Two Hundred Years of Financial Integration: Latin America Since Independence

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Latin America’s Financial Integration: Booms and Busts

International Gross Primary Issuance
(Billion Dollars)
# Booms and Busts: A Summary

<table>
<thead>
<tr>
<th>Peak Year</th>
<th>Total Issuance</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Booms</td>
</tr>
<tr>
<td></td>
<td>Amplitude</td>
</tr>
<tr>
<td>1981</td>
<td>...</td>
</tr>
<tr>
<td>1997</td>
<td>5,774</td>
</tr>
<tr>
<td>2007</td>
<td>296</td>
</tr>
<tr>
<td>average</td>
<td>3,035</td>
</tr>
</tbody>
</table>

Increase in Issuance (Peak 2007 versus Peak 1981): 308 Still ongoing
Worries

- In the midst of the current financial crisis, Latin America’s volatile participation in international capital markets since 1980 does not seem so atypical.

- Still, the boom-bust cycles of the 1990s seem mild compared to that of the 1980.

- What about the end of the 2003-2007 capital flow bonanza?

- A new “Lost Decade”?

- Yet, many of the emerging markets of the 19th century posted the most prolonged episodes of growth and prosperity in the heydays of financial integration during the Gold Standard period.

- Was financial integration different in those times?
Questions

• I look at the Latin American countries’ participation in international capital markets from independence in the early 19th century to 1931 and compare to their participation in the late 20th and early 21st centuries.

• Some Questions:
  – Was financial integration until 1931 as erratic as it has been since 1980?
  – Is it just sovereign borrowing? What is the ability of the private sector to borrow internationally?
  – What about cycles of “excess liquidity”?

• The most important contribution of the paper: I collect information on participation in the international financial centers of the 19th and early 20th centuries: London, Paris, Berlin and Frankfurt, and New York.
BUENOS AYRES 6% STATE LOAN, 1870,

Under the authority of the State Laws of the 17th November, 1868, and 31st January, 1870, 15th of February, 1869 (as varied by a further Law of 2nd September, 1869), and 25th January, 1870,

FOR £1,034,700 STERLING,

In Bonds to Bearer for £100, £500, and £1,000 each,

The Interest Payable Half-Yearly in London.

The Loan to be redeemed at par by Annual Drawings in about 39 years, by means of an accumulative Sinking Fund, which however the Government reserves to itself the right to increase, so as to redeem the Loan at an earlier period.

PRICE OF ISSUE, 88 PER CENT.
ÉTATS-UNIS DU BRÉSIL

COMPAGNIE
DU
CHEMIN DE FER DE VICTORIA À MINAS

ÉMISSION
DE
50,000 Obligations Hypothécaires 5\%/ Or de 500 Francs
AU PORTEUR

Rapportant 25 francs nets par an
Remboursables au pair en 80 ans à partir de 1920
Jouissant pendant 80 ans d'une
GARANTIE OR DU GOUVERNEMENT FÉDÉRAL BRÉSILIEN

Prix d'émission : 465 francs
Three More Examples

• San Lorenzo Nitrate Co. £5 shares (Chile)
  – Issued: September 29, 1902
  – Nominal Value: £120,000
  – Issued in London

• Havana Cigar and Tobacco Factories 5.5% Debentures (Cuba)
  – Issued: 1898
  – Nominal Value: £260,000
  – Banker: Lloyd's Bank

• Havana Cigar and Tobacco Factories 7% Preferred £10 Shares (Cuba)
  – Issued: 1898
  – Nominal Value: £270,000
A Chronology of International Capital Markets and Latin America Financial Integration: The 1820s

- London emerged as the new international financial center following the end of the Napoleonic Wars. The first London international issue was arranged in 1817. It was a loan to finance French war reparations. (This loan was denominated in francs). In 1818, Rothschild arranged the first foreign loan in sterling for Prussia.

- The early 1820s were years of increasing liquidity fueled by the decline in military spending and also because of the monetary injections of the Bank of England.

- The newly independent Latin American countries were able to tap London for funding. The first country to issue was Gran Colombia, but it was followed by Argentina, Chile, Mexico, and Peru.

- The liquidity pumped into the economy helped pulled up commodity prices and helped create an import boom.

- A growing trade imbalance and a drain on the Bank of England’s gold reserves led the Bank to raise its discount rate in the summer of 1825. A stock market crash followed and the crisis spread to continental Europe and Latin America.

- Peru defaults in 1826 and it is followed by all Latin American countries. It took three decades before the debts were renegotiated and capital flows to Latin American resumed.
• International capital flows surged again in the 1830s, with the United States as the prime destination.

• The lending boom, (slowed down by the panic of 1837) came to an abrupt end in 1839, again with a severe monetary contraction in England to stop the loss of reserves. U.S. suspends specie payments in May 1837. By 1842 eight U.S. states had defaulted.

• The world economy and world trade started to boom again in mid 1840s, triggering an increase in the price of primary products and raw materials that benefited Latin America (In particular, Chile and Peru).

• Growing international trade brought a fiscal bonanza to all Latin American countries. This created new opportunities for settling debts and new borrowing. Chile was the first to renegotiate its debt in 1842, Peru followed in 1849. Most Latin American countries renegotiated their debts in the 1850s.

• Brazil was the first to re-enter the market in 1852 and was followed by Peru in 1853.
A Chronology of International Capital Markets
and Latin America Financial Integration: The Late 1800s

• Following the U.S. crisis of 1857 (which spread to England and Europe) and the 1866 crisis in England, a new loan boom to Latin America flourished in the 1860s, with capital flows financing the construction of railways and the creation of joint-stock banks.

• This boom in international capital flows ended in 1873, with the stock market crash in Vienna that spread rapidly to continental Europe, United States, the Near East, and Latin America. Trade tax revenues in Latin America sharply dropped and triggered a new wave of defaults across Latin America. Importantly, Argentina, Brazil, and Chile did not default.

• By the early 1880s a process of recovery had begun and the defaulters in Latin America renegotiated their foreign debt. The foreign trade of many nations in the region increased and tended to become more diversified. Capital flows followed.

• Now, not only British but also French, German, and North American firms started to invest in the banking sector as well as in railways, tramways, mines, sugar refineries, flour mills, gas works, and electric and telephone companies.

• This long expansion of foreign investment ended in 1890 with the crisis resulting from the near-failure of Baring Brothers.
A Chronology of International Capital Markets
and Latin America Financial Integration:
The Turn of the Century until 1931

- The final and longest period of expansion of British capital exports began in 1893 and ended two decades later in 1913.

- British private investments in Latin America doubled. While Britain continued to be the main creditor, France and the United States became major players in the region.

- The outbreak of war in Europe caused an abrupt suspension of capital exports and threatened to dislocate the financial structures of all the Latin American economies. Yet, in spite of the disruption in international capital flows, Latin American countries did not default.

- International capital flows only recovered in the 1920s, with New York as the main financial center. Latin American countries started to float bonds in New York, with issuance reaching its peak during 1925-1928. Borrowing financed railways, ports as well as urban modernization, the establishment of gas works and electrical plants, the construction of modern drainage systems, and the paving of streets and avenues.

- By 1927 prices of commodities had started to decline. Financial conditions in Latin America also began to deteriorate before the onset of the crisis in October 1929. The world depression in 1930 and 1931 was instantly reflected in stock market crises around the globe and the collapse of international capital flows.
Access to International Capital Markets, 1820-1931

International Gross Primary Issuance in London and New York
(Million British Pounds)
# Booms and Busts: A Summary

<table>
<thead>
<tr>
<th>Peak Year</th>
<th>Total Issuance</th>
<th>Booms</th>
<th></th>
<th>Busts</th>
<th></th>
<th>Peak to Peak Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Amplitude</td>
<td>Duration</td>
<td>Amplitude</td>
<td>Duration</td>
<td></td>
</tr>
<tr>
<td>1824</td>
<td>3</td>
<td>...</td>
<td>2</td>
<td>-100</td>
<td>15</td>
<td>...</td>
</tr>
<tr>
<td>1865</td>
<td>15</td>
<td>...</td>
<td>3</td>
<td>-93</td>
<td>3</td>
<td>132</td>
</tr>
<tr>
<td>1872</td>
<td>933</td>
<td>1,933</td>
<td>2</td>
<td>-99</td>
<td>5</td>
<td>50</td>
</tr>
<tr>
<td>1889</td>
<td>37,019</td>
<td>12</td>
<td>5</td>
<td>-98</td>
<td>9</td>
<td>117</td>
</tr>
<tr>
<td>1909</td>
<td>5,831</td>
<td>15</td>
<td>9</td>
<td>-95</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>1927</td>
<td>3,146</td>
<td>9</td>
<td>4</td>
<td>-91</td>
<td>9</td>
<td>63</td>
</tr>
<tr>
<td>average</td>
<td>11,982</td>
<td>9</td>
<td>5*</td>
<td>-97*</td>
<td>15</td>
<td>71</td>
</tr>
</tbody>
</table>

Increase in Issuance (Peak 1927 versus Peak 1824): 1062
# The Doldrums: Then and Now

## Years of Stagnation in Issuance Following a Peak

<table>
<thead>
<tr>
<th>Peak Year</th>
<th>Years of Stagnation in Issuance Following a Peak</th>
<th>Years of Stagnation in Issuance Following a Peak</th>
<th>Years of Stagnation in Issuance Following a Peak</th>
<th>Years of Stagnation in Issuance Following a Peak</th>
</tr>
</thead>
<tbody>
<tr>
<td>1824</td>
<td>30</td>
<td>36</td>
<td>80% Below the Previous Peak</td>
<td></td>
</tr>
<tr>
<td>1865</td>
<td>2</td>
<td>2</td>
<td>50% Below the Previous Peak</td>
<td></td>
</tr>
<tr>
<td>1872</td>
<td>7</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1889</td>
<td>4</td>
<td>15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1909</td>
<td>3</td>
<td>7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1927</td>
<td>1</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>average 1865-1909</td>
<td>4</td>
<td>9</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## The great moderation?
Booms and Busts: Then and Now

• Modern lending cycles are milder than those of the pre-WWII era.
• Only the retrenchment in the 1980s is as severe as those of the earlier period.
• What is different?
• The capital flow reversals of the 1990s are triggered by problems in the periphery, Mexico in 1994, Thailand in 1997, and Russia in 1998. The financial center is basically unscathed.
• The reversal starting in 1982 originates in the financial center. There are a total of 1351 bank failures from 1980 to 1991 in the United States.
• The crises of the 19th and early 20th centuries have a remarkably similarity to the crisis of the 1980s. To mention a few:
  – The 1825 crisis starts in London and spreads very quickly to the financial centers in continental Europe. Hundreds of banks fail in Germany, Italy, Amsterdam, Saint Petersburg, and Vienna.
  – Similarly, the reversals in 1873 and the 1929 start in the financial sectors of the center countries and spread quite rapidly to the periphery.
• Severity of the ongoing crisis?
Public and Private International Issuance

International Gross Primary Issuance
(Billion Dollars)
Public and Private International Issuance

International Gross Primary Issuance in London and New York
(Million British Pounds)
Private and Public Issuance

• Shares of sovereign/public and private issuance are similar then and now.

• Cycles in private and public issuance are similar.

• One Difference:
  – Private issuance in the earlier period was financing export-oriented activities: Railways in Argentina, nitrates in Chile.
  – Private issuance now finances a larger part of non-traded industries.
  – Does this matter?
Measuring Financial Integration: Then and Now

<table>
<thead>
<tr>
<th>Episodes</th>
<th>Issuance/Exports</th>
<th>Episodes</th>
<th>Issuance/Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1880s</td>
<td>0.66</td>
<td>1980s</td>
<td>0.18</td>
</tr>
<tr>
<td>1890s</td>
<td>0.23</td>
<td>1990s</td>
<td>0.22</td>
</tr>
<tr>
<td>1900s</td>
<td>0.15</td>
<td>2000s</td>
<td>0.16</td>
</tr>
<tr>
<td>1910s</td>
<td>0.12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1920s</td>
<td>0.11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average 1885-1931</td>
<td>0.20</td>
<td>Average 1980-2008</td>
<td>0.18</td>
</tr>
</tbody>
</table>

A Caveat: Overall economies were more open to trade in the 1800s. For example, Argentina’s Exports were about 30% of GDP at the turn of the 20th Century but was about 10% of GDP in the 1980s.
Access to International Capital Markets

International Gross Primary Issuance, 1980-2008
(Billion Dollars)
Access to International Capital Markets

International Gross Primary Issuance, 1820-1931
(Million British Pounds)
The Triggers of Booms and Busts: Then and Now

- Monetary Policy in Financial Centers and global imbalances.

- Commodity Prices.

- Technological Shocks:
  - Steam Engines, Railways, Electricity, Internal Combustion Engines, telegraph, telephone, Construction of Cities: Tramways, Ports, Gas, Drainage, Canals, and fertilizers in the Old Times.
  - Computers, Internet, Broad Band, Cell Phones in Modern Times.

- Financial Innovations:
  - Joint Stock Banks, Limited-liability corporations and banks, Deposit Banks in France and Germany, Central Banks in the 1800s and early 1900s.
  - Development of the Euro Dollar market and floating exchange rates in the 1970s, mutual funds in the 1980s, derivatives, Credit Default Swaps, CDOs in the 1990s.
Interest Rates and International Liquidity

US Federal Funds Rate (nominal rate)

Latin American Gross Primary International Issuance
Interest Rates and International Liquidity

Panic 1825
Crisis 1847
Crisis 1866
World Crisis 1873
Panic 1837
Panic 1839
Crisis 1857

UK Bank Rate (nominal)  US Commercial Paper Rate (nominal)
Latin America Gross Primary International Issuance
Commodity Prices and International Liquidity

The Economist Price Index (nominal)  The Economist Price Index (real)
Latin America International Issuance
Peru, the Guano Boom, and the Default

Guano Nominal Price Index  Guano Real Price Index
Issuance and Terms of Trade

Argentina

Brazil

Coffee Boom

Rubber Boom
Access to International Capital Markets
or
Excess Liquidity?

International Gross Primary Issuance/Exports

- Argentina
- Brazil
Access to International Capital Markets or Excess Liquidity?

International Gross Primary Issuance/Exports

Argentina Brazil
Reflections
Stories of the 1800s and 1900s for the 2000s

• Then and Now, greater financial integration opened new opportunities and created new risks for borrowers and lenders.
  – A Lesson? When the Financial Center is the Epicenter
  – Differences: Trade openness, financial integration, lending-cycle volatility, and growth?
  – Bonds versus Loans: Effects on contagion

• The history of Latin America following the 1931 crisis until the 1970s is a history of financial repression, high inflation, high domestic debt, and no constraints on domestic macro policies.

• The crisis of the 1930s: Output and international trade collapse, protectionist upsurge, but above all, … the loss of the sanctity of contracts.

• Just emerging markets? No. Remember the derogation of the gold clause in the United States in 1933, Britain’s suspension of payment on the war debt, and Germany’s failure to make payments on the greater part of her international obligations.
The Past is Never Dead, It’s Not Even Past

William Faulkner
(Act I Scene III of Requiem for an Nun)