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The Effect of Southern State Bond Repudiation and British Debt Collection Efforts on Anglo-American Relations, 1840–1940

V. Markham Lester

Abstract British officials' largely negative impression of the United States caused by America's intransigence in allowing renegotiation of Britain's First World War debts must be viewed against a backdrop of a longstanding debtor-creditor relationship between the two nations. Since the mid-nineteenth century, British creditors, largely through the efforts of the London-based Corporation of Foreign Bondholders, vigorously yet unsuccessfully attempted to collect large debts on repudiated American state bonds. This article provides greater understanding of this history and shows that the nineteenth-century debt controversy might well have been avoided to the economic benefit of the British and particularly the American South.

During the course of the First World War, Britain borrowed $4.6 billion from the United States, a debt America routinely sought to collect until the advent of Lend-Lease in 1940.[1] This large indebtedness cast a pall on Anglo-American relations throughout the interwar years. Some historians maintain that arguments between the two nations over the debt had far-reaching implications well beyond the debt itself. In the most recent and authoritative study of the debt controversy, Robert Self convincingly asserts that American intransigence in renegotiating the loan left British officials, particularly Neville Chamberlain, with such a negative impression of the United States that it severely hampered cooperation between the two nations in the crucial years leading up to the Second World War.[2]

But the origins of the controversy did not start in the second decade of the twentieth century. Indeed, Anglo-American tensions over debt repayment had been festering since before the American Civil War, when Southern states began borrowing heavily from British investors large sums that they never repaid. By the 1930s, a time of escalating international tensions, the Great Depression, and ultimately war,

V. Markham Lester is professor of history at Birmingham-Southern College. He would like to thank Drs. G. Ward Hubbs, Clark Malcolm, James Sack, and David W. Ullrich, and the editors and reviewers of the *Journal of British Studies*, for their valuable comments and suggestions.

[1] Payments on the debt ceased in 1934. By June 1939, the total principal and interest on the debt totaled $5,466 million, an amount all agreed could not be paid without American concessions. Robert Self, *Britain, America and the War Debt Controversy: The Economic Diplomacy of an Unspecial Relationship, 1917–1941* (London, 2006), 15, 203.

[2] Ibid., 213.

the relationship between Britain and the United States—on which the fate of democracy would ultimately hinge—had been strained by the longstanding and continuing controversy. To most Americans, the issue of British repayment of the First World War debt was simple, expressed in the famous quip attributed to President Calvin Coolidge, "Well, they hired the money, didn't they?" For the British, the controversy was obviously much more complicated, only to be understood in the larger context of a century of poor debtor-creditor relationships between the two nations.

Historians have largely failed to recognize, much less appreciate, the role that the nineteenth-century Anglo-American debt controversy played in shaping the British view of their First World War obligations. For decades, British creditors, largely through the efforts of the London-based Corporation of Foreign Bondholders, had vigorously attempted to collect repudiated bonds issued either by individual American states directly or by entities for which the states had pledged their full faith and credit. These were not bonds of the Confederate States of America, for which the Fourteenth Amendment to the US Constitution blocked collection, but rather bonds issued both before and after the American Civil War for banks, railroads, and other developmental purposes. Over and over, the Americans blocked collection efforts with an assortment of constitutional arguments and legal maneuvers. By the 1920s, it is estimated that the amount owed on these obligations totaled approximately $75 million in principle and $300 million in interest.[3] It is difficult, if not impossible, to calculate exactly what portion of the defaulted indebtedness was owed to British citizens; however, most estimates placed the figure at a third.[4] Perhaps even more important than the *amount* of the debt is its *source*: many of those holding the defaulted bonds were the "gentleman capitalists" described by Peter Cain and Anthony Hopkins as being at the center of British political and economic life.[5] Even though this $125 million owed to the British represented only a fraction of the $4.6 billion owed by Britain after the First World War, it is still not surprising that many of the British elite viewed the Americans as hypocritical when taking a high moral tone about the sanctity of contract. The question posed by the *Financial Times* in 1920 was typical, "Why should America be so eager for the redemption of our loans from her, and at the same time persist in the repudiation of her own indebtedness to us?"[6]

Using the records of the Corporation of Foreign Bond holders and other sources, this article traces the history of British attempts to collect the defaulted bond debt of American states from the mid-nineteenth century to the 1930s, when all attempts

[3] Corporation of Foreign Bondholders, *Defaulted Debts of the Southern States of the United States of America: Extracts from the Annual Reports of the Corporation of Foreign Bondholders* (London, 1925), 32; C. P. Howland, "Our Repudiated Debts," *Foreign Affairs* 6 (April 1928): 395–407.

[4] *Glasgow News*, 26 December 1874; *Saturday Review*, 3 March 1877. Unless otherwise stated, all newspaper articles referenced are from Council of Foreign Bondholders, *The Newspaper Cuttings Files of the Council of Foreign Bondholders*, United States (General) 1871–1901, 1913–1931. *Financier*, 21 August 1922, estimated only £585,000 ($2,925,000) of Southern state debt had been traced to Britain. There was no explanation as to how this estimate was calculated. This figure is almost certainly incorrect in light of earlier estimates and, as will be seen, in the level of concern voiced in Britain over the defaulted indebtedness.

[5] P. J. Cain and A. G. Hopkins, *British Imperialism: Innovation and Expansion, 1688–1914* (London, 1993).

[6] *Financial Times*, 16 March 1920.

were finally abandoned. Particular focus will be on the redoubling of efforts after the First World War when the existence of the British war debt created renewed interest in collections of past debts of Americans to British investors. Many on both sides argued that fundamental fairness demanded the British be allowed to set off uncollected bond claims against the British war debt. The failure of the United States to recognize these state debts aided greatly in turning, in Harry Allen's phrase, "Uncle Sam into Uncle Shylock" in the minds of many in Britain.[7] This extended history of debt controversy greatly added to the perception of the British elite that the United States was hypocritical and untrustworthy, and thus contributed to the weakening of Anglo-American relations in the critical period before the Second World War. The controversy could have been avoided on numerous occasions through an equitable renegotiation of the indebtedness, helping the American South economically and removing a significant roadblock to more amicable Anglo-American relations.

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Although the notion of Britain and America sharing a "special relationship" developed in the twentieth century, in terms of trade and finance the two nations have a long and complex history of interdependence. This linkage had its own "organic unity" that facilitated commerce and especially the financial arrangements that supported such commerce.[8]

In 1838 Britain had invested an estimated $174 million in the United States, representing 67 percent of all foreign investment in America. Investment in America continued to rise, so that by 1885 the British had invested $1.5 billion, representing 75 percent of all foreign investment in the United States.[9] The British bought bonds, the most common form of international investment in the nineteenth century. Although the risks were high, so were the rates of return, making such investments popular, particularly on the London exchange and, to a lesser extent, in Paris and Berlin.[10] As America pushed westward, newly formed states, strapped for capital, sought foreign investment to finance banks, roads, and other internal improvements. In the 1820s and 1830s, American states increased their debts by a factor of thirteen, mostly for the purpose of transportation improvements and banking.[11] Naturally Britain, as the chief international source of capital, became the major lender, and state bonds soon became the "critical link" between the now well-integrated financial markets of Britain and the United States.[12]

Repudiated nineteenth-century American bonds fall into three categories: bonds issued before the American Civil War, bonds of the Confederate States of America,

[7] H. C. Allen, *Great Britain and the United States: A History of Anglo-American Relations (1783–1952)* (New York, 1955), 755.

[8] Joseph Dorfman, "A Note on the Interpretation of Anglo-American Finance, 1837–1841," *Journal of Economic History* 11 (Spring 1951): 147.

[9] J. H. Dunning, *Studies in International Investment* (London, 1970), 151 (table 2).

[10] Charles Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley, 1985), 5.

[11] William B. English, "Understanding the Costs of Sovereign Default: American State Debts in the 1840s," *American Economic Review* 86 (March 1996): 261.

[12] Namsuk Kim and John Joseph Wallis, "The Market for American State Government Bonds in Britain and the United States, 1830–43," *Economic History Review*, 2nd ser., 58 (November 2005): 737–38.

and bonds issued during the Reconstruction period following the war. The Fourteenth Amendment to the US Constitution specifically repudiated the Confederate bonds by providing "neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States."[13] Confederate bonds were never at the center of controversy over repudiated debts by American states, and in fact, proponents of a setoff of state debts against British war loans always made a point that their claims did not include those represented by the repudiated Confederate bonds.

Rather, those who urged a setoff against British war debt focused their attention squarely on repudiated state bonds that were issued before and after the American Civil War. For the first half of the nineteenth century, individual American states looked to Britain, and to a much lesser extent other European nations, for significant amounts of funding. Without such foreign investment, even though American expansion would have occurred, it would have doubtless been at a slower pace.[14] While post–Civil War Southern apologists for default attempted to attribute all failure to repay debts to corrupt illegitimate state governments, in this early period it was common for unquestionably legitimate state governments to sell their own securities abroad to finance public projects. Most investments in such things as railroads and canals were through this method rather than by direct investment. By the end of the Jackson era in the 1830s, state debts had risen to $172 million (a quarter of which had been issued for railway development), more than the US government itself had ever owed.[15] Of this indebtedness, foreign ownership varied from between 50 and 76 percent at any one time.[16]

The financial crisis of 1837–39 in both Britain and the United States was the result of a "foreign credit mania" and, as a result, caused a partial interruption in credit arrangements.[17] Stemming from the crisis, in 1841 and 1842 eight states and one American territory defaulted on their loans, and British investments in American state government paper ground to a halt.[18] Within this two-year period, these nine states defaulted on almost $121 million in loans.[19] Some states later refinanced their loans or repaid them in full, but many states, particularly those of the South, never paid on their bonds and specifically repudiated them in most cases. By 1843 few governments in the world had worse credit than American state governments. It is particularly noteworthy that a substantial portion of the defaulted securities had been purchased by members of the governing class in Britain and that, as Leland Hamilton Jenks argued in 1927, "the resentment which they felt at their mistaken judgment spread without delay to all persons and things American."[20]

[13] US Constitution, amend. 14, sec. 4.

[14] Leland Hamilton Jenks, *The Migration of British Capital to 1875* (New York, 1927), 73; D. C. M. Platt, *Foreign Finance in Continental Europe and the United States, 1815–1870: Quantities, Origins, Functions and Distribution* (London, 1984), 144–45.

[15] Mira Wilkins, *The History of Foreign Investment in the United States to 1914* (Cambridge, 1989), 54, 66; P. J. Cottrell, *British Overseas Investment in the Nineteenth Century* (London, 1975), 21.

[16] Cottrell, *British Overseas Investment*, 21.

[17] Jenks, *Migration of British Capital*, 87–88.

[18] Wilkins, *History of Foreign Investment*, 70, 100; Reginald C. McGrane, *Foreign Bondholders and American State Debts* (New York, 1935), 382–83.

[19] John C. Bishop, "The Repudiation of State Debts, 1836–1845," *Southern Studies* 3 (Summer 1992): 79.

[20] Jenks, *Migration of British Capital*, 99, 104.

The British market reacted swiftly to the defaults. An 1846 Barings circular noted that the sale of American stocks abroad had declined even at low prices, and there would be little inclination "to purchase either old or fresh securities until the differences between the United States and Great Britain were amicably settled."[21] This statement reflected the hope among European investors that the US government might take responsibility for the defaulting states. There were even rumors of war between the United States and Britain if the debts were not assumed by the federal government.[22] Despite the US Senate passing resolutions in 1840 disclaiming any federal government responsibility for state debts, the defaulting states became such an embarrassment to the United States that an angry John Quincy Adams introduced a resolution in Congress in 1843 urging that, if a foreign nation attempted to collect the debts through acts of war against a defaulting state, the state would "cease thereby to be a State of this Union" and "will have no right or claim to aid" from the United States.[23] That same year the US House of Representatives produced a 600-page report discussing the possibility of the national government assuming the repudiated debt, but it was eventually tabled.[24] Some historians have argued that the federal government gained credibility in world markets by making it clear early on that it would not bail out individual states.[25]

By the 1850s the creditworthiness of the United States and most individual states was restored. Only Mississippi, Florida, and Arkansas remained in default. Once again, British and other European investors provided the capital for an expanding America. As in the 1830s, by the 1850s American state government securities represented the largest category of foreign investor holdings. For many Southern states, foreign holdings were significant. Treasury estimates in 1853 were that foreigners held 98 percent of the debt for Alabama and 83 percent for Louisiana.[26]

The third category of repudiated state debts was those incurred by Southern states during Reconstruction following the American Civil War. Many Republican Southern state governments in the late 1860s and early 1870s wholeheartedly adopted what Mark Summers terms the "gospel of prosperity," whereby they attempted to rebuild the South by attracting capital through tax breaks and bond issues. Railroads in particular benefited from this largesse, either through direct payments or by having their bonds backed by the full faith and credit of the state.[27] Their Democratic opponents fought the growing debt, calling it a swindle, discouraging investors, and threatening to repudiate the debts once they gained power.[28]

[21] Quoted in Reginald C. McGrane, *Foreign Bondholders*, 268.

[22] Wilkins, *History of Foreign Investment*, 70–71.

[23] Jenks, *Migration of British Capital*, 100; US Congress, House Report No. 296, 27th Cong., 3rd Sess., 559 (1843).

[24] Bishop, "Repudiation of State Debts," 82.

[25] Michael D. Bardo, Agnieska Markiewicz, and Lars Jonung, "A Fiscal Union for the Euro: Some Lessons from History," Working Paper 17930, National Bureau of Economic Research, September 2011, 25.

[26] Wilkins, *History of Foreign Investment*, 75, 77.

[27] Mark W. Summers, *Railroads, Reconstruction, and the Gospel of Prosperity: Aid Under the Radical Republicans, 1865–1877* (Princeton, 1984); Eric Foner, *Reconstruction: America's Unfinished Revolution, 1863–1877* (New York, 1988), 379–82.

[28] Summers, *Railroads*, 202; B. U. Ratchford, *American State Debts* (Durham, 1941), 174.

Despite these protests, the more radical Republican regimes were able to raise millions of dollars for railroads and other improvements, increasing the region's indebtedness by an estimated quarter of a billion dollars.[29]

Although it is impossible to ascertain exactly how many of these state bonds were purchased in Britain, there is no doubt that many were held by British subjects.[30] This can be seen indirectly by a peak in outflow of British investment in the United States that was reached in 1872.[31] The highpoint of foreign government financing was reached in the early 1870s, and in November 1874 the Commercial and Financial Chronicle estimated one quarter of all American state bonds were held abroad.[32] There was certainly enough investment to cause some to worry about it at the time. The *Anglo American Times* in 1875 blamed British investors for not being more careful in investing in Southern state bonds, alleging such investors were "profoundly ignorant of the political condition and carefully evading the trouble of learning."[33]

The extent to which investors accurately took risk into account in the pricing of securities of American states is somewhat complicated. For securities issued before the American Civil War, when transatlantic communication was difficult, investors were largely ignorant of risk. As other historians have noted, in this early period even a trained investigator knew little of the risks involved and no British investor would have understood that the individual American states had sovereign powers beyond any court's jurisdiction.[34] As a result of such lack of knowledge, the price of the bonds almost certainly did not accurately reflect the risk involved. In contrast, investors in Reconstruction era bonds had much greater knowledge of potential risks. Southern Democratic newspapers and politicians warned the public that "swindling bonds" issued by Republican-controlled state governments would never be recognized if the Republicans were thrown out of power, and these challenges were reported in the foreign press.[35] In some instances, these threats apparently made little difference in the risk calculation. For example, Alabama bonds sold in 1869 and 1870 for 81 percent and 94 percent of par value, respectively, easily competing with 1870 Massachusetts bonds, which sold for 87 percent of par.[36] Yet by 1873, when US government obligations were selling at between 14 and 21 percent above par value, South Carolina bonds were selling at 70 to 85 percent below par.[37] The discounting of new Southern state bonds due to their earlier defaults continued to cost the defaulting states millions of dollars. In July 1914, Virginia state bonds were selling at 16 percent below par while California bonds were selling at only 3 percent below, and New York bonds were actually

[29] James T. Moore, "Redeemers Reconsidered: Change and Continuity in the Democratic South, 1870–1900," *Journal of Southern History* 44 (August 1978): 370.

[30] C. P. Howland, "Our Repudiated Debts," 395; Ratchford, *American State Debts*, 178.

[31] Dunning, *Studies*, 147.

[32] Jenks, *Migration of British Capital*, 282; Wilkins, *History of Foreign Investment*, 112–13.

[33] *Anglo-American Times*, 11 April 1876.

[34] Jenks, *Migration of British Capital*, 79.

[35] McGrane, *Foreign Bondholders*, 282.

[36] Wilkins, *History of Foreign Investment*, 112, table 4.6.

[37] 17th Annual circular of Thomas Denny & Co., New York, January 1874, 26–37, Council of Foreign Bondholders, *The Newspaper Clippings Files of the Council of Foreign Bondholders*, United States (General), 1871–1901, 1913–1931, 1:26–37.

selling slightly above par.[38] In short, investor knowledge of the risk involved with American state bonds continued to expand in the half century following the American Civil War much to the detriment of the Southern states that had to pay increased interest rates because of their prior defaults.

Who in Britain was willing to invest in the South? Tracing the actual investors in almost any nineteenth-century enterprise is extremely difficult and often simply impossible. To some extent, the records of the state of Alabama provide a unique insight into the question. According to the 1874 state treasurer's report, the portion of the state's bonded indebtedness payable in London as of September 1874, based on four issues (two in 1866, and one each in 1867 and 1870), was almost $1.5 million.[39] A little less than one-half of these issues represented refinanced exchanges for pre–Civil War bonds issued in 1850.[40] In addition, English bondholders had approximately $9 million in claims on Alabama and Chattanooga Railroad bonds, which had been endorsed by the state of Alabama.[41]

After the overthrow of the Republican Reconstruction government in the state, the Alabama legislature in December 1874 established a debt commission to ascertain the extent of the state's indebtedness.[42] The Corporation of Foreign Bondholders forwarded more than 100 claims to the commission, which are preserved in the Alabama Department of Archives and History.[43] The 118 claims, representing ninety individual claimants, totaled $1,385,840, or 4.6 percent of the total state bonded indebtedness found by the commission. All but 3 claims were for bonds issued in 1866, 1867, and 1870. Therefore, in light of the $1.4 million total bonded indebtedness payable in London officially reported by the Alabama treasurer, the Corporation of Foreign Bondholders claims must have been close to all Alabama bondholders in Britain. A number of the larger claims were by companies on behalf of individual claimants—for example, a claim of $173,500 by Messrs. Drummond Bankers of London for 188 bonds held by various unnamed individuals.[44] A member of Parliament, W. B. Beaumont, filed one of the larger individual claims, amounting to $95,000. There were, however, a number of what might be considered small claims, such as that filed by the Reverend Henry Beath for $225.[45]

The record of British claims on defaulted Alabama bonds confirms many of the conclusions reached by Lance E. Davis and Robert A. Huttenback as to the composition of British investors in foreign government paper, as well as Cain and Hopkins's concept of "gentlemanly capitalism."[46] These authors argue that the investment of

[38] William L. Raymond, *American and Foreign Investment Bonds* (Boston, 1916), 137–38.

[39] *Report of the Treasurer of the State of Alabama for the Fiscal Year Ending 30 Sept. 1874* (Montgomery, 1874), 61.

[40] *Report of the Treasurer of the State of Alabama to the Governor for the years 1866 –7, 1867–8, 1868–9, Ending 30 Sept. 1869* (Montgomery, 1869), 113.

[41] Horace Mann Bond, "Social and Economic Forces in Alabama Reconstruction," *Journal of Negro History* 23 (1938): 341.

[42] Walter L. Fleming, *Civil War and Reconstruction in Alabama* (New York, 1905), 583.

[43] Bond administration files (1862–1919), SG 8096, Alabama Department of Archives and History (hereafter ADAH).

[44] Ibid., claim no. 96.

[45] Ibid., claim no. 72.

[46] Lance E. Davis and Robert A. Huttenback, *Mammon and the Pursuit of Empire: The Political Economy of British Imperialism, 1860–1912*(Cambridge, 1986); Cain and Hopkins, *British Imperialism*.

"elites" and "gentlemen capitalists" played a significant role in world development through loans to foreign governments and direct investment. This relatively small group of investors held almost 40 percent of British-owned foreign investments.[47] Although the Alabama records do not indicate the specific occupation of the British investor, in most cases they do record the individual investor's residence. Just as Cain and Hopkins discovered in their research, almost all the British investors in the defaulted Alabama bonds appear to have been "gentleman capitalists" residing in the wealthy areas of London and the southeast of England. Likewise, the presence of such a large proportion of these "gentlemen capitalists" is also in line with Davis and Huttenback's finding of the preference of "elites," more than other groups, to invest in foreign government paper.

It is impossible to ascertain what amount, if any, was ultimately paid on these Alabama claims. After the commission reported, the legislature "adjusted" the state's indebtedness, authorizing the issuance of $7 million in new bonds to be exchanged for bonds held by "bona fide" purchasers.[48] As for the Alabama and Chattanooga Railway bonds, the state agreed to pay $1 million on the $9 million indebtedness with a transfer of half a million acres of railroad land to first mortgage bondholders.[49] In 1877 the state auditor reported that "the compromise offered by the state has been accepted by nearly all the holders of the bonds, and others will doubtless make the exchange at an early day."[50]

As Democratic "redeemer" governments slowly returned to power throughout the South in the late 1870s and 1880s, more and more Reconstruction era bonds were repudiated.[51] As might be expected, these actions led to British frustration. "One administration issues bonds," the British *Anglo American Times* reported in 1875, and after bonds were issued, "another Administration repudiates a portion, and recognizes another portion; a third administration repudiates a further portion of its recognized portion, and so on, til the bonds that are to be paid and the bonds that are not, would become of a 'mixed' character but for the emptiness of the treasury, which in effect leaves them all alike unpaid."[52] Estimates of the total debt repudiated are difficult to make. In many cases, states stopped keeping records of repudiated debts. The best estimate is that by 1890 Southern states had repudiated approximately $116.3 million in debt by either outright repudiation or a reduction of the principal through scaling down.[53] As of 1933, best estimates were that the principal indebtedness amounted to approximately $85 million with $249.8 million interest in arrears, at least third of which was owed to British citizens.[54]

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[47] Ibid., 200.

[48] Fleming, *Civil War and Reconstruction*, 584.

[49] Bond, "Social and Economic Forces," 341.

[50] *Report of the State Auditor of Alabama for the Fiscal year Ending 30 Sept. 1876* (Montgomery, 1877), 5.

[51] McGrane, *Foreign Bondholders*, 282–381, provides an excellent summary of each individual Southern state's bond issuance and repudiation.

[52] *Anglo-American Times*, 20 March 1875.

[53] Nathanial T. Bacon, "American International Indebtedness," *Yale Review* 9 (1900): 265–85, 268; B. U. Ratchford, *American State Debts* (Durham, 1941), 192.

[54] Max Winkler, *Foreign Bonds, An Autopsy: A Study of Defaults and Repudiations of Government Obligations* (Philadelphia, 1933), 203.

Repudiation triggered an eighty-year attempt by British investors to recover some of their investments in Southern state bonds. The key player in this effort was the London-based Corporation of Foreign Bondholders (CFB) founded in 1868, according to its charter, "for the purpose of watching over and protecting the interests of holders of foreign bonds."[55] The CFB was founded largely in response to the reluctance of the British government, dating back to the days of Canning, to be involved in the collection of private debts. The British government might provide bondholders its "good offices" or issue "stern representations" to a defaulting government but nothing more.[56] Lord Palmerston, for example, refused outright a request of holders of defaulted American state bonds to file a protest with the US government. "British subjects who buy foreign securities," said Palmerston, "do so at their own risk and must abide the consequences of any speculation of this kind which they may enter into."[57]

Before the formation of the CFB, when a foreign bond went into default or was repudiated, the only recourse for a bondholder was to work through the issuing house and perhaps through an ad hoc committee of the stock exchange if enough interested investors formed one.[58] The corporation formalized this system with the formation of bondholder committees under its rules and regulations. The corporation collected information and assisted in attempts at settlement, usually by working to deny further credit to defaulting states. With the 1898 passage of the Corporation of Foreign Bondholders Act, the corporation achieved the status of a quasi-public body with new rules and regulations for the appointment of members of the council and for general conduct of the corporation.[59]

Considering the great collection weapon at the CFB's disposal, it is arguable whether bondholders even continued to want the assistance of the British government in collection efforts. London was by far the most important credit market in the world throughout the nineteenth century, and the CFB could put tremendous pressure on defaulting governments by threatening to block future bond issues from being listed on the London Stock Exchange.[60] This became the organization's principal tactic to collect defaulting government debts, and the CFB's collection efforts were remarkably similar whether they were to collect the bonds of Paraguay, Turkey, or, as shall be seen, Southern American states.

Acting largely through the CFB, efforts of British investors to collect Southern state debts can be roughly divided into two phases. In the first phase, lasting until the First World War, investors attempted to negotiate with the defaulting states, while at the same time keeping up pressure on them through attempts to block the extension of any new credit. This initial phase was the best opportunity to settle equitably the claims through renegotiation of the terms of the indebtedness.

[55] Quoted in Edwin M. Borchard, *State Insolvency and Foreign Bondholders: Volume 1, General Principles* (New Haven, 1951), 203.

[56] Jenks, *Migration of British Capital*, 286, 288; D. C. M. Platt, *Finance, Trade, and Politics in British Foreign Policy, 1815–1914* (Oxford, 1968), 53.

[57] Quoted in Reginald C. McGrane, "Some Aspects of American State Debts in the Forties," *American Historical Review* 38 (July 1933): 682.

[58] A. Behr, "Isidor Gerstenberg (1821–76): Founder of the Council of Foreign Bondholders," *Transactions, Jewish Historical Society of England* 17 (1953 for 1951–52): 207.

[59] Borchard, *State Insolvency*, 206–7.

[60] Platt, *Finanace, Trade, and Politics*, 51.

Eventually investors realized that Southern states would never honor the debts. Because legal avenues of collection by individuals or other states were blocked for the most part, when British First World War debts to the United States opened up the possibility of collection through some sort of setoff, a second phase began in which the CFB largely abandoned efforts to negotiate with defaulting states and focused on a setoff or the last legal hope of redress, an action brought by a foreign country against a defaulting state.

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In the 1870s, the British came to believe that former states of the Confederacy were suffering under Reconstruction regimes. *The Daily Recorder* commented that "the Southern States with few exceptions have been cruelly and abominably misgoverned under the wretched constitutions set up by the Federal Reconstruction Act."[61] Despite this, there was also a general feeling of optimism that the South was making progress toward economic recovery. "Unless this progress should be unexpectedly checked," *The Times* predicted in 1876, "the calamities of the Civil War will quickly be obliterated by the rising tide of prosperity almost without parallel, even in the American experience."[62] A circular in the files of the CFB from Henry Clews & Co., Wall Street, dated June 1875, lamented that the distrust of Southern states' bonds was "perhaps too sweeping and indiscriminate" and urged that investors keep in mind "that the South has always been pre-eminent for its honour" and that, even though it has been weakened by war, "it has yet vast wealth, and all the elements of rapid recuperation."[63]

Some of the positive British view of the South may have been due to the absence of Anglophobia in Southern attacks against Reconstruction era bonds. As Mira Wilkins has observed, during the nineteenth century many Americans expressed concern about foreign, particularly British, investment in America.[64] This was not the case with the Southern states' discussion of their defaulted obligations. First and foremost, Southerners viewed the carpetbag governments that created the debts, not the investors, as the real culprits. If bondholders were blamed at all, it was not foreign bondholders who were criticized but rather bondholders from Northern states. The logic used was that Northern bondholders, by their actions in the Civil War, caused the impoverishment of the South that made payment on the bonds impossible.[65]

One thing, however, was clear from the beginning. Despite the British investing community's sympathy with the plight of the South, it vigorously opposed any attempt by Southern states to void payment of their debts. As redeemer governments succeeded radical ones, arguments that the Democrats should not be responsible for

[61] *The Daily Recorder*, 3 June 1874.

[62] Corporation of Foreign Bondholders, English Committee of Alabama 8 Per Cent Gold State Bonds of 1870, *The Hill Country of Alabama, U.S.A.; or the Land of Rest* (London, 1878) quoted in *The Times*, 23 June 1876.

[63] Circular of Henry Clews & Co., Wall Street, New York, June 25, 1873, Council of the Corporation of Foreign Bondholders, *The Newspaper Cuttings Files of the Council of Foreign Bondholders*, United States (General) 1871–1901, 1:13.

[64] Wilkins, *History of Foreign Investment*, 578.

[65] Ratchford, "The North Carolina Public Debt," *North Carolina Historical Review* 10 (January 1933): 15.

carpetbagger debts fell on deaf British ears. The *Saturday Review* argued that when former Confederates were readmitted to the rights of citizenship, it was on the condition that they accept the Republican regimes, including "all the rights and all the obligations of the 'carpet-baggers.'" The whites now, however, "insist upon enjoying the benefits and repudiating the burdens."[66] "[F]oreign capitalists cannot be expected to study the constitutional technicalities of a borrowing state," declared the *Standard*. Investors "are entitled to regard the Government as authorized to act for a State, and the latter must be bound by all acts, however, illegal."[67] The view of British investors was perhaps best summarized in a comment by *Money Market Review* concerning repudiated American bonds: "It is a maxim which is true enough in itself, for, whatsoever changes may take place, in the course of time, in the condition of indebted Communities and States, *a Bond never dies*." For as the *Review* explained, in an age when credit was an absolute necessity, the repudiated bonds "must ultimately be met or in some way satisfied" if any future credit was to be extended.[68]

But successful collection of defaulted or repudiated bonds was a different matter altogether. Various laws barred individual investors from suing defaulting states. "The English Courts," declared Sir Robert Phillimore in his 1882 edition of *Commentaries upon International Law*, "have decided that bonds payable to bearer issued by the government of a state only create a debt in the nature of a debt of honour, which cannot be enforced by any foreign tribunal nor by the tribunal of the borrowing state itself, unless with the consent of its government" (citing *Crouch v. Credit Foncier of England*, L.R. 8 Q.B. 374 [1873] and *Twycross v. Dreyfus*, 5 Ch. D. 605 [1877]).[69]

Even without this pronouncement of the English courts, American law created many roadblocks for bondholders' suits against states.[70] The key legal issue was to what extent the Eleventh Amendment to the US Constitution prevented an individual from suing a state.[71] At first, bondholders were encouraged when the US Supreme Court ruled in 1876 that, under the particular circumstances of the case, a bondholder could recover against the state of Louisiana. According to the unanimous opinion of the court, the Eleventh Amendment did not prevent the Court from ordering a state official to do his nondiscretionary duty to pay on bonds.[72] The Court, however, did an about-face in 1882 in *Louisiana ex rel. Elliot v. Jumel,* in which it denied relief to another Louisiana bondholder. The Court reasoned that, since Louisiana law prohibited suits against the state in its own courts, the Eleventh Amendment blocked such suits in federal courts.[73] No attempt was made to

[66] *Saturday Review*, 3 March 1877.

[67] *Standard*, 8 July 1876.

[68] *Money Market Review*, 7 July 1883.

[69] Quoted in Borchard, *State Insolvency*, 6.

[70] For an excellent summary of the development of American law regarding bondholders' cases against repudiating states, see John V. Orth, *The Judicial Power of the United States: The Eleventh Amendment in American History* (New York, 1987).

[71] "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." US Constitution, amend. 11.

[72] *Board of Liquidation v. McComb*, 92 U.S. 531 (1876).

[73] *Louisiana ex rel. Elliot v. Jumel*, 107 U.S. 711 (1882).

distinguish the Court's earlier opinion in *McComb*. The *Jumel* ruling effectively blocked the road for individual bondholders to seek redress in American courts against defaulting states.

The only instance in which individual bondholders succeeded in an action against a state was against Virginia. The repudiated Virginia bonds were unusual in that they provided coupons representing interest on the bonds that could be used in payment of state taxes. In a series of cases, the Supreme Court ultimately ruled that even though an individual could not sue the state on the bonds, Virginia officials could not interfere with taxpayers who tendered the coupons in payment of taxes.[74]

If an individual was blocked from suing a state, what about a state suing a state? The Supreme Court in *North Dakota v. North Carolina* held that, as long as it was not acting as "mere collecting agent," a state could bring suit against another state on defaulted bonds.[75] The effect of *North Dakota v. North Carolina* was not as great as might be expected. North Carolina accepted a compromise settlement, and no other states filed similar cases.[76] One commentator has suggested that even if a state prevailed against a defaulting state, the legislature of the defaulting state would more than likely refuse to make the appropriation to pay interest or principal.[77]

There was also the possibility that the South's powerful representation in Congress might retaliate against a state that brought an action on the defaulted bonds. As the CFB noted, Southern senators were always careful to amend treaties so has to have a Senate veto on subjects to be submitted for international arbitration such as defaulted Southern state bonds.[78] In 1897, for example, Georgia's senator Augustus O. Bacon had the Senate amend the Olney arbitration treaty to state "nor shall any claim against any state of the United States alleged to be due to the government of Great Britain or to any subject thereof, be a subject of arbitration under this treaty."[79] Likewise, in 1911 Bacon convinced the Senate to add a reservation to the General Arbitration Treaty with Great Britain that the treaty did not concern "the question of the alleged indebtedness or monied obligation of any State of the United States."[80]

As door after door to American courts closed to collection efforts, the CFB took other steps to collect on repudiated bonds. The corporation decided on a two-pronged attack. It would make attempts to renegotiate the bonds by offering more favourable payout terms, while continually insisting on the full payment of principal and interest. At the same time, pressure would be kept on the repudiating states by ensuring that they would not be able to float new bond issues in world bond markets, especially in London or New York, until payment on repudiated bonds was renewed. The records of the CFB are replete with references to various attempts to

[74] *McGahey v. Virginia* 135 U.S. 662 (1890); see also *Poindexter v. Greenhow*, 114 U.S. 269 (1885).

[75] *North Dakota v. North Carolina*, 192 U.S. 286 (1904).

[76] Orth, *Judicial Power*, 84.

[77] W. L. Raymond, *State and Municipal Bonds* (Boston, 1923), 12–13.

[78] Council of Foreign Bondholders, *The International Aspect of the Debts of the State of Mississippi Repudiated Before the Civil War*, (London, 1931), 6.

[79] US Congress, Arbitration treaty with Great Britain, 58th Cong. 3rd sess., S. Doc. 161, 26.

[80] US Congress, Report of the Committee on Foreign Relations . . . general arbitration treaties with Great Britain and France . . ., 62nd Cong., 2nd sess., S. Doc. 98, 29.

obtain reasonable settlements with the defaulting Southern states. In the mid-1870s, the CFB worked with representatives from the state of Arkansas, while in June 1883 holders of Mississippi bonds held a meeting at the headquarters of the CFB and passed a motion asking bondholders to deposit their bonds with the CFB to give the organization "a direct right of representation."[81]

An example of the willingness of British investors to work out some kind of restructuring of the bonded indebtedness can be seen in their contacts with the state of Alabama. In 1874, after a Democratic redeemer government came to power, the Alabama legislature authorized the appointment of a commission to liquidate and adjust all claims against the state arising from Reconstruction era bonds. In March 1875, the secretary of the CFB wrote to the commission in the hopes that "through your exertions an equitable adjustment of the Debt of Alabama may be arrived at, and the credit of the State thus be restored."[82] Two months later the CFB secretary forwarded to the commission the names of over one hundred British investors in Alabama bonds and the particulars of those investments. He even invited the state to send one of the commissioners to meet with bondholders in London, where "no doubt but that your representative will be met in a fair spirit by the Bondholders."[83] These efforts were again to little avail. In 1876 Alabama enacted a funding act that repudiated over $4 million in railroad bonds and restructured other debt to the disadvantage of bondholders. British investors were outraged. London investor James Spear reacted by writing to the commission that Alabama's actions were "monstrous." According to Spear, if carried out, the state would be placed "alongside the Bankrupt States of South America." He went on to assert that the result would be "all England against you" and that the state would never again be able to use the London market.[84] Although such frustration was understandable, many investors continued to believe that a restructuring was still the best route to recovering the debts. As late as 1883, Alabama's New York agent, Duncan Sherman & Co., wrote to Governor David P. Lewis that it had received a note from Somerset Beaumont, a member of Parliament and of the CFB, and that "bondholders in Europe are very anxious to receive some proposition & would unite in what could be reasonably asked of them."[85]

By far the most potent weapon the CFB had to punish defaulting states was to force financial exchanges to refuse to carry quotes on new issues, thus making the floating of new issues difficult, if not impossible. This practice actually predated the formation of the CFB in 1868. Since as early as 1827, the London Stock Exchange and other continental exchanges refused to allow quotations on new loans while an old one was in default. As a result, the exchange boycott forced a number of governments to accommodate with creditors of defaulted obligations in order to gain readmission to the market.[86] As Southern states began to default in the 1870s, the reaction in London was quick. In 1872, for example, the

[81] *The Times*, 1 November 1880; *Money*, 13 June 1883.
[82] Hyde Clarke to the Commission, 25 March 1875, Bond administration files, SG 8096, ADAH.
[83] Hyde Clarke to the Commission, 8 May 1875, Bond administration files, SG 8096, ADAH.
[84] James Spear to Commission, January, 1876, Bond administration files, SG 8096, ADAH.
[85] Duncan Sherman & Co. to Governor David P. Lewis, 7 April 1883, Bond administration files, SG 8096, ADAH.
[86] Victor E. Morgan and W. A. Thomas, *The Stock Exchange: Its History and Functions* (London, 1962), 93.

London Stock Exchange notified the governor of Florida that until the defaulted debt was adjusted, no Florida bonds would be sold on the exchange.[87]

By the 1880s the Southern states realized that it was pointless to attempt to issue new bonds. Many of the Southern states had as well passed constitutional amendments severely limiting the power of the state to borrow. Yet as the new century began, the South realized the impossibility of any real economic progress without the use of credit and hoped that enough time had passed to allow repudiations and defaults to be forgotten. The CFB rudely disabused them of this hope. In 1910 the states of Mississippi and North Carolina tried to float new bond issues, Mississippi's for a total of $600,000 at 4 percent interest. The CFB immediately issued a warning in the British press pointing out that both states were in default on previous obligations. Mississippi did not receive a single tender.[88] According to the CFB, North Carolina could only place its issue locally by putting pressure on local textile mills' banks and by using methods that "would appear to be more in keeping with the middle ages than the present century."[89] The state tried again in 1911 with a $1.25 million issue, but it met with the same results. With the exception of one American insurance company, the state did not receive a single tender in either New York or London. The CFB report derisively explained that the issue was "eventually taken up by a group of bankers in the neighbouring—and defaulting—State of Louisiana."[90]

While the London market was important, the CFB knew that the New York exchange's support of any boycott of new Southern state issues was essential. While the New York exchange did not have a specific rule like the London and continental exchanges against listing new issues by defaulting states, the exchange followed the practice.[91] For years, CFB efforts in this regard had been helped immeasurably by a New York law that did not permit its savings banks to invest in securities of states that had defaulted in debt payments within the last ten years. With New York savings banks making some of the largest investments in state bond issues, such a prohibition made the floating of bonds by defaulted Southern states virtually impossible. But in 1913, when the state of Louisiana floated a new issue, the attorney general of New York abruptly issued an opinion that the Louisiana bonds did not come under the category of a state debt, an opinion the CFB said was so remarkable as to need no comment.[92] An outraged British financial press responded vehemently. The *Financial Times* reproduced a facsimile copy of an actual defaulted Louisiana "Baby Bond" (it had a picture of a young child on it) and pointed out the language on the bond pledging the full faith a credit of the state. "Perhaps Mr. Woodrow Wilson, the new President," the *Financial Times* asserted, "will find time to direct attention to this disgraceful state of affairs,

[87] McGrane, *Foreign Bondholders*, 302.

[88] "The Honour of Mississippi" (pamphlet signed by *Financial Times*), Council of Corporation of Foreign Bondholders, *The Newspaper Cuttings Files of the Council of Foreign Bondholders*, Untied States (General) 1871–1901, 1913–1931, 10:54.

[89] Corporation of Foreign Bondholders, *Defaulted Debts of the Southern States of the United States: Extracts from the Annual Reports of the Corporation of Foreign Bondholders* (London, 1925), 12.

[90] Ibid., 19.

[91] Borchard, *State Insolvency*, xxiv.

[92] Corporation of Foreign Bondholders, *Defaulted Debts*, 18.

which his two predecessors, while lecturing Central American Republics for not observing their financial obligations, conveniently overlooked."[93] Even with the New York attorney general's change of mind, the 1913 Louisiana issue failed. The *Daily Dispatch* observed that the CFB warning "has evidently had its effect," and the *Financial Times* gloated that it was only through "such humiliating experience as this that defaulting states can be brought to understand that the investors' views of credit do not coincide with the state's own depraved ideas of financial honesty."[94]

Yet the story was not over. The New York legislature, despite vigorous protest by the CFB, amended the state statute to allow savings banks to invest in the securities of states that had not defaulted since 1878.[95] Clearly American investors were changing their views about the risk of new Southern state obligations. The South was beginning to witness a new era of prosperity, and many investors saw an opportunity for profits through the extension of credit. The CFB nevertheless persisted in its efforts. In May 1914, Edward L. Andrews, the American CFB counsel, asked the New York Stock Exchange to continue to request bankers "to refuse to participate in the purchase and negotiation of new issues by these defaulting States, until those Governments agree to arbitrate on their defaulted debts."[96]

The first phase of attempts by the British to collect on Southern state debts was a period of missed opportunities. Over and over again, the British showed a willingness to renegotiate the terms of the debts, while at the same time refusing to waver in their insistence that the full amount of the principal be repaid. To their own detriment, Southern states rejected these offers and thereby denied themselves badly needed credit and the economic progress such credit represented. Good faith negotiations by both parties might have easily resulted in an equitable settlement whereby the British would have collected their debts, or at least a large portion of them, and Southern states would have had access to credit they desperately needed for economic development.

■ ■ ■

The prospects for British investors in the defaulted Southern state bonds looked far from promising when the First World War broke out in August 1914. Some new bond issues by defaulting states had been blocked, but the clear trend among American investors was to allow new issues. The British knew that if this trend continued, one of their strongest collection tools would soon be lost. The war, however, presented investors with a new opportunity for collection, paradoxically, because of the debt Britain incurred to the United States during the course of the war. Would a setoff be possible?

"The Council of Foreign Bondholders," *The Times* declared after the war ended, "has the chance of a lifetime to add to the good work it has quietly done in the past."[97] During the course of the conflict, Britain borrowed approximately $4.6 billion (£920 million). In return, the British government provided the US Treasury with "certificates of indebtedness," for which the secretary of the Treasury set an

[93] *Financial Times*, 4 April 1913.
[94] *Daily Dispatch*, 2 April 1913; *Financial Times*, 22 April 1913.
[95] Corporation of Foreign Bondholders, *Defaulted Debts*, 20.
[96] Quoted in *Daily Telegraph*, 21 May 1914.
[97] *The Times*, 5 May 1921.

interest rate of 4.5 percent.[98] At the conclusion of hostilities, repayment of the loans remained at an impasse until Congress established the World War Foreign Debt Commission in 1922. Chancellor of the Exchequer Stanley Baldwin led a British delegation to Washington in January 1923 to begin negotiations.

In the initial phase of negotiations to repay British war debts, the CFB had no false hopes about the possibility of including some type of setoff for defaulted Southern state bonds in the final agreement. In 1919, James D. Cooper, secretary of the CFB, wrote to an American businessman, Marcus H. Burnstine, "I confess I do not see, as matters stand at the present, there is much scope for cooperation between the American and British interests."[99] Three years later, just after Congress provided for the Debt Commission, Cooper was no more hopeful than he had been earlier. "It seems to me that the assumption by the United States Government of the payment of any or all of these repudiated State Debts," he frankly admitted, "is a most improbable event and in any case, that it would be a pure act of grace on their part."[100]

The British press, particularly the more nationalistic papers, however, was keen on the idea of a setoff. The *Morning Post* assumed that "recognition by America of these long outstanding debts by defaulting states will be regarded as a very sacred and urgent obligation."[101] "The question that may well be asked now," said the *Daily Express*, "is that why the British Government, especially in view of America's sermons to us regarding how we should meet our debts, does not take the whole matter in hand and bring pressure to bear on the American States whose long outstanding defaults are not only a disgrace to the States themselves, but to America as a whole."[102] *John Bull* asked, "I wonder how the Yankees would like it if the British Government started to quibble about paying its 850 millions of war debt until these old scores were settled?" The advantage, according to *John Bull*, was that if such a position was adopted, "we have lawyers clever enough to keep the wrangle going till the crack of doom."[103]

The British government was not about to attempt such a tactic. In the eyes of the government, the debts owed British investors by defaulting Southern states were private debts, and while the government might be sympathetic to private collection efforts, it had no intention of letting the issue disrupt delicate and difficult negotiations with the United States over the repayment of war debts. Even the CFB secretary recognized the Foreign Office was in a "difficult position."[104] The British government reached a final agreement with the Americans in January 1923 to pay the $4.6 billion war debt over sixty-two years. The agreement did not mention any setoff for defaulted Southern state debts. With this settlement, the CFB was

[98] Self, *Britain, America and the War Debt Controversy*, 15, 18.

[99] James Cooper to Marcus H. Burnstein, 26 August 1919, Correspondence of the Corporation of Foreign Bondholders, USA, Correspondence out letters, item 3 (1919–1926), MS 34806, Guildhall Library.

[100] James Cooper to T. Oldroyd, 8 August 1922, Correspondence of the Corporation of Foreign Bondholders, Correspondence out letters, item 3 (1919–1926), MS 34806, Guildhall Library.

[101] *Morning Post*, 3 May 1921.

[102] *Daily Express*, 16 March 1922.

[103] *John Bull*, 26 March 1921.

[104] James Cooper to Maj. Gen. F. Lorn Campbell, 11 July 1923, Correspondence of the Corporation of Foreign Bondholders, Correspondence out letters, item 3 (1919–1926), MS 34806, Guildhall Library.

ready to give up on the idea of setoff. James Cooper confidentially wrote two months after the signing of Anglo-American war debt agreement, "We fear any chance of the Government of the United States accepting the repudiated Debts of the Southern States as a set off against England's Debt to her is impossible as scarcely to call for discussion."[105]

The immovable object that investors had reached in their attempt to force some type of setoff of defaulted Southern state debts against British war debts was no longer the US government directly. It was the British government. Even though the issue was raised again and again in Parliament, successive British governments, even when sympathetic with the plight of investors, refused to budge in their insistence that the debts were a private matter.

The issue seemed to be dead by the mid-1920s, when, surprisingly, an American gave new life to the debt setoff scheme. In January 1925, Raymond Turner, professor of history at Johns Hopkins University, wrote a widely publicized article in *Current History* reviving the idea of the justice of a setoff of repudiated state debts against British war debts.[106] Turner carefully established that none of the debts were incurred by the Confederate States of America but were loans "made to the Governments legally constituted for the time being." The South had repudiated its debts with justification similar to the way "repudiation of Russian debts was justified by the Bolsheviki." The great injustice was that creditors, due to the Eleventh Amendment to the US Constitution, had no legal recourse. "It is difficult for the foreigner to see justice in this situation," observed Turner. To the foreigner, "if it is the Constitution of the United States that makes it impossible on occasion to collect debts owed by parts of the Union, then the United States should itself become responsible for payment." More than that, Turner saw the hypocrisy in demanding full payment from the British for war debts, "when they are staggering under terrible taxation, hard times, and have a greatly lowered standard of living." The article ended with ringing questions. "Are not people in the South to raise this question again, and do what should honorably be done? Or is there not some statesman of integrity and independence at Washington, with eyes raised above the level of what is merely expedient for himself, who will lead the way?"

The Turner article received wide publicity and the *Financial News* republished it in September 1926.[107] Turner's call for repayment did not go unchallenged. The next year the academic debate heightened when University of North Carolina professor of history J. G. de Roulhac Hamilton published a response in the *Virginia Quarterly Review*. Hamilton, a prominent "lost cause" historian, admitted that bonds issued before the Civil War should be paid "regardless of the irregularities of issue." Reconstruction era bonds, however, were an entirely different case. According to Hamilton, "all the world at the time" knew the circumstances of the issuance of the bonds and the possibility they might be repudiated. The low market price for the bonds at the time "indicated the lack of public confidence in their ultimate value." Drawing an analogy to the Great War, Hamilton stated that, if it was necessary to require the

[105] James Cooper to Marcus H. Burnstine, 23 April 1923, Correspondence out letters, item 3 (1919–1926), MS 34806, Guildhall Library.

[106] Raymond Turner, "Repudiation of Debts by States of the Union," *Current History* (January 1926): 475–83.

[107] *Financial News*, 23 September 1926.

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South to pay Reconstruction era bonds, "[i]t would be quite proper to hold Belgium responsible for debts that might have been contracted in her name by the German invading army."[108]

The Turner article was only part of a growing sentiment among the American investment community that something should be done about the defaulted Southern state debt. The CFB annual report for 1925 stated that "the feeling is growing in America that this state of things cannot be allowed to continue."[109] Perhaps in response, the Association of British Chambers of Commerce suddenly became involved in the controversy and in April 1926 passed a resolution drawing the attention of the US government to the states that were in default and expressing hope that it would take measures to remedy the injustice. Further, the association requested the foreign secretary present its resolution to the American ambassador to Britain.[110] A few months later, the *Financial Times* reported that the defaulted bonds had once again become a live issue and bondholders "may even experience a mild flicker of hope." The *Financial Times* directly attributed this to the recent efforts of the Association of British Chambers of Commerce, "which body passed resolutions last April and took steps to have them brought to the notice of the American Government."[111]

In 1928 the CFB took the extraordinary step of hiring what would today be called a "publicity agent" to promote its cause. Ernest F. Barry of Boston, Massachusetts, was annually paid the handsome sum of 200 guineas for only part-time work.[112] Barry based his campaign on increased media attention and solicitation of Congress and the Treasury. He also made contact with American holders of repudiated bonds to coordinate collection efforts. In addition, he kept an eye on state governments, particularly Mississippi, and urged them to negotiate at least partial payment. The level of publicity about the defaulted bonds increased after the CFB hired Barry, and there was a great deal of truth in Barry's report to the CFB in 1930 that "the question of these repudiated debts is receiving much more attention generally in America and that Government officials are beginning to find the topic a troublesome one."[113] The Scripps Howard newspaper chain started a public campaign in early 1928 to repay the Southern state debts. Other newspapers joined in. Even Colonel Robert McCormick's strongly anti-British *Chicago Daily Tribune*, in a lead editorial titled "Let Us Pay and Be Done with It," argued that the US government itself should pay off the defaulted bonds and "should not quibble over technicalities." The final amount should be decided by the two governments, he wrote.[114] Barry frequently advised the secretary of the CFB of the ins and outs of the American press. In one letter he noted that,

[108] J. G. de Roulhac Hamilton, "Those Southern Repudiated Bonds," *Virginia Quarterly Review* 3 (1927): 501, 504–05.

[109] Corporation of Foreign Bondholders, *Defaulted Debts*, 30.

[110] *The Times*, 24 April 1926; Minutes of the Council of Foreign Bondholders, vol. 7 (1917–1929), MS15749, Guildhall Library (hereafter cited as CFB Minutes 1917–1929), April 29, 1926, 242–43.

[111] *Financial Times*, 26 September 1926.

[112] Minutes of Council of Foreign Bondholders, vol. 8 (1929–1938), MS15749, Guildhall Library (hereafter cited as CFB Minutes 1929–1938), 30 April 1932, 66–67.

[113] Ibid., 30 October 1930, 48.

[114] *Daily Express*, 23 May 1928; *Chicago Daily Tribune*, 15 February 1928.

while the *Christian Science Monitor* had wide circulation, the *New York Times* "also reaches all *financial houses*, and should not be overlooked."[115]

Another boost to the campaign for payment of the defaulted bonds came with an article in *Foreign Affairs* by a prominent professor of government at Yale University, Charles P. Howland.[116] As Howland pointed out, under the Anglo-American war debt settlement, British payments were to be made to the United States for over sixty years. If the British continued to honor their debts, why not simply credit the British for the unpaid bonds against the last payments? In this way, "no American taxpayer living would know any difference." Although Howland was not familiar with the term "moral hazard," he did realize that there might be some risk in the federal government assuming the debts of individual states. To answer this possible problem, Howland suggested the US government could take assignment of the bonds and itself bring a suit in the Supreme Court to fix the amount of the states' liability and collect, for the Constitution does not protect individual states from action by the federal government. However, the possibility of creating a "moral hazard" by even the outright assumption of the Southern states' debts would have been minimal. This was a unique situation in which the debts would not technically be assumed but only be used as an offset to British debts, and such action could hardly be used as a precedent for the outright assumption of any future state defaulted debt. Howland's plan unfortunately never reached the point of discussion in Congress.

Barry's publicity campaign was also apparently raising some interest in the American financial community. A representative of the National City Bank of New York approached the CFB in 1928, intimating that "interest had been shown in unspecified official quarters in the United States as to whether the council would favor a settlement of repudiated Southern States' debts by set-off against War-Debt payments." The council welcomed "any equitable settlement" but said that it would be necessary to consult the British government.[117] At about the same time, the CFB received an inquiry from a representative of Guaranty Trust Company of New York asking what the council might expect in the way of a settlement of the state of Mississippi debt. The council observed that, while these two inquiries "took place quite independently of each other," "[t]he spontaneity and close coincidence of the two overtures indicate that at last their case was receiving serious consideration in America."[118]

As has been pointed out, the CFB efforts to prevent the New York exchange from carrying bonds of the defaulting states, even those originating before the Civil War, were beginning to fail. This, however, did not prevent the CFB from continuing to attempt to have such new issues receive unfavorable ratings. Here again we see the hand of the CFB's agent Barry. When the state of Mississippi attempted to float a new issue in 1930, Barry pleaded with Moody's Investors Service to lower its initial favorable rating for the bonds. The problem, of course, was that attitudes

[115] Ernest F. Barry to D. Reid, 2 December 1930, Correspondence of the Corporation of Foreign Bondholders, file 3 (1930–1931), MS 34818, Guildhall Library (hereafter cited as CFB Correspondence 1930–1931).

[116] Howland, "Our Repudiated Debts."

[117] CFB Minutes 1917–1929, 25 October 1928, 321–22.

[118] Ibid.

toward the South were changing, and many in the American financial community, contrary to what some newspapers and academics argued, believed it was time to forget past indiscretions. A. W. Wallace of Moody's responded to Barry's plea, stating that while it was true Mississippi had repudiated bonds years ago, "it is nevertheless true that the state has enormous resources and is well able to provide for its recognized obligations." Wallace went on to criticize what he saw as the CFB's attempt to use Moody's to collect debts. "We wish to assure you that we are in sympathy with the cause for which you are working," he wrote, "but to be frank we do not feel that our ratings can be used in pushing this Cause."[119]

In a further attempt to learn why financial houses had taken up the recent Mississippi bond issue, Barry met late in 1930 with Frank H. Morse of Lehman Brothers. Morse explained that to some extent partners in Lehman Brothers believed that, if they did not take the issue, other houses would. Moreover, he revealed that one partner, Herbert Lehman, planned to run for governor of New York and was a friend of the then governor, Franklin D. Roosevelt, who was candidate for president. Both men, Morse explained, "simply cannot afford politically to jeopardize their chances by alienating the sympathies of Mississippi, a Democratic state."[120]

When the Great Depression hit in 1929, Britain's payments to the United States became harder and harder for the government to make. The difficulty in balancing a budget while having to make large payments to America led to even more interest in calling for a setoff of balances due on repudiated Southern state bonds. A letter to *The Times* signed a "widow" lamented the fact her recently deceased husband held defaulted Mississippi bonds that, if not repudiated, could have been used to pay high death duties ironically caused in part by the need to pay off American war debts.[121] The CFB continued to keep the issue before the public eye with numerous publications, including *The Federal Aspect of the Debts of the State of Mississippi Repudiated Before the Civil War* published in 1930. Many nations were beginning to weaken in their resolve to pay war debts to the United States, and in this publication the CFB was quick to point out America's hypocrisy in demanding payment in full while Southern states had yet to pay their debts. This was particularly galling when "politicians from repudiating states, including Mississippi, have in recent years taken a leading part in demanding collection of the War Debts 'up to the limit of the capacity to pay.'"[122]

The high point of the movement to demand a setoff of repudiated Southern state debt against American war debt came in March 1930 when the House of Lords took up the issue.[123] In what was one of the most extensive debates in the House of Lords during the interwar years regarding relations with the United States, Lord Redesdale raised the question of "whether, having regard to the heavy annual payments now being made by His Majesty's Government to the United States Government," the government had any intention of raising the issue of the repudiated Southern States' debt "with a view to its early adjustment."

[119] A. W. Wallace to Ernest F. Barry, 23 December 1930, CFB Correspondence (1930–1931).

[120] Ernest F. Barry to D. Reid, 1 January 1930, CFB Correspondence (1930–1931).

[121] *The Times*, 24 March 1930.

[122] Council of Foreign Bondholders, *The Federal Aspect of the Debts of the State of Mississippi Repudiated Before the Civil War* (London, 1930), 7.

[123] *Parliamentary Debates, Lords*, 5th series, vol. 76 (1930), cols. 862–66.

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Urging the repayment of the defaulted bonds, the Earl of Limerick reminded his peers that the loans resulted "solely from the free contractual relations" of the lender and the states "at rates of interest proper for such times and risks." The Southern states were repudiators and, to the Earl of Limerick, nothing was so low. "If 'default' is an ugly word, what shall be said of 'repudiation'?" he demanded. In one of the more telling points raised in the debate, he described how the US government had itself collected on repudiated Southern state bonds that it had purchased. Finally, he quoted American president Warren Harding on the issue of the British war debts. "'The call for the world today,'" said Harding "'is for the integrity of agreements, the sanctity of covenants, the validity of contracts.'" The earl concluded, "Our case could not be put better."

The parliamentary secretary of the Ministry of Transport, Lord Ponsonby of Shulbrede, responded for the government. According to the government, the states' bonds were "loans made by foreign individuals to State Governments in which the Federal Government was in no way concerned," while the war aid was "a loan granted by the United States Government." Lord Ponsonby's main criticism was of the timing of the issue being raised. The World Disarmament Conference was at that moment being held in London, and Lord Ponsonby thought it "most unfortunate" proponents of repudiated bond debt collection chose this time to attack the United States and that speeches should be made of "this very critical character and epithets used of rather a grave kind," including comparisons to debt repudiation by Russia.

The debate ended with no action being taken, and the issue was never again raised in the House of Lords. Although it had been hoped that the debate would be given wide publicity and would aid in collection efforts, and this did occur to some extent in Britain, this was not the case where it mattered most—America. The *Morning Post* reported from Washington that there was little interest in the House of Lords debate, and it "barely received passing mention in the press." More important, the paper observed that the question of the repudiated state debts "is treated in Congressional and Administrative circles here as of mere archaeological interest."[124]

As the Lords debated the issue, Barry, the CFB American, was actively working the halls of Congress and calling on government officials. To no avail, the CFB brought its case before the National Commission of Law Observance and Enforcement, appointed by President Herbert Hoover in May 1929.[125] In May, Barry met with an undersecretary of the Treasury to put forward the CFB claims, stating that he desired to "remove a thorn from Anglo-American relations." The Treasury official disappointingly responded by again setting forth the American position, as Barry reported, telling him that "the Federal Government considers itself no more responsible for Mississippi's debts than for those of, say, the city of Lynn, Mass." In response, Barry pointed out that, unlike the defaulting Southern states, the city could be sued.[126] That summer, the American CFB agent urged the secretary of the CFB to write a letter to the chairman of the Conference of Governors and reported that the letter sent "is quite effective, and will, I think, call forth some

[124] *Morning Post* (London), 15 March 1930.

[125] Council of Foreign Bondholders, *Federal Aspect*, 1–2.

[126] Ernest F. Barry to George James, United States Treasury, 20 August 1930, CFB Correspondence 1930–1931.

formal reply at any rate."[127] In July, Barry wrote the CFB that "Senator A. W. Barkley of Kentucky would certainly be worth sending pamphlets to, and perhaps a covering letter."[128] By the end of the year, however, Barry understood the politics of the situation and the impossibility of expecting any favorable congressional action. He frankly told the CFB that his sources in Washington had reported "that there appears to be no single one who sees any *advantage* in mooting or handling this question, however much they may agree as to the rights of the case." The bottom line was, "[t]hey have no interest in it *politically*."[129]

With a deepening economic depression, the more important issue soon became whether or not Britain could honor its war debts. Despite frantic negotiations, the American government remained as intransigent as ever on full payment. During this period, the hope of British investors for a setoff became less and less realistic, yet it never died. In 1932 a member of Parliament asked the chancellor of the Exchequer, Neville Chamberlain, whether or not he intended to raise the issue of the American debt the next time the British debt was to be discussed with the United States. Chamberlain frankly stated, "I see no advantage in pursuing this suggestion."[130] When Prime Minister Ramsay MacDonald returned from negotiations in Washington in 1933, an MP asked if the repudiated Southern state debts had been raised, to which the prime minister responded that they had not.[131] Finally, in June 1934 the British government decided to suspend all further payments on the American war debt. With this decision came the final end of investors' hopes of collection through a setoff. Yet, even though defeated in their setoff strategy, the CFB and investors still had one more avenue to pursue in their collection efforts. That avenue lay in detouring around the legal and political roadblocks to find a third party that would bring suit in American courts on the bonds.

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The CFB and other interested parties would not give up on the attempt to create some basis for responsibility of the US government to pay on the bonds. The CFB was heartened in 1927 when the Institute of International Law passed an article that called for a federal government to be responsible for the conduct of its separate states. According to the CFB, this rule "appears to support the Bondholders' views on Federal responsibility."[132] Further good news on the international law front came in 1930 when the British government took the position at the Conference on the Codification of International Law meeting at the Hague that "[a] Government which is the appointed organ for the conduct of foreign affairs of other units cannot evade responsibility by alleging that constitutionally its powers of control over these units are inadequate to enable it to enforce compliance with international obligations."[133] It is unclear exactly why the government chose to take a position that seems to contradict the stance taken in the House of Lords debate and the posture

[127] Ernest F. Barry to D. Reed, 1 July 1930, CFB Correspondence 1930–1931.
[128] Ernest F. Barry to D. Reid, 15 July 1930, CFB Correspondence 1930–1931.
[129] Ernest F. Barry to D. Reid, 9 December 1930, CFB Correspondence 1930–1931.
[130] *Parliamentary Debates*, 5th ser., vol. 261 (1932), cols. 1025–26.
[131] *Parliamentary Debates*, 5th ser., vol. 278 (1933), col. 30.
[132] Council of Foreign Bondholders, *International Aspect of the Debts*, 3.
[133] CFB Minutes 1929–1938, 24 April 1930, 26–27.

assumed in responding to questions in the Commons regarding war debt setoff proposals. In these statements, the government readily accepted the American position that the defaulted state debts were in no way the responsibility of the US government. The council of the CFB recognized this contradiction, but it offered no explanation.[134]

Efforts to have international law forums recognize some responsibility of the US government might have cheered the CFB and investors, but such efforts did not lead to debt collection. A more promising avenue might have been to get another state of the Union to sue on the debts. As previously noted, this method had been successful once in 1904, but getting states to be plaintiffs against Southern states had previously proved impossible. Yet the CFB knew that, as the 1907 CFB report stated before the war, "the only way to test in the Courts the question as to the legal responsibility of Southern States for their repudiated Debts is to induce some other State or Government to become a plaintiff in the action."[135] In 1916, an unidentified source proposed to the council of the CFB that 25 percent of the Mississippi bonds be donated to a state bringing a case against Mississippi. "As considerable doubt was felt with regard to the standing of those interested in the matter as to the ability to carry out the case through to a successful issue," the council of the CFB requested more information, which was not forthcoming.[136] In April 1928, the state of Connecticut sued North Carolina but later withdrew the case because of "the threat by North Carolina that she would oppose certain claims by Connecticut against the Federal Government."[137]

If a state of the Union could not be induced to bring an action against a defaulting state, what about a foreign nation? An early attempt to bring this about took place in 1916 when Cuba sought leave of the US Supreme Court to bring suit against North Carolina for $2 million in principal and interest on defaulted bonds.[138]

The CFB had planned the entire action. The bonds on which the action had been brought were received by Cuba through the CFB. Before the case could be adjudicated, however, North Carolina senators succeeded in getting Cuba to withdraw the petition though diplomatic pressure.[139] The council of the CFB discussed a possible test case by a European nation in 1928. According to the plan, the unnamed country would be sold an option to acquire a substantial holding of similar bonds held on deposit by the CFB, "the purchase price to be paid as a fractional extent in cash, and for the greater part in bonds or notes of the State falling due three years later." The option would only be exercisable "after a decision had been obtained on all relevant legal and material points of the test case."[140] Complications regarding title of bonds and other issues scuttled the plan.

Perhaps the strangest episode in the CFB's many years of debt collection attempts began in 1929 when the relative of a ruling European sovereign approached the council. His family members were large holders of defaulted Mississippi bonds. As

[134] Ibid.

[135] Corporation of Foreign Bondholders, *Defaulted Debts*, 3.

[136] CFB Minutes 1917–1929, 25 April 1917, 11–12.

[137] *Financial Times*, 12 April 1928; CFB Minutes 1917–1929, 26 July 1928, 309–10.

[138] *Republic of Cuba v. State of North Carolina*, 242 U.S. 665 (1917).

[139] Ratchford, *American State Debts*, 240; Orth, *Judicial Power*, 86.

[140] CFB Minutes 1917–1929, 26 April 1928, 297–98.

reported to the council, his "family were attempting to obtain the interest of the Sovereign, whose personal fortune also contained holdings."[141] The contact, later revealed in council minutes, was Mr. Del Drago, grandson of the dowager queen Christina of Spain. His brother was an Italian prince "and acquainted with the independent Republic of San Marino." With Del Drago's urging, an action could be brought by San Marino against an American state on defaulted bonds. Of course Del Drago would be paid a fee keyed to the amount of the recovery, a "legitimate practice in America."[142] The council saw immediate advantages in such an action over earlier test case schemes. First, it would be brought by an original bondholder and not a speculator. Second, it would be an action by a European state "outside the vagaries of American politics." Third and finally, "a comparatively minor percentage of the recoveries would suffice to satisfy this small state."[143]

All efforts of the CFB to get a foreign state to collect came to naught in 1933 when the US Supreme Court handed down its ruling in *Principality of Monaco v. State of Mississippi*.[144] In this case, Monaco attempted to bring an action against Mississippi on a number of pre–Civil War bonds that had been given to the principality. Under the terms of the gift, any proceeds collected could be used "[t]o the causes of any of its charities, the furtherance of its internal development of the benefit of its citizens as it may effect." The Supreme Court denied leave to Monaco to sue, holding that a state of the Union is immune from suits brought against it by a foreign state without its consent. With states of the Union reluctant to bring actions against their sister states and now foreign states barred from action, the doors of American courts were now closed to any attempt of investors to seek recovery of their debts.

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The British war debt controversy weakened Anglo-American relations during the critical period of the 1930s. The broader context of the debtor-creditor relationship of the two nations over the previous century readily reveals lost opportunities to reduce those tensions between America and Britain years before.

It is important to recognize the economic harm done to the American South as a result of the repudiation of the region's debts, even though that damage was only one of many factors contributing to Anglo-American tensions in the 1930s. Bond defaults by Southern states in the 1870s caused British investors to lose all enthusiasm for American securities "once and for all," ending the foreign market for American state bonds.[145] This was not good news for the South, which badly needed market-rate credit for at least the next half century, a need that would be accentuated by the region's continued inability to catch up economically with the rest of America. As late as 1938, the Roosevelt administration's famous *Report on Economic Conditions of the South* declared that "the South has not yet been able to build up an adequate supply of credit—the basis of the present-day economic system."[146] Sadly, the door to London, the "undisputed money market center of the world," was closed

[141] CFB Minutes 1929–1938, 31 October 1929, 16.
[142] CFB Minutes 1929–1938, 21 July 1932, 104.
[143] Ibid.
[144] *Principality of Monaco v. State of Mississippi*, 292 U.S. 313 (1933).
[145] Wilkins, *History of Foreign Investments*, 137, 187.
[146] The National Emergency Council, *Report on Economic Conditions of the South* (Washington, 1938), 52.

to the region. Widespread bitterness over Reconstruction made any Southern state government's consideration of renegotiation of defaulted loans next to impossible, even if in its own best economic interest. Any admission of the validity of the debts would contradict the accepted narrative among Southerners of the absolute evil of "carpetbag" governments. This stubborn refusal to renegotiate provided the CFB with a legitimate excuse to block the South from using important credit markets.[147]

The Southern states, of course, found other lenders, since they could not survive without credit. Between 1912 and 1932, the South's proportion of the national total of public debts actually grew from 15 percent to 23 percent. Yet as has been shown, such loans could be obtained only at above-market rates because of the Southern states' credit histories and the CFB limiting the markets listing their securities.[148]

Prior to the First World War, the Southern states' own best interests would have been best served by cooperating with the British investment community. Time and time again, the British offered to renegotiate the terms of the indebtedness of Southern states, only to have such offers summarily rejected. By renegotiating and then repaying the defaulted and repudiated debts on favorable terms to both parties, badly needed cheap credit would have opened to the South. Northern investors would have had to compete with British investors for Southern state loans, in turn reducing the interest rate charged. With such new and expanded credit, the South could have had a more rapid economic recovery and emerged less dependent on the North. As it was, the Southern economy, especially its industry, became overwhelmingly dependent on Northern creditors and ultimately owners.

Despite damaging the South's economy for decades, the defaults were never a direct issue of dispute between the British and American governments. From the early nineteenth century, the British government's position was clear and consistent. Englishmen who invested abroad were seen by their government as doing so for their own profit, more likely for a higher rate of return, and were acting independently of the interests of the nation. As a result, the government believed it had no responsibility to assist in collecting such investments if they failed.[149] Likewise, the American government's position was never in doubt. The debts of the Southern states were not the debts of the federal government, and the United States could not legally force the individual states to pay their debts.

Although specific arguments between the two governments over the defaulted Southern state bonds never materialized, members of Parliament and the financial press made repeated calls for their government to challenge the United States on this issue, particularly in response to the United States' repeated demands for payment of Britain's war debt. The unpaid debt of the American states was the subject of one of the most lengthy debates concerning the United States in the House of Lords during the interwar years. The long historical context of the defaults helped form the negative impression of the United States among British leaders at the time. As Neville Chamberlain and other leaders attempted to renegotiate the

[147] Wilkins, *History of Foreign Investments*, 156, 618.
[148] B. U. Ratchford. "Public Debts in the South," *Southern Economic Journal* 2 (January 1936): 15.
[149] Platt, *Finance, Trade, and Politics*, 41.

British war debt, they did so against an economic legacy of defaulted American state bonds. These defaults had not been forgotten. Reginald McGrane in *Foreign Bondholders and American State Debts* reported in 1935 that "[c]reditors in Europe are no more willing to give up all hope of receiving payment than the government and the people of the United States are of collecting war debts."[150] Many British political leaders found America's insistence on the full repayment of the war debts, combined with self-righteous moralizing statements, an irritation to say the least.[151] Most important, these same leaders convinced Chamberlain that he had "the misfortune of dealing with a nation of cads" and confirmed his prejudices against Roosevelt and the United States in a period when cooperation between the two nations was of critical importance.[152]

The United States missed its chance to assuage feelings on both sides of the Atlantic by failing to follow wise suggestions to use Southern state debts as a setoff against the final British payments of First World War bonds. The effects of such a plan for Southern states would have been immediate. With their indebtedness settled, their credit in London would have been restored, opening up renewed credit market opportunities and making possible negotiations of future loans at more favorable rates. From the British standpoint, a setoff of Southern state debts would have had a largely psychological, yet decisive, impact. Even though under a setoff scheme, repayment of Southern state debts lay in the distant future, the British would nonetheless have had the satisfaction that America at long last recognized the fundamental fairness of century-old British claims. Without such setoff, in the eyes of many important British political leaders and financial elite, the United States remained a hypocritical "Uncle Shylock" who had yet to learn that "a Bond never dies."

[150] McGrane, *Foreign Bondholders*, 384. Even as late as 1939, the defaulted bonds were still mentioned in works concerning debts and foreign policy. See James W. Gantenbein, *Financial Questions in United States Foreign Policy* (New York, 1939).

[151] David Dutton, *Neville Chamberlain* (London, 2001), 166.

[152] Robert Self, *Neville Chamberlain: A Biography* (Aldershot, 2006), 190.