certainly is relevant here.2/ But while insisting that war debts were business transactions to be honored like any other, by the standards of commercial creditors the U.S. displayed considerable flexibility when negotiating the payment schedule. She did not insist on immediate repayment in the exceptional circumstances of the early postwar years. The individual agreements negotiated and ratified by Congress were adapted to the economic circumstances of the debtor. The agreement with Britain concluded in June 1923, for example, stretched out the repayment period to more than 60 years and reduced the interest rate from the high levels at which Britain had been forced to borrow during the war. Arrears from the immediate postwar years were capitalized at concessional rates that varied with the debtor's ability to pay. These concessions reflected a realization on the part of business interests that U.S. prospects were linked to the successful economic recovery of the heavily indebted nations of Europe.3/ If the U.S. was unwilling to simply cancel these debts or even to enter into multilateral negotiations, she nevertheless exhibited some flexibility in negotiations with individual debtors and set an important precedent for subsequent debt negotiations by acknowledging the relevance of ability to pay.

The second thread in the tapestry was German reparations. Their story is depressingly familiar. In 1919 signatories of the Versailles Treaty, unable to agree on an amount, appointed a Reparations Commission which in April 1921 delivered a figure of 132,000 million gold marks, an amount roughly twice German GNP. Payments on 50,000 million of the

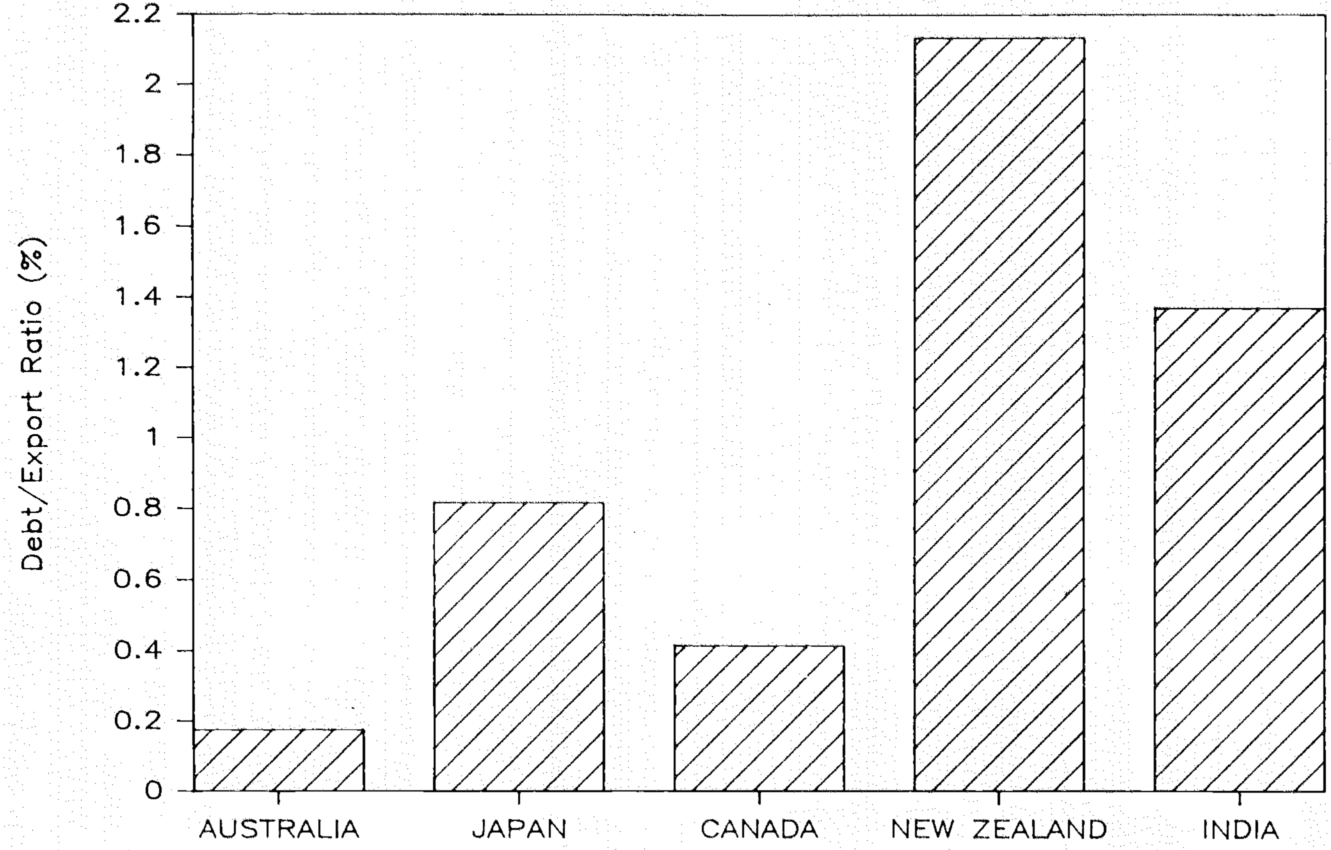
132,000 million mark total were to commence immediately. Like war debts, German obligations were partially indexed to economic conditions: in addition to her fixed obligation of 2,000 million gold marks annually, German would pay 26 per cent of her export revenues. Germany's payments in foreign exchange and kind dwindled rapidly -- whether due to calculated German strategy or a sincere inability to pay is still disputed today -- leading an exasperated France and Belgium to occupy the Ruhr in January 1923. Occupation led not to resumption of full payments but to passive resistance and hyperinflation. At year's end, the exhausted British, French and German governments agreed to a commission to reschedule reparations in a manner that would buttress the precariously stabilized German currency. Under the chairmanship of Charles Dawes, director of the U.S. Bureau of the Budget, the Commission scaled down Germany's total obligation and deferred the bulk of the payments. Annual transfers started at 1,000 million gold marks, rising gradually to 2,500 million after five years. In a significant departure from the manner in which commercial bond covenants were structured, reparations were indexed to state of the world economy (rising or falling if the price level varied by more than ten per cent). In addition, the payments schedule was indexed to domestic economic conditions, as measured by such items as the volume of automobile sales. Germany's obligation ended with the deposit of domestic currency to the reparation authority's account; responsibility for effecting the transfer into foreign currency rested with the recipients. If transfer difficulties arose, the reparations committee was to reinvest the funds in Germany. A foreign Agent-General was appointed to monitor and enforce the provisions of the plan. To seal the agreement, a loan of 800 million marks secured by the assets of the German railway system was floated in foreign financial centers.

This capsule account conveys little sense of the complexity of negotiations. A central source of difficulty was that reparations were interwoven with other obligations, notably war debts. Notwithstanding U.S. insistence that the two were unrelated, Britain, France, Belgium and Italy, for whom reparations receipts offset war debt expenditures, were disinclined to extend debt relief to Germany unless the U.S. similarly relieved them of wartime obligations.4/

The third thread in the tapestry was made up of foreign bonds floated mainly in New York in the 1920s. These were tightly interwoven with the intergovernmental debts just described. Not only had the process of large-scale foreign lending in the 'twenties had been initiated by successful flotation of the Dawes Loan in New York and London, but a significant share of bonds subsequently sold in New York on behalf of foreign borrowers were floated on behalf of Germany and the successor states of Eastern Europe that owed reparations. Despite its disastrous denouement, the process was not without logic. Long-term borrowing was a way for these countries to defer a transfer that was difficult in the short run. A reparations obligation of, say, 1,200 million marks in 1926 could be funded by borrowing an equal amount from the United States, thereby permitting payments to be spread out over the life of the bond. While the present value of the obligation was unchanged, transfer was deferred until a time when the disorganized conditions of the 1920s could be surmounted. By delaying the transfer until the productive potential of the German and Eastern European economies was fully restored, these

COMPARATIVE DEBT/X RATIOS

1928

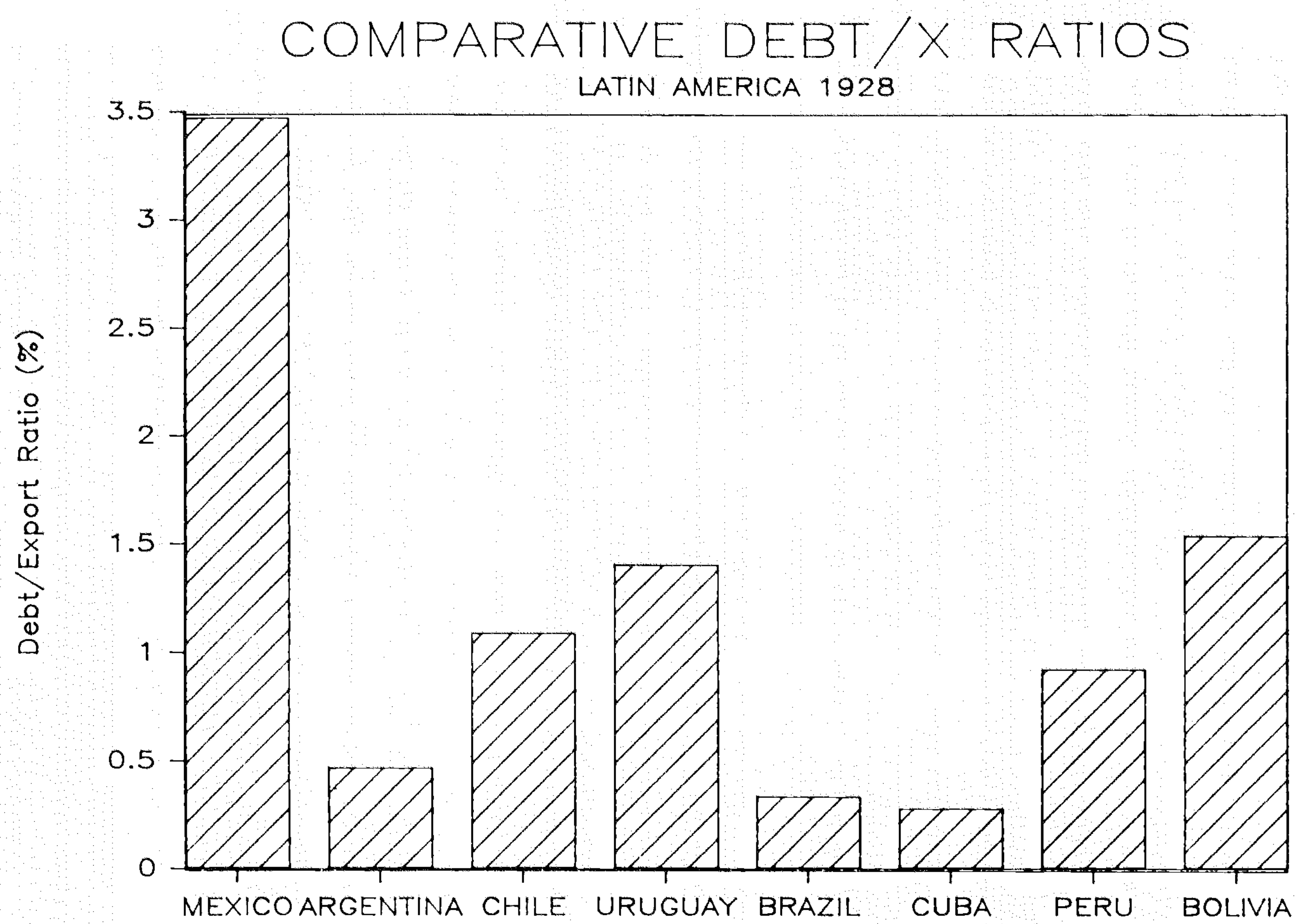


countries would have been permitted to grow out from under the burden of the debt.5/

The final thread in the tapestry was short-term debt: loans, foreign deposits and acceptances. Often short-term loans were extended to long-term borrowers by the syndicate of underwriting banks and issue houses over the period required to successfully market their bonds. To these should be added the foreign deposits maintained by creditor-country banks and corporations doing business abroad, for use in making payment for goods and services purchased from foreigners or receiving payment for those rendered. Acceptances, a form of trade credit on behalf of commercial borrowers, should also be included under this heading.6/ As the most volatile component of foreign lending, short-term debts had considerable capacity to interfere with the balance-of-payments position and hence with the debt-servicing capacity of foreign debtors.

2. Origins of Debt-Servicing Difficulties

The debt crisis of the 1930s did not result from any single cause. As in the 1980s, it arose out of interaction of a sequence of unanticipated disturbances with a set of fragile initial conditions. Over the period of large-scale foreign lending (1924-1928), the sheer volume of debts to be serviced had increased enormously. Annual interest and amortization payments could amount to ten per cent of the debt outstanding; thus in relatively heavily indebted Latin American countries like Bolivia, Uruguay and Chile, upwards of 15 per cent of export receipts were required to service the central government's external debt alone (see Figure 1).7/ In other countries where the absolute value of the debt was greater (such as Australia and Canada, shown in Figure 2), the burden relative to exports was less. In Latin America, with such a large share


COMPARATIVE DEBT/X RATIOS
LATIN AMERICA 1928
Debt/Export Ratio (%)
3.5
3
2.5
2
1.5
1
0.5
0
MEXICO
ARGENTINA
CHILE
URUGUAY
BRAZIL
CUBA
PERU
BOLIVIA

of export revenues already going to debt service, once new lending evaporated in 1928 a significant transfer from debtor to creditor could be required to keep service current. The indebted countries were clearly vulnerable to export and price-level shocks.

Shocks came not in isolation but in rapid succession. The terms of trade of primary-product exporting countries had already been deteriorating over the 1920s. They then plunged downward with the onset of the Great Depression. The United States was the leading market for primary products, accounting for nearly 40 per cent of the consumption of the 15 leading industrial countries, and the severity of the Depression in the U.S. was unparalleled. Between 1929 and 1930, the terms of trade of wheat and tin exporters declined by roughly 10 per cent, of cotton, sugar and silk exporters by 20 per cent, of rubber exporters by 30 per cent.8/ By increasing the cost of inelastically-demanded imports, the terms-of-trade shock left a smaller trade surplus for use in debt service. That shock was reinforced by the global deflation; since external debt was denominated in foreign currency (mainly dollars) and bore fixed interest rates, the decline in wholesale prices in the United States of approximately 10 per cent between 1929 and 1930 reinforced the shock to the debt-servicing capacity of borrowing countries. Sovereign debt/export ratios of most borrowing countries rose more dramatically after 1928, when foreign borrowing had virtually halted, than before. In other words, the shock to export markets contributed more dramatically than the preceding wave of borrowing to the alarming rise in the debt burden. Difficulties at the periphery were exacerbated by increased protectionism at the core, especially since the new tariffs imposed after 1929 discriminated against agricultural goods.9/ Together, depression and protectionism reduced the export revenues of 41 primary-product exporting countries by some 50 per cent between 1928-29 and 1932-33. The magnitude of the shock suggests that the extent to which the indebted countries squandered the funds they borrowed on unproductive projects, while relevant, is of secondary importance.

The weight of the debt and the magnitude of the external shock, while critically important, were not the only determinants of default. Eichengreen and Portes (1986) have presented a multivariate analysis of the incidence and extent of default in the 1930s. The probability of default was found to rise with both the debt/income ratio and the percent deterioration in the terms of trade. But in addition, domestic policy responses to the Depression, notably the change in the government budget deficit, also affected the tendency to default. Countries which adopted draconian fiscal responses to the budget deficits induced by the macroeconomic slump were less likely to default than other countries with similar debt/income ratios, similar terms-of-trade shocks, but more expansionary fiscal policies. Default depended not only on the external shock but on the domestic response.

Part II: Out of the Crisis

1. Global Plans

The challenge facing those attempting to renegotiate debts in the 1930s was how to deal with the overlapping nature of different liabilities. These interdependencies were what gave special appeal to global plans.

(i) <u>The Bank for International Settlements (1930-32)</u>

The most straightforward global approach to the debt crisis would have been to empower the Bank for International Settlements. The B.I.S. had been founded in 1930 as part of the Young Plan rescheduling of German reparations. France and Britain had never been satisfied with the Dawes Plan apparatus on the grounds that achieving the transfer was not properly the responsibility of Germany's creditors and their Agent-General. At the same time, they hesitated to place discretionary power in German hands. Hence the establishment of an international bank to perform these financial functions.10/

Having been established to manage reparations, it was logical to ask whether the B.I.S. might be used to address other debt problems. According to J.W. Beyen (Alternate of the President of the B.I.S. from 1935 to 1937, President from 1937 to 1940, and author of the Beyen Plan discussed below), the B.I.S. was initially conceived not just to administer reparations but "also for international loans floated either in connection with reparation payments or for other purposes."11/ In a proposal reminiscent of those for an expanded role for the IMF today, Hubert Henderson of the British Economic Advisory Council suggested that the B.I.S. might issue unbacked "International Certificates," to be allocated to countries in proportion to the gold value of their exports in 1928. The receipts could be used for any purpose, including presumably the maintenance of debt service.12/

The suggestion bore no fruit, due in part to the financial position of the B.I.S. itself. Having made unsuccessful loans in defence of the gold standard to Austria, Germany and Hungary in 1931, many of Bank's assets were frozen. The profits derived from the everyday business of collecting German reparations in Reichsmarks and converting them to francs and sterling were eliminated by the Hoover Moratorium. The balance sheet total of the B.I.S. fell from two billion Swiss gold francs at the beginning of 1931 to barely one-third that amount in 1933. The B.I.S. had little liquidity of its own to inject into the international system, while creditor-country governments hesitated to entrust new foreign lending to an institution with so dismal a record of loan administration.

B.I.S. officials took little initiative to raise additional capital or to lobby for a more active role, and concentrated instead on fostering cooperation among central banks. Exchange-rate stability rather than foreign debts became their primary concern. This is unsurprising since the B.I.S. was a creature of the creditor countries and since the governors of their central banks dominated its Board. These officials attached priority to the instability of currencies rather than to the collapse of foreign lending. Indeed, to insulate efforts to insure international currency stability from impinging political pressures, the statutes of the B.I.S. prohibited the new institution from extending loans directly to governments.13/ After their unsatisfactory encounter with sovereign lending in 1931, central banks were disinclined to alter these statutes or to contemplate yet more ambitious initiatives. If a global solution to the debt crisis was in the offing, it would not originate with the B.I.S.

(ii) The Kindersley-Norman Plan (1931)

Attributed variously to Sir Robert Kindersley, Chairman of Lazard Brothers and a director of the Bank of England, Sir Charles Addis, one time British representative to the Reichsbank, and Montagu Norman, Governor of the Bank of England, this scheme came to be known as the

Norman Plan once the Governor presented it at a meeting of the directors of the B.I.S. Resembling ideas offered previously by Hjalmar Schacht among others, the plan was to establish a special international facility, resembling the Bretton Woods institutions to be founded after World War II, to make loans to foreign countries and corporations incapable of obtaining them through normal channels. The facility would be independent, not a branch of the B.I.S.14/

The corporation, to be headquartered in Holland or Switzerland for fiscal reasons, would be endowed with a board of directors on which the bankers and other financiers would be represented. While Britain and possibly also Switzerland and Holland would help fund the facility, the major contributions were to come from the U.S. and France, the two countries running significant balance-of-payments surpluses. "World recovery will be impeded," read the original version of the Plan "by the fact that the U.S. and France, instead of lending back to the world their surplus for a usable balance of payment, have been taking this surplus in the form of gold."15/ Signficiantly, however, most of the money to be lent would come not from governments but from private investors. The scheme envisaged a corporation with £25-50 million of ordinary capital, put up by governments and the B.I.S., and the power to issue bonds in amounts up to three times the value of subscribed capital. The corporation would lend to "such Foreign Governments, Municipalities, Mortgage Banks, Harbour Boards, Railways and Public Utility Companies, as are in need of funds which cannot be obtained at the time through customary channels, and are in a position to offer really good security." These loans would have the effect "of reestablishing the credit of the foreign Governments, corporations, etc., to whom the money is lent, to

[sic] improving the price of their securities in all markets of the world, and the purchasing power of their nationals..."16/

This debt would take the form of debentures purchased in the creditor countries by banks, issue houses, and corporations and companies "of any magnitude." Trust and insurance companies, as owners of existing bonds, were likely customers since they were "vitally interested" in steps that might repair the credit of foreign debtors. Industrial firms dependent on export markets similarly might be willing to subscribe. Other investors could be encouraged through moral suasion. The cost to the borrowers would be one to two per cent over the yield to the bondholders, the margin to be placed in the corporation's reserve for contingencies.

Memos describing the plan fail to explain why banks and issue houses, otherwise disinclined to lend to illiquid debtors in 1931, might willingly contribute £100-150 million to such a facility. One possibility is that underwriting governments might have guaranteed the loans to financially embarrassed borrowers, although this would have greatly increased their financial commitment.17/ Another is that new loans might be granted seniority relative to old ones.18/ By backing not specific loans but its entire portfolio with its £25-50 million of capital, the corporation might have been able to pool default risk more effectively than smaller creditors. Debtor-country authorities might have been less inclined to default on loans extended by an international facility, extending them the kind of favored treatment usually reserved for League of Nations loans. Perhaps the corporation's loans to fund private investment or public works would succeed in restarting growth, thereby reducing debt/income ratios and restoring creditworthiness.

To what extent was the Kindersley-Norman Plan a sincere effort to deal specifically with default and the collapse of foreign lending, not simply a device to prop up sterling by inducing France and the U.S. to stimulate the demand for British exports by debtor nations? The Plan was developed and presented to the B.I.S. at the same time other talks were underway for strengthening sterling. In November and December 1930, Norman was discussing the possibility of Britain floating a long-term loan in France to reduce its short-term liabilities to foreigners.19/ Clarke's (1967, p.181) view is that the proposal as presented to the B.I.S. was at bottom an attempt to obtain "indirect support for Britain's financial position." This seems more plausible than to assume that the British were operating out of altruism. While it remains true that loans to indebted countries would have helped them keep current the service on their sterling debts, the tendency of this to buttress Britain's financial position would have been only one effect of the initiative.

Insofar as the Kindersley-Norman Plan represented an effort to deal with the problems of debtor nations, it is not entirely clear which nations British officials had in mind. Skidelsky (1967) and Kindleberger (1973) suggest that they were concerned mainly to assist Britain's traditional export markets: Germany, Eastern Europe, Australia and South America. Except for Australia (where the threat of default by New South Wales in 1931 did not turn into actuality), these were the principal regions where default ultimately took place. Hence an amply-funded institution directing foreign capital to these regions might have done much to head off the debt crisis.

In the end, the Kindersley-Norman Plan came to naught. As early as January 1931 Norman confessed that the plan was not particularly practical, by which he meant that it was unlikely to be favorably received.20/ As Thomas Lamont's Paris partner reported following the 9 February 1931 meeting of the B.I.S. at which Norman's memo was read, "no comments were made and no special interest was shown in it."21/ Merle Cochran, the American Consul in Basle, was more blunt, describing how the plan was poorly received since it placed the blame for the collapse of foreign lending on France and the United States.22/

A related problem, as Norman admitted to his American colleague Harrison, was "the unwillingness, which we have seen in certain quarters, to support a scheme of which the control and the funds are truly international."23/ J.E. Crane, Deputy Governor of the New York Fed in charge of foreign affairs, concluded that U.S. reluctance to lend abroad would not be dissipated by a scheme over which New York had little control. J.P. Morgan and colleagues voiced their unwillingness to purchase foreign bonds through the agency of an international corporation over which they had only limited control, and which might be influenced by foreign politicians and attacked by Populist Congressmen. Rather than create artificial agencies, Morgans insisted that new loans meet the market test. The most that should be done was to appoint an advisory committee to stimulate private bankers "to go ahead with their own projects."24/ Even this modest proposal to improve the climate for lending met a mixed reception.

France's resistance was even stronger. Since the lion's share of the funds was likely to come from France, the Paris commercial banks and even the Bank of France insisted that control over any new corporation rest in French hands. In the event such a scheme was adopted, the French favored several separate institutions, one for agricultural loans, one for railway construction, and so forth.25/ But the French and Belgians agreed that the initiative for formulating such a plan properly rested with bankers, not governments.26/

(iii) The Beyen and Crena de Jongh Plans (1932)

The Beyen and Crena de Jongh Plans were floated in the winter of 1931-32. Compared with other plans discussed here, their scope was limited: they were designed to address the problem of short-term debts, not default on long-term bonds.

Beyen made his proposal to the Standstill Conference in the winter of 1931.27/ This conference arose out of the threat to creditor-country banks and acceptance houses due to the German financial crisis.28/ German banks and firms relied heavily on short-term credits from abroad.29/ The prospect that the repayment of credits might be interrupted by the German financial crisis posed a serious threat to the London acceptance houses. These institutions specialized in the extension of trade credits, advancing to foreign exporters the funds they would receive once their goods were shipped and payment was received. Payment when received was passed along to the owner of the acceptance, interest earned taking the form of the spread between the payment received and the amount advanced to the exporter. In practice, British acceptance houses resold their paper to the market, functioning as intermediaries rather than investing their own capital in the acceptance business. Their reputation served as guarantee in the event that the debtor failed to deliver the money on the date required. So long as default on these short-term debts was exceptional, the acceptance houses could treat it as a cost of doing business. But if many debtors defaulted simultaneously or their governments imposed exchange control, the acceptance houses themselves could be pushed into default.

This delicate mechanism functioned smoothly because the acceptance houses could count on support from the Bank of England. But the Bank of England had its own regulations to obey; it could not extend loans to the acceptance houses on unacceptable collateral, or so its Governor, Montagu Norman, argued.30/ Hence for the Bank to lend in 1931 it was necessary to maintain the pretence that German credit was still good. Under the provisions of the first German Standstill Agreement concluded in Basle under the auspices of the B.I.S. on August 19, 1931, participating bankers agreed not to call in outstanding credits nor to cancel the credit lines under which German debtors could draw bills. Bankers who refused to sign could of course call in their credit outstanding but would receive only blocked Reichsmarks under the provisions of German exchange control.31/ The governments involved put considerable pressure on the bankers to sign.

In Beyen's view, this charade would eventually be seen through, leading to runs on financial institutions. Default on short-term debts, in his view, was more serious than default on long-term loans. While not belittling the seriousness of default on bonds, he concluded that "whatever the loan contracts may say to the contrary, the capital is in fact not called for, and the default on interest payments does not seriously hamper the economic life of the debtor country until it needs to borrow again."32/ As a banker, he regarded default on short-term debts the more serious threat to financial stability.

Beyen's proposal to the second Standstill Conference that met in Berlin in December 1931, at which he was a member of the Dutch delegation, was to convert short-term credits into long-term loans repayable in installments over a period of of 20 years. There was no plan for government to assume obligations incurred by the private sector or for other administrative changes. Each debtor was to be considered individually. If the problem was not one of illiquidity, which could be resolved simply by lengthening the maturity of the debt, but one of the insolvency of a foreign corporate debtor, then the remaining assets of the company should be allocated among the creditors, natives and foreigners receiving equal treatment. But in Beyen's view the problem was mainly one of illiquidity, not insolvency. If this could be dealt with by lengthening the maturity of the debt, repayment could begin and German exchange controls could be lifted. The creditworthiness of the debtor having been restored, the normal operation of international capital markets could recommence.

In the event that a debtor country did not succeed in earning foreign exchange adequate to service the long-term debt, there would be provision for payment in local currency. In the event of a foreign exchange shortage, debtor countries would be permitted to extend preferential treatment to creditor countries who were their best customers; creditors running bilateral deficits would have first claim on the available foreign exchange.

To say that the Beyen Plan was unenthusiastically received is to put it mildly. The bankers preferred to maintain the charade of business as usual in the hope that events might turn for the better. Germany, embroiled in reparations negotiations, insisted that servicing even long-term loans was impossible in light of the limited availability of foreign exchange. Given the interlocking nature of different debt instruments, a global plan limited to short-term debts was not global enough.

An alternative to the Beyen Plan was submitted to the Standstill Committee by another Dutch banker, Crena de Jongh. It took a different approach to lengthening the maturity structure of the debt. In contrast to the Beyen Plan, creditors were to repay their short-term debts on schedule, but in local currency rather than foreign exchange. A central administrator would issue foreign-currency-denominated bonds to be serviced with the return from investing the funds stemming from the repayment of short-term loans by domestic debtors. Where the Beyen Plan relieved domestic debtors of the obligation to repay in the short run, the Crena de Jongh Plan would have required domestic debtors to make prompt payment, albeit in local currency. If Crena de Jongh viewed the crisis simply as a transfer problem, Beyen viewed it principally as a problem of domestic illiquidity that would have interrupted service even had the short-term obligations been denominated in domestic currency. In contrast to the Beyen Plan, which failed to specify the composition of the agency which would collect and administer the foreign exchange, under the Crena de Jongh Plan administration was placed firmly in the hands of creditor-country banks.

As Beyen (1951, p.69) put it, the Crena de Jongh Plan "met with as little response from the Standstill creditors as my suggestions."

(iv) The World Economic Conference (1933)

The World Economic Conference which convened in London on 12 June 1933 was an outgrowth of the conference on intergovernmental debts held at Lausanne in 1932. Part of the rationale for the London Conference was the feeling, especially prevalent in Europe, that the problems of war debts, commercial debts, deflation, exchange-rate stability and trade warfare could only be resolved if all were addressed simultaneously. Despite or perhaps because of these interconnections, debts remained, in the view of the Europeans, one of the central issues to be taken up in London. But the United States still regarded war debts as off limits. Consequently, the agenda for London was limited to money and credit policies, exchange-rate stabilization, and tariff and and nontariff barriers to trade. With the dollar's devaluation on the eve of the conference and President Roosevelt's refusal to agree to its early stabilization, European delegations increasingly focused on what they perceived as the ongoing disintegration of the international monetary system.

The heavily indebted countries of Latin America and Eastern Europe saw things differently and did their utmost to remind creditor-country governments of the urgency of the debt crisis. In a series of preparatory meetings with U.S. officials in Washington, D.C., they advocated ambitious initiatives to restart international capital flows. The idea of a "normalization fund" to funnel capital to countries requiring foreign funds in order to restart debt service and to fund public works programs had been mooted by the Special British Mission.33/ Britain proposed an international fund of $1500 to $2000 million, to be subscribed by creditor-country governments and designed to make loans to debtor-country central banks, which would respond by lifting trade barriers and exchange controls. One after another, debtor-country delegations endorsed the proposal. The Rumanians argued that this initiative was essential for the recovery of countries with no domestic financial market to finance deficit spending. Their representative stated "with great emphasis that it should be clear that some international arrangement simply has got to be worked out to help them."34/ Turkey proposed the establishment of an "international credit bank" to promote international capital flows.35/

Czechoslovakia, though not among the most heavily indebted nations, acknowledged the dependence of its economic prospects on the recovery of its trading partners and attached great importance to "the general alleviation of the indebtedness of the Central and Eastern Europen agricultural countries which were formerly her best customers."36/

But with intergovernmental debts off limits, it was hard to hold a productive discussion of commercial obligations. Had she entertained Latin American and European proposals for a wide-ranging solution to the problem of commercial debts, the U.S. would have undermined the official position that it was inappropriate to reconsider intergovernmental debts. In private, U.S. officials admitted that an international fund to lend to countries requiring capital inflows to aid recovery could not be pushed through Congress. As they put it to the Polish ambassador, "American experience with respect to international loans has not been sufficiently happy to encourage it to enter into additional obligations."37/ In the end, debt was not extensively discussed in London. The atmosphere was best summed up by Beyen, who again appears on the scene this time as deputy delegate from the Netherlands. "We met in the Geological Museum at Kensington," he subsequently wrote, "and none of our activities disturbed the fossils."38/

2. Negotiations Betweeen Governments

With the rejection of global plans, negotiations were officially left in private hands. One wonders how the give and take between debtor and creditor would have been shaped had governments been more intimately involved. Some light can be shed on the question by considering war debts and reparations, where official involvement was inevitable because governments were both the major creditors and the major debtors.

The Dawes Plan under which German reparations had been rescheduled in 1924 was never conceived as a permanent solution. A new committee which differed from the Dawes Committee by virtue of Germany's full and equal representation was appointed in January 1929 to effect such a solution. Fatigued by endless disputes, those involved hoped for a settlement that would entail early evacuation of the Rhineland, which had been occupied in the course of previous reparations quarrels, and elimination of the extraordinary provisions of the Dawes Plan, notably a foreign Agent-General on German soil to collect earmarked revenues and administer their transfer into foreign currency.

In line with previous policy, the U.S. government did not participate in the conference out of fear that its involvement would be seen as acknowledgement of the linkage of war debts and reparations. Instead it provided the committee's neutral chairman, Owen D. Young (corporate executive, former Agent-General for reparations, and current director of the Federal Reserve Bank of New York). Negotiators eliminated those provisions of the Dawes Plan that Germany found most objectionable, notably a reparations agency to monitor German finances. Not only was the bill scaled down and pushed further into the future, but Germany's obligation was once again indexed to economic conditions: the total was split, with provision that the second, or conditional, tranche could be deferred in the event of transfer problems.

The Young Plan represented a significant reduction of Germany's reparations payments. The principal stumbling block to further steps in the direction of realism remained U.S. intransigence on war debts. The relationship of reparations to war debts was readily acknowledged by other governments: under the Young Plan Germany's reparations bill would be reduced automatically by at least two-thirds of any war debt relief extended by the U.S. To circumvent U.S. objections, this rider was contained in a separate "concurrent memorandum."

The prominent feature of the Young Plan was its short life. The Great Depression underscored the fantastic nature of the transfer schedule, swiftly rendering the plan redundant. The problem of acknowledging this reality was again the linkage with war debts. President Hoover vacillated out of fear that a moratorium on reparations and war debts would destroy once and for all U.S. ability to deny the existence of a link.39/ In the event, the severity of the Depression and the outbreak of financial crisis in Austria and Germany left little choice. The Hoover Moratorium announced on 20 June 1931 suspended all payments on all intergovernmental debts.

The moratorium was designed to last for a year. To negotiate a more durable solution, national delegations assembled once more in Lausanne in June 1932. The U.S. was absent yet again, this time because Congress, in an election year, had passed a resolution prohibiting the Administration from negotiating any reduction in foreign debts. In light of the continued deterioration of economic conditions, radical concessions were made on reparations. To extinguish her obligation, Germany was required only to deliver £150 million (or RM 3 billion) of five per cent redeemable bonds to the B.I.S., which amounted to about one year's transfer under the 1921 plan. But under "the Gentlemen's Agreement," ratification of this plan was made contingent upon the successful conclusion of parallel negotiations on war debts.

British officials argued that concessions were in the interest of even the United States. They regarded debt relief not simply in terms of the feasibility of repayment but in terms of global repercussions. "Experience has, in fact, shown," Sir R. Lindsay wrote, "that when dealing with international transfers of the character and of the unprecedented magnitude of the post-war intergovernmental obligations, the principle of "the capacity to pay" of the debtor -- even if thus applied -- can only be regarded as of secondary importance compared with an even wider principle, viz., that of the capacity of the world to endure the economic and financial consequences which those transfers would involve."40/

By insisting on prompt payment of interest and principal, the British argued, the United States was worsening the Great Depression. Between 1929 and 1932 manufacturing production in the U.S. had fallen by 48 per cent, and unemployment had risen to nearly 24 per cent of the American labor force. Under such circumstances it was unrealistic to suppose that the U.S. would willingly increase its imports from Britain. It was equally difficult for the U.K. to increase exports since, in contrast with commercial debts incurred for productive purposes -- what the British called "self-liquidating" loans -- it had not been possible to invest the war loans productively. Absent the option of increasing exports, the U.K. could service its debts only by shipping gold. British gold exports would add to the concentration of reserves in the U.S., forcing monetary contraction on the rest of the world.41/ The balance-of-payments difficulties caused by such transfers encouraged exchange control, bilateral clearing and the further disintegration of the international monetary system, whose reconstruction the British viewed as essential to recovery from the slump. As a result of U.S. war debt policy, the British argued, "The international monetary mechanism without which the modern world cannot effectively conduct its daily life is being broken into pieces with all the manifold forms of privation and distress which this involves."42/ Even the U.S. would benefit from wiping the slate clean of debts if this permitted reconstruction of the international financial system.

British observers did not overlook the irony of American inability to see the logic of their position, especially when exceptional measures like farm foreclosure moritoria were being adopted domestically. Sir Frederick Leith-Ross, chief economic advisor to the British government, submitted the following satire to the editor of Punch.43/

"A Tip to our Statesmen"

"'You cannot expect,' said my American friend, 'the farmer of Iowa to understand the advantages of debt cancellation. It is no good preaching economics to him: he is a hard-boiled fellow who considers that a debt is a debt and a debtor is a dog. What you have got to do is to follow his methods.

Now, in Iowa, debt cancellation is unknown. Debt repudation is unheard of. Debts must be honoured. How are they honoured? A farmer can't pay debts out of deficits. His Bank forecloses. A salesman comes down to collect. How does he collect? He advertises the property. The neighbours attend. They stand around, and to make sure that the proceedings are all correct and above board and that the saleman does not quit betimes they put a halter around his neck. Then the bidding opens. It is not brisk. Prospective purchasers find a gun firmly planted in their ribs. It discourages them. Finally, the farmer concerned, or a friend, bids a dollar, and the debt is settled.

This procedure is simple, practical and perfectly effective: and there seems no reason why it should not be given a wider application. The World Conference is to meet in in London. As its first proceedings, the Chairman will no doubt emphasise the need for getting together. He will quote amid resounding cheers the encouraging references to good neighbouring relations uttered by Mr. Franklin D. Roosevelt. He will then call upon the American representatives to deal with the question of debts. The representatives of the United States will place on the table the Bonds of the Allied Governments and will express the unanimous conviction of Senate and Congress that these debts must be encashed.

'Well,' says the Chairman, 'let's see what we can get for them. Any bids?'

No bids forthcoming from the United Kingdom? From France? no: Italy? No: Belgium? No: Holland? No: Germany? at this point Hitler raises his arm with a gesture that commands attention, 'Ein Mark'. From the opposite end of the Conference room the representative of the Soviet Union shouts 'Ein rouble'. He is hastily ejected. Hitler has it. He collects the bonds and from henceforward the world is his debtor. Heil Hitler!

After all, it might not be a bad way out."

As the Depression deepened, U.S. officials hesitantly began to entertain alternatives. Hoover's Secretary of State, Henry Stimson, while opposing unilateral cancellation, in 1932 suggested trading debt concessions for access to British and Commonwealth markets.44/ Progress slowed and rhetoric escalated with the approach of the 1932 presidential election. The Hoover Moratorium having expired in the autumn of 1932, immediately following the election France and Britain requested a suspension of the December 1932 installment, which the Americans refused. France then defaulted on her payment, and Britain took the symbolic step of paying the entire installment in gold to protest against U.S. accumulation of gold and hesitancy to reflate. When the next installment came due six months later, Britain made only token payment and six other debtors defaulted. In June 1934, Congress condemned token payments, in response to which the British, like the others, paid nothing at all. War debts and reprations sputtered out like a candle in the rain.

What do these negotiations reveal about governments' attitudes toward the renegotiation of foreign debts? Three points emerge. First, to a greater degree than many private lenders, public officials acknowledged the relevance of ability to pay. Had governments participated more actively in the renegotiation of commercial debts in the 1930s, commercial creditors might have been forced to more quickly accept ability-to-pay criteria. Second, although govenments should have been best able to appreciate the impact of default on the world economy as a whole, U.S.

attitudes toward war debts reveal that some major governments appreciated these impacts incompletely. Third, because of the existence of interlocking debtor-creditor relationships, governments found it impossible to reschedule one form of foreign debt without at the same time considering the others.

3. Bilateral Negotiations

The alternative to global approaches to the debt crisis was to deal with defaults on a case-by-case basis. The difficulty with initiating negotiations between borrowers and bondholders was determining who represented the latter. Typically, representative committees of bondholders were organized. It is tempting to view these committees as an efficient solution to the bargaining game between creditors and debtors. All parties could gain if through negotiations they moved toward the core of cooperative solutions. The bondholders would gain if at least token interest payments were restarted. The debtors would gain if, through the payment of some interest, sanctions prohibiting the flotation of new issues on behalf of foreign borrowers in default, like those regularly imposed by the London market, were removed. By facilitating negotiation, a bondholders representative committee might improve the position of all those involved and still keep a slice of the pie for itself.

In Britain, the mechanism through which negotiations took place was firmly established by the 1930s. The Corporation of Foreign Bondholders (CFBH) was universally acknowledged to speak for the bondholders. Founded in 1868, the CFBH was composed initially of representatives of the issue houses and of individual bondholders.45/ In 1898 it was reorganized by an Act of Parliament; henceforth the Council of the Corporation, its governing body, was made up of representatives of the British Bankers'

Association, representatives of the London Chamber of Commerce, and miscellaneous members at least six of whom were substantial bondholders. Removing representatives of the issue houses was designed to allay fears that the CFBH was a mere organ of the underwriters, thereby permitting the government to delegate to the Council responsibility for all disputes over defaulted debts. By the 1930s, representatives of the British Bankers Association, the London Chamber of Commerce and individual bondholders were joined on the Council by representatives of the Association of Investment Trusts and the British Insurance Association -- representing institutions with substantial holdings of foreign bonds -- along with the Stock Exchange and the Bank of England.

The official British government position was that default on foreign loans was a private matter. Officials found it convenient to have a reputable bondholders' committee to which disgruntled investors could be referred. To infer from this that the British government did not involve itself in debt negotiations would be incorrect, however. Rather than divorcing itself from negotiations, when bondholders and issue houses attempted to enlist government assistance, they were required to do so via the CFBH. The CFBH's minutes noted in 1937, for example, "We know that the Treasury expect any request for Government action to be made to them by this Council and Messrs Lazards, have, I understand, been informed of this attitude."46/

Government assistance took various forms. Upon learning of developments that improved the prospects for productive negotiations, the government might pass the information to the Council. Information on the political and economic situation might be obtained from the local Embassy. To initiate negotiations, the CFBH might rely on the local Embassy staff and the Ambassador himself. Although communications from the CFBH to foreign officials might be conveyed by the Ambassador, the CFBH did not hesitate to remind Embassy officials that the Council did the negotiating. When the British Ambassador to Brazil hesitated to convey a sharply worded memorandum and recommended specific revisions, the CFBH instructed the Foreign Office that "the Memorandum should be delivered to the Brazilians without further delay...we have no reason to modify its terms."47/ The price paid for government assistance was pressure when settlement was desired for diplomatic or military reasons. In July of 1939, with the British government anxious to conclude a political treaty with Greece as a bulwark against German expansion, the Chancellor of the Exchequer and the Foreign Secretary pressed the Council to accept Greece's debt offer to facilitate the successful conclusion of treaty negotiations. According to the CFBH, the Chancellor "in so many words.... advised us to take whatever was available."48/ The CFBH refused. Thus, there is no evidence that the price of government assistance was particularly high.

In the United States, the mechanism for negotiations remained incompletely formed when default broke out. As late as 1913 the U.S. had remained a net foreign borrower. Foreign flotations on the scale of those witnessed in the 1920s were a new phenomenon for the American capital market.49/ There had been no occasion to establish a standing committee representing American bondholders. Initially, ad hoc committees were established to negotiate resolutions to individual defaults. As default spread, the shortcomings of the approach became evident.50/ Committees set up to negotiate over individual bond issues had higher administrative expenses than an ongoing organization. Temporary committees, with little reputation to protect, might be set up by questionable individuals lured by generous commissions into preying on ill-informed bondholders. Rival committees set up by issue houses, disaffected bondholders and independent entrepreneurs might compete for bondholder allegiance. Each wishing to be first to conclude a negotiated settlement, the debtor could play off one committee against another. Ad hoc committees lacked established ties with government and, unlike the British Council, were unable to credibly threaten sanctions prohibiting future flotations.

In response to these problems, the Foreign Bondholders Protective Council (FBPC) was founded in 1933. As Herbert Feis (the State Department official involved) tells the story, government officials were intimately involved.51/ Having published in 1930 his classic study of prewar lending (Feis, 1930), Feis explicitly adopted the British Council as the model for the new American organization, battling both sceptical officials who opposed government support for the new organization and bankers who wished to control it. Because requests for intervention from bondholders were absorbing so much time, the idea of a bondholders' association was favorably received in the Hoover Administration's State Department in 1932. A committee was set up under State Department sponsorship to draw up plans for a private organization. One problem was how to finance the committee without relying on public funds or the banks, either of which might undermine the independence of the new association. The solution was to solicit finance from charitable foundations and the Stock Exchange until commissions rendered the FBPC self-sustaining. Another problem was determining whether the FBPC would conduct negotiations itself or simply discourage the formation of competing committees by conferring its stamp of approval on a particular committee. The 1933 banking crisis did more than Feis's arguments to defeat the proposal that the bankers form the committees and the FBPC play only a facilitating role. A final problem was enlisting the support of both the banks and the Roosevelt Administration, each of whom feared that any new organization would fall under the influence of the other. Here again the spread of default and the drain on the time of both State Department officials and private bankers did much to induce their accession.

Like the British Council, the FBPC liasoned with the government and enlisted the State Department in its negotiations. In turn, the State Department sent visitors (Feis and William O. Douglas) to consult with the FBPC at its New York office. Owing to the predilictions of the Roosevelt Administration, however, relations between the FBPC and State remained more distant than those between the British Council and the Foreign Office. The Administration remained suspicious that the FBPC was little more than a mouthpiece for the banks. Compared to sterling bonds, defaults on dollar bonds were both numerous and geographically widespread; active support for the bondholders would have required modifications in U.S. foreign policy not just in Central Europe, as was the case for Britain, but globally. Still more influential was the priority the Roosevelt Administration attached to trade liberalization. Cordell Hull in particular viewed trade warfare as both an economic evil and a source of diplomatic tension. With the passage of the Reciprocal Trade Agreements Act in 1934 the U.S. began to move back toward freer trade, in part to strengthen its international alliances. Effective U.S. pressure on governments in default had to involve, at least implicitly, the threat of trade sanctions, which Hull viewed as incompatable with broader American objectives.

A telling example of government involvement took place in connection with the 1933 German standstill.52/ That summer the German government declared a moratorium on the foreign transfer of interest payments on national, municipal and corporate bonds. The Dutch and Swiss threatened to impose trade sanctions against Germany, with whom they ran balance of trade deficits. The Germans then settled with both countries, whose nationals were to receive full interest on their Dawes and Young Plan bonds and 3 1/2 to 4 1/2 per cent on most other German bonds. Sweden, France and Belgium followed suit. The British Government no sooner prepared to ask Parliament for power to establish a clearing arrangement than a German financial delegation traveled to London. Following negotiation, an agreement was reached under which Britain would impose no sanctions against Germany, in return for which Germany would continue to service Dawes and Young Plan bonds held by British citizens.53/ That arrangement survived until the outbreak of World War II.

The contrast with the American response is striking. U.S. officials had been warned by Schacht that a moratorium was imminent. Although the Roosevelt Administration expressed its "shock" at Germany's decision, in response to Schacht's request for help in opening channels of communication with the bondholders, the Secretary of State responded, according to Herbert Feis, that "the American government could not get involved in these private debts..."54/ Despite official protests, American bondholders received nothing. The contrast with the experience of Germany's European creditors drove home the influence governments exercised over negotiations between debtors and bondholders.

It was through such negotiations that the debt crisis of the 1930s was ultimately resolved. The process was far from efficient and painless, requiring up to a quarter of a century to complete. Bolivia, the first country to default in 1931, was the last to settle in 1955. The expectations of the bondholders and foreign governments differed widely, and considerable time could be required for their convergence.

Each negotiation between bondholders and foreign governments is a story unto itself. Both sides offered concessions as time dragged on: after having received nothing for years the bondholders grew increasingly willing to accept any reasonable offer, while foreign governments grew increasingly anxious to settle in anticipation of the prospect of renewed international lending. The compromises accepted by the bondholders' representatives were significant. Using Eichengreen and Werley's (1988) sample of foreign dollar bonds issued in the United States in the 1920s, the spread between the ex ante yield and the internal rate of return (IRR) realized on these loans can be regressed on the years elapsed between default and settlement, yielding:

$$\underset{}{\text{Ex Ante Yield} - \text{IRR}} = \underset{(3.22)}{0.006} + \underset{(20.65)}{0.00245}\ \text{Years Elapsed} \qquad R^2 = .68$$

t-statistics in parentheses

The return realized by the bondholders relative to the contracted rate declines significantly with the length of the period between the early 1930s and the time of settlement, indicating how the bondholders moderated their demands as the period progressed. 55/

Often a negotiated solution required many years to achieve. That the bond market never recovered fully from the defaults of the 1930s and that large-scale foreign lending through other channels only reappeared 40 years after the interwar defaults must be attributed in large part to the difficulty of negotiating cooperative solutions to those defaults. It is not obvious that creditor-government intervention could have expedited the process. As described above, the British and American governments were not adept in their use of moral suasion to influence the stance of bondholders' committees. Had they been more effective arm twisters, it is not clear that it would have been feasible to induce the bondholders to accept the same terms at an earlier date. The bondholders' committees were engaged in a bargaining game with the foreign governments. If creditor governments had somehow compelled the bondholders to settle earlier without altering the behavior of the debtors at the same time, this would have weakened the bargaining position of the creditors and forced them to settle for less. Achieving the same outcome at an earlier date through pressure on the creditors would have required matching pressure on the debtors. The obvious way of accomplishing this was by increasing the cost to the debtors of remaining in default, which accrued in the form of inability to borrow.56/ Only by promoting the reactivation of the international market could the creditor-country governments have brought this about. In a sense, their inability to agree on global plans for restarting lending also impeded the ability of creditor-country governments to expedite privately negotiated solutions to the crisis.

3. Conclusion

Comparing current proposals for achieving a global solution to the LDC debt crisis with their interwar antecedents reveals how little is novel or unprecedented in recent plans. Interwar proposals for dealing globally with the problem of defaulted foreign loans included schemes to swap one liability for another, to encourage creditor-country banks and bondholders to engage collectively in additional lending, to lengthen the maturity structure of the debt, to service the debt in local currency, and to establish an international fund to lend to indebted countries who private markets would not touch. Each of these suggestions has its counterpart in recent discussions of the debt crisis.

Individuals currently advocating global solutions will not be heartened by the failure of the interwar schemes. At the same time, there are lessons to be derived from these earlier failures. First, bankers will actively resist any plan that limits their control over negotiations or commits them to a specific course of action. Governments will need to be exceptionally adept in their exercise of moral suasion to elicit cooperation. Second, governments must be exceptionally enlightened to recognize the benefits of global plans. As in tariff negotiations, the benefits of debt relief or new money at concessional terms, which accrue to the creditor countries largely in the form of a more stable world economy, are diffuse relative to the costs, be they capital losses on existing loans or the budgetary cost of new ones. Government officials are more inclined to pursue other issues whose payoff is more apparent.

FOOTNOTES

1. See Cline (1987) and Fischer (1987) for reviews and critiques of the alternative proposals.

2. The standard work on the subject is Moulton and Pasvolsky (1932). Recent revisionist accounts have offered a more nuanced view of the American position, incluencing the interpretation I offer here. See Parrini (1968), Murray (1969) and Wilson (1971). An account which emphasizes French rather than American intransigence is Rhodes (1969).

3. Leffler (1972), pp.586-589.

4. The debate resembles current discussions in which even those with sympathy for the principle of debt relief find it difficult to agree who is deserving and to know where to stop once the process of extending relief has begun.

5. Feis (1966), p.15-16.

6. For details, see Eichengreen and Portes (1987).

7. Total external central government public debt is taken from United Nations (1953), exports from League of Nations (various years). A problem in constructing these ratios was created by the fact that, in aggregating total foreign-currency debt and expressing it in domestic currency, the UN attempted to remove the impact on domestic-currency values of short-run exchange-rate fluctuations, therefore using artificial exchange rates (often the official rate where it differed from the market rate) for the conversion into domestic currency. I used these same artificial rates to convert the debt back into dollars. Market rates were used to express exports in dollars. Because only sovereign debt is included, these figures differ from total-foreign-debt-to-export ratios like those in Cardoso and Dornbusch (this volume).

8. Eichengreen and Portes (1986), p. 612.

9. See Eichengreen (1988).

10. Establishing an international bank to replace the Dawes Plan agencies was not universally supported. See Dulles (1932).

11. Dulles (1932), pp. 45-46.

12. Henderson seems to have been concerned more with the global reserve shortage constraining monetary reflation than with the foreign debt crisis. See Henderson (1932).

13. Beyen (1951), p.51. There was disagreement between U.S. and European officials about the scope of the new bank. The Europeans, notably Schacht, urged the creation of an institution with ample resources for use in stimulating long-term credit flows and promoting international trade. The Americans, George L. Harrison of the Federal Reserve Bank of New York

prominent among them, preferred a modest institution that would concentrate on stabilizing exchange rates. See Costigliola (1972).

14. Clarke (1967), p.179. In one variant of the plan, however, the B.I.S. would be responsible for appointing its president and the majority of its directors.

15. Cited by Kunz (1987), p.37. This passage was struck from the memorandum following its icy reception at the B.I.S. For the original memo, see National Archives RG39, Box 104, M.H. Cochran to J. Cotton, 11 February 1931. The revised memo can be found in this same source and in the Lamont Papers (Baker Library, Harvard University), 181-19, copy of proposal, 2 February 1931.

16. Lamont Papers (Baker Library, Harvard University), 181-19, Copy of proposal, 2 February 1931.

17. Bennett (1962), p.104.

18. I am aware of no conversations to this effect.

19. Clarke (1967), p.178.

20. Kunz (1987), p.35.

21. Lamont Papers (Baker Library, Harvard University), 181-19, N.W. Jay to Thomas W. Lamont, 14 February 1931.

22. National Archives RG39, Box 104, M.H. Cochran to J. Cotton, 11 February 1931.

23. Norman letter to Harrison, 3 March 1931, quoted in Clarke (1967), p.179. The remainder of this paragraph draws on Clarke, pp.179-80.

24. NA RG39, Box 104, M.H. Cotton to W.R. Castle, Jr., 11 March 1931.

25. NA RG39, Box 104, M.H. Cochran to J. Cotton, 26 February 1931.

26. A proposal to establish a holding company, or investment trust, to handle foreign bonds, to be made up of the three or four largest international banking houses in New York, had been circulated in December 1930 by Max Winkler of Griscom and Company. National Archives RG39, Box 104, M.H. Cochran to J. Cotton, 11 February 1931.

27. What follows is from Beyen (1951). Harold James informs me that more information can be found in the records of the Reichsbank's Committee on External Debts.

28. The difficulties created by short-term credits in 1931 are recounted by Eichengreen and Portes (1987).

29. James (1986) describes this situation in detail. Forbes (1987, p. 574) reports that in the summer of 1931 as much as £50 million of credit was extended to German banks and to German enterprise by British banks and acceptance houses.

30. It is conceivable that the Bank of England could have bent or broken its rules, as it had done on a number of prior occasions. See Kindleberger (1978), pp. 174 ff. But there was the counterargument that doing so would itself serve to undermine confidence in sterling.

31. Standstill Agreements were also arranged with Austria and Hungary, the Austrian Agreement serving as a model for the German Standstill. See Forbes (1987).

32. Beyen (1951), p. 62.

33. Kindleberger (1973), p.211.

34. United States (1933), p.563.

35. United States (1933), p.571.

36. United States (1933), p.530. In an intriguing departure from the borrowing-country line, the Chilean representative, Benjamin Cohen, suggested that the initiative fell on Chile to take measures to restart debt service. Too much of Chile's borrowing had been squandered on "trivial" expenditures such as sending military missions abroad and holding a 100 per cent gold cover on central bank liabilities purely for reasons of national pride. Although raising taxes or reducing government expenditures to fund debt service threatened to provoke civil unrest and naval mutiny, Chile had recently reorganized the Nitrate Sales Corporation, which marketed one of its principal exports, permitting 25 per cent of its profits to go toward rehabilitating Chilean credit. If the Chilean delegate to the London Conference dramatically announced the measures that had been taken, as Cohen proposed, perhaps other countries might be provoked to similarly resume some service on their foreign debts. Why the Chilean approach differed is unclear. A hint may lie in the fact that Cohen's discussions in Washington proceeded from debt to commercial policy. It could be that the Chileans' ultimate concern was market access and that they viewed concessions on debt as a way to secure favorable treatment for their exports. United States (1933), pp.518-519.

37. United States (1933), p.561.

38. Beyen (1951), p.82.

39. Kindleberger (1973), p.154.

40. United Kingdom (1932), p.7.

41. The assumption was that the U.S. would not expand its money supply in response to gold inflows, thereby failing to "recycle" its gold imports to the rest of the world.

42. United Kingdom (1932), p.5.

43. Leith-Ross (1968), pp.155-156. For obvious reasons the satire never made its way into print.

44. Stimson (1932), p.3. The occasion for these suggestions was Britain's decision to extend preferential tariff treatment to the Dominions as part of the 1932 Ottawa Agreement. On the Ottawa Agreement, see Cairncross and Eichengreen (1983), chapter 3.

45. Jenks (1927), pp.288-289. For details, see Eichengreen, Humm and Portes (1987), from which the present discussion draws.

46. CFBH Minutes, Poland, 23/2/37.

47. CFBH Minutes, Brazil, 14/7/38.

48. CFBH Minutes, Greece, 18/7/39.

49. The shifts in America's external position described here are elaborated upon in Eichengreen (1987).

50. Eichengreen and Portes (1986), p.622.

51. Feis (1966), pp.266-278.

52. This discussion is taken from Eichengreen and Portes (1986), pp.619-620.

53. Leith-Ross (1968), pp.186-187.

54. Feis (1966), p.141. The sentence continues, "...but that perhaps the Treasury or the Federal Reserve System might be able to suggest a procedure for arranging consultation with the bond holders."

55. A problem with interpreting this equation as evidence of how creditors' demands for compensation declined with time is the possibility of heterogeneity, or "sorting," on the side of the debtors. The alternative interpretation is that the creditors' demands for compensation on each type of loan were inelastic with respect to time, that they demanded less of countries perceived to have less ability to pay, and that the countries with the least ability to pay were the least inclined to settle. In reality, it is likely that both effects were operative.

56. There is little evidence that an individual country's ability to borrow in the 1940s and 1950s depended on its debt service record in the 1930s. But default in the 'thirties and delays in settling thereafter interfered with the ability of all developing countries to borrow subsequently. In other words, much of the impact on creditworthiness of interwar default took the form of an externality. See Eichengreen (1987).

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