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Explaining Latin America's persistent defaults: an analysis of the debtor–creditor relations in London, 1822–1914

JUAN FLORES ZENDEJAS
University of Geneva

This article analyses the reasons why most Latin American governments frequently defaulted on their debts during the nineteenth century. Contrary to previous works, which focused on domestic factors, I argue that supply-side factors were equally important. The regulatory framework at the London Stock Exchange prevented defaulting governments from having access to the capital market. Therefore, the implicit incentive for underwriting banks and governments was to accelerate negotiations with bondholders, particularly during periods of high liquidity. Frequently, however, settlements were short-lived. In contrast, certain merchant banks opted to delay or refuse a settlement if they judged that the risk of a renewed default was too high. In such cases, even if negotiations were extended, the final agreements were more often respected, allowing governments to improve their repayment record.

Keywords: sovereign debt, defaults, underwriting, financial crises

JEL classification: N26, F34, G15, N23

As Latin America obtained independence in the 1820s, the newly established governments became frequent borrowers in London, at that time the main financial centre of the world.[1] The subsequent history of Latin America's indebtedness during the nineteenth century was one marked by frequent episodes of debt defaults. Therefore, the historiography has mainly focused on the reasons behind governments' poor performance in terms of debt repayment. Scholars have emphasised the role of domestic conditions to explain the region's tendency to default.[2] In this article, I argue that the relationships between governments and merchant banks were at least as relevant as borrowers' internal conditions.

J. Flores Zendejas, Paul Bairoch Institute of Economic History, University of Geneva, 40, bd du Pont-d'Arve CH-1211 Geneva 4, Switzerland; email: juan.flores@unige.ch

[1] On the history of international financial centres, see Cassis (2006).
[2] See Dawson (1990) for the first lending boom. Marichal (1989) provides an excellent narrative on nineteenth-century and interwar debt crises in Latin America. Recent overviews on those crises can be found in della Paolera and Taylor (2013) and Flores Zendejas (2016).

The literature on Latin American debt crises during the nineteenth century is abundant.[3] Their frequency has been explained by the region's political instability and persistent state of war (Sicotte and Vizcarra 2009), and its macroeconomic volatility. This volatility was caused, in turn, by Latin America's integration into the world economy, based on exports of its commodities (Prebisch 1922; Ford 1956) and marked by an unfavourable trend of the region's terms of trade (Williamson 2008). Reinhart *et al.* (2016) show that between 1815 and 2015 falling commodity prices were accompanied by reversals of capital flow bonanzas. These double shocks to commodity-exporting countries were historically followed by waves of sovereign defaults.

These works do not consider other external factors related to international financial markets. In this article I focus on the dynamic relationships between merchant banks, bondholders and Latin American governments, and analyse whether conflicts of interest among merchant banks could have contributed to Latin America's persistent defaulting. My point of departure is the literature on the history of stock markets and their regulatory framework.[4] In particular, the regulations established at the London Stock Exchange obliged potential borrowers to settle bondholders' claims before a new loan could be issued. Merchant banks could then collude with borrowing governments, offer investors generous settlement terms on defaulted debt, and then issue a new loan. Given the potential profits that banks could generate from underwriting commissions, the debt settlements that they promoted during lending booms were often short-lived. As we shall see, several loans that were issued in the aftermath of a debt settlement defaulted shortly thereafter.

The general position of nineteenth-century Latin American governments was one of severe financial strain, with very few alternatives to increase their financing sources. Accepting debt settlements, which they were unable to pay, was the norm. This pattern questions the notion of market efficiency as discussed in the literature on sovereign defaults. According to these studies, falling bondholders' losses and declining defaults' duration demonstrate that markets operated more efficiently over the nineteenth century. I posit, on the contrary, that these variables may be misleading under specific contexts. The attitude of the most important British merchant bank for Latin America, Baring Brothers, was to avoid approving debt settlements if it had reasonable doubts about a government's capacity to repay. The period that a government remained in default could therefore be extended, even though the settlement reached had a higher probability to endure.

I provide historical evidence that most debt settlements during the nineteenth century were short-lived, and that many of them were followed by the placement of new government bonds and renewed defaults. I observe that favourable credit conditions – the supply factors – favoured the resolution of debt disputes, even if such

[3] For a comprehensive literature review, see della Paolera and Taylor (2013).
[4] For an excellent summary of this literature, see Kamlani (2008).

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arrangements rarely considered the fiscal position of borrowers. The relations between governments and financial intermediaries were most often short-lived, as they benefited from a one-time collusion at the expense of bondholders and at the governments' own medium-term fiscal costs.[5] However, investors were not passive observers of this structure, and penalised governments' unstable relations with their underwriters through higher borrowing costs.

In the rest of the article, I begin with a brief sketch of the argument, based on the literature of bondholders' committees and the position of merchant banks. I then describe the long-term pattern of debt settlements in Latin America, outline a historical analysis of the first boom and bust period and analyse the role of financial intermediaries. Thereafter, I provide further evidence on the process through which merchant banks assisted Latin American governments to settle their debt disputes, mainly during periods of high liquidity. I contrast this behaviour with the attitude of Baring, a bank caring about its reputation and therefore unwilling to place in the market bonds with a high probability of default. Baring preferred to delay an agreement and to refrain from issuing new loans if the bank perceived that a settlement would not be permanent. I conclude with some final remarks.

I

The literature on sovereign defaults emphasises that a major reason why borrowers repay their debts is the possibility of otherwise being excluded from capital markets.[6] In the nineteenth century, London emerged as the world's leading financial centre (Cassis 2006). Economic historians have described how the London Stock Exchange (LSE) emerged as the institution that enforced the capacity of unsatisfied bondholders to exclude borrowers from the market (Neal and Davis 2006; Flandreau 2013). This capacity was mainly pursued through the General-Purpose Committee, which was in permanent communication with organised bodies of bondholders. Kamlani (2008) posits that it was the 'structural power' of British capital, related to the capacity of the British government to impose a wide range of sanctions, that provided an immense bargaining power to bondholders' bodies and merchant banks. These sanctions involved the withholding of credit, international creditor coordination and coercion, and international law.

British bondholders organised committees to facilitate negotiations and to gain bargaining power through increased government lobbying. Suter (1992) had first argued that the fall in default durations observed in the nineteenth century was related to the coordination mechanisms established in particular through the creation of the British

[5] In a previous paper, we called those merchant banks appearing in the market during lending boom 'wildcat banks' (Flandreau and Flores 2009).

[6] Panizza, Sturzenegger and Zettelmeyer (2009) provide a general overview on the internal and external costs of defaulting.

Corporation of Foreign Bondholders (CFB).[7] Esteves (2007, 2013) argued that the CFB contributed to an acceleration of the negotiations between bondholders and governments. This perspective also corresponds to previous remarks by Marichal (1989) and Suter (1992), who observed that the lengths of default decreased in the nineteenth century (falling from 14 years between 1821 and 1870 to 6.1 years between 1871 and 1925).[8] However, Flandreau (2013) provides a more sceptical view about the role of the CFB. For this author, previous organisations, in particular the Spanish Bondholders Committee, had been particularly relevant since at least 1836, or about 30 years before the creation of the CFB. This predecessor to the CFB also held its bargaining power through its permanent communication with the LSE. Finally, Flandreau and Flores (2012a) also show that the sole participation of the CFB in debt negotiations did not have an effect on bond prices. On the contrary, bond prices increased when the CFB was supported by a prestigious merchant house (Baring in particular) during the negotiations with defaulting governments.

A major bone of contention among scholars concerns the precise role of merchant banks. A strand of the literature posits that merchant banks supported the creation of the CFB due to 'the conscience of the loanmongers', as the banks were originally responsible for selling the bonds to investors (Jenks 1927). Economic historians have concurred that banks acted with self-interest by allowing governments to enter into the market. Eichengreen and Portes (1986) suggest that merchant banks (issuing houses) were prone to a conflict of interest, as they had two sets of customers – bondholders and borrowing governments. Esteves (2007) also argues in favour of a moral hazard argument, in which banks profit from an asymmetry of information, giving them incentives to issue high-risk loans and also influencing bondholders' committees. However, Flandreau and Flores (2009) introduced a reputation argument for 'prestigious banks', whose main interest was to issue low-risk loans, as a default could damage their reputation and thus their market share.

Following this banks' reputation argument, Flandreau and Flores (2012a, 2012b) showed that when governments contracted the agency of a 'prestigious bank', the risk premium fell and new loans were issued on better terms. This was also the case when such banks participated in the negotiations with bondholders. Their ability to impose sanctions on defaulting governments stemmed from the fact that those banks were capable of excluding governments from capital markets by assuming the role of market gatekeepers, given the high concentration in the underwriting market of sovereign debt in London.[9] In the aftermath of lending booms, two banks (Rothschild and Baring) basically monopolised the totality of loan issues, while during booms their participation declined significantly. Esteves (2013) recognises that the participation of prestigious merchant banks led to particularly positive

[7] On the history of the CFB, see also Mauro and Yafeh (2003).
[8] A summary of this literature can be found in Kamlani (2008).
[9] See Flandreau *et al.* (2010).

results for bondholders in terms of profitability, but argues that the participation of the CFB in default negotiations led to better results as compared to negotiations with ordinary banks' intervention.

To summarise, scholars who claim that the establishment of the CFB had positive effects on the sovereign debt market argue that merchant banks had previously obliged bondholders to accept unfavourable agreements in order to allow a government to regain capital market access. The existence of the CFB led to more rapid debt default settlements and better outcomes for the bondholders. However, a main question is whether such a framework was established at the expense of a higher default frequency. On the contrary, 'prestigious banks' did not suffer from conflicts of interest, but their defaults' management should have led rather to longer default durations and more short-term bondholders' losses, but also to fewer defaults and a slower acceleration of loan issuing.

II

Table 1 shows the proportion of time during which Latin American countries were in default from first market access until 1914.[10] The upper part of the table includes the countries that accessed the market during the first wave of lending (during the 1820s), while the lower part displays those that entered the market thereafter. These figures provide a first insight into the strong diversity of experiences within the subcontinent and suggest that borrowers' seniority and repayment records are unrelated. Brazil and Uruguay could be considered as good payers, as they were rarely in default (2% and 9% respectively). Brazil was among the first borrowers and 'only' defaulted twice by the end of the period (1898 and 1914) (Abreu 2006). Uruguay issued its first loan in London in 1864 and defaulted in 1876 and 1890. Interestingly, Brazil's domestic conditions were not unique in Latin America in terms of political and macroeconomic stability.

The relevance of supply-side factors in analysing the timing of debt settlements is shown in Figure 1. According to the narrative described above, we would expect that periods of high liquidity should foster the number of debt settlements, and be accompanied by new lending booms. The figure depicts the number of debt settlements per year between 1820 and 1914 (right axis) along with market conditions in the London sovereign debt market. As a liquidity measure, I include the yields paid by UK long-term bonds (UK consols), and the total amount of capital exports as computed in Stone (1999).[11] Debt settlements can be clustered around specific subperiods. Before 1855, we observe only four settlements that followed the first waves of defaults.

[10] I consider all Latin American countries that issued at least one loan in the London Stock Market. Original sources are: CFB (1915), Fortune (1838), Fenn (1869), Fenn and Nash (1883).

[11] The series for the UK yields are constructed from the following sources: until 1839, I estimated them from prices reported in Wetenhall (1818-30). Thereafter, between 1840 and 1879 they are from the NBER Macrohistory Database. After 1880 they are from Klovland (1994).

Table 1. *Entering the market and time in default, 1822–1914*

Country	Successor states	First access to the market (London)	Total time in default (percentages)
First wave			
Buenos Aires	Argentina	1824	34.1
Brazil		1824	2.2
Chile		1822	22.6
(Gran) Colombia	Colombia	1824	65.6
Federation of Central America	Guatemala	1825	65.5
Mexico		1824	68.1
Peru		1822	39.8
Successive waves			
Bolivia		1872	11.6
Federation of Central America			
	Costa Rica	1871	44.4
	El Salvador	1889	40
	Honduras	1867	92.2
	Nicaragua	1886	56.6
(Gran) Colombia			
	Ecuador	1904	69.9
	Venezuela	1863	62.4
Paraguay			38.6
Santo Domingo		1888	65.2
Uruguay		1871	9.8

Notes: Argentina assumed the debt of Buenos Aires in 1880. The Federation of Central America was dissolved between 1838 and 1840. According to the CFB (1915), there was a previous agreement (in 1827) on the shares of the first loan to be assumed by each country. The Republic of Colombia was divided into three separate countries in 1832 (New Granada, Ecuador and Venezuela), and a convention was agreed upon regarding the proportions of the first loan to be assumed by each country in 1834.

This means that during three decades, governments from Latin America were unable (or unwilling) to reach a settlement with bondholders. On the contrary, between 1855 and 1867 – the years that preceded the formation of the CFB in 1868 – there were already six settlements.

We cannot assess the relevance of supply-side factors during those years based on Figure 1, as UK consols were stable, and Stone's capital export series began only in 1865. However, historical narratives concur that lending to foreign governments soared since the late 1850s, and was interrupted by the world's economic crisis of 1873 (Marichal 1989; della Paolera and Taylor 2013). The recovery was rapid and

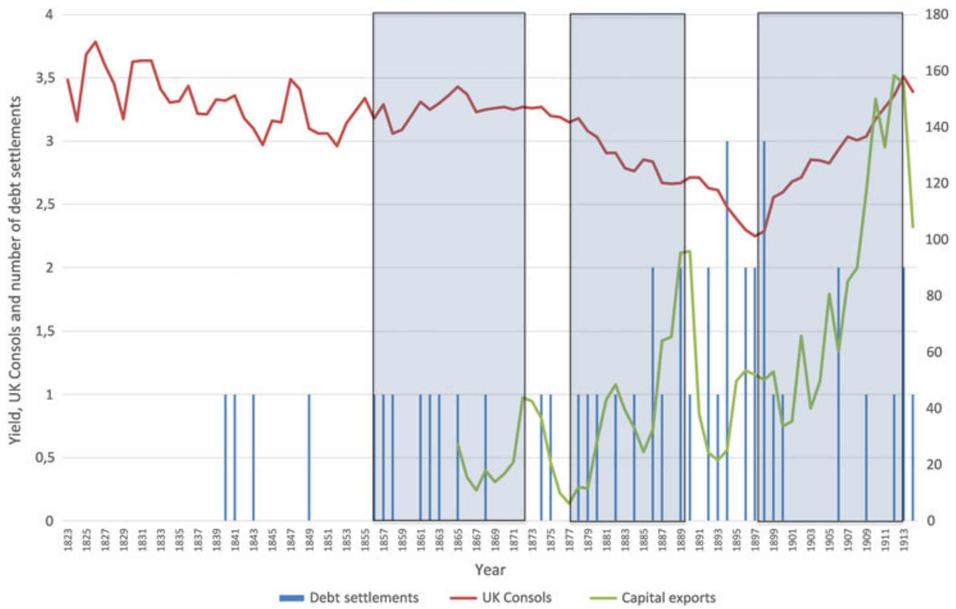

Figure 1. *Debt settlements, capital exports and UK consols, 1823–1914*
Source: See text.

the number of settlements in the late 1870s and early 1880s was accompanied by a decline in the yields of UK consols and by a renewed surge in capital exports. Finally, the export boom at the turn of the century was also preceded, in the late 1890s, by a high number of settlements.

The capacity of governments to attract foreign loans during favourable junctures was enabled by a market structure capable of mobilising investors. The number and identity of intermediaries who intervened in different phases of a loan issue varied. Most of them were originally European merchants, now active in borrowing countries.[12] Through their privileged position as well-informed agents in both Europe and Latin America, they were also the first to detect the potential opportunities to issue loans in Europe's capital markets. However, the marginal nature of their underwriting activity meant that they held no moral obligation to intervene in case of default. Table 2 provides the names of the firms that were involved in the first wave of lending to Latin America, and also those of the intermediaries who participated in the negotiations of the subsequent defaults.[13]

[12] See O'Hagan (1929); Suzuki (1994); Flores Zendejas (2010).

[13] I do not display the identity of contractors nor that of agents in charge of coupons' payments. However, for the issues included in Table 2, all the contractors in the 1820s were the same as the issuers, with the exception of the Buenos Aires loan. Further details are included in Flandreau and Flores (2009).

Table 2. *First settlements and role of merchant banks in the aftermath of the first wave of lending to Latin America*

Country	Successor states	Default in	First settlement	Original issuer	Conversion by	Mediator other than bondholders	Default
Buenos Aires							
	Argentina	1826	1857	Baring Bros & Co.	Baring Bros & Co.	Baring Bros & Co.	1890
Chile		1826	1842	Hullett Bros & Co.	George & James Brown & Co.	Baring Bros & Co.	1880
(Gran) Colombia							
	Colombia	1826	1861	Herring, Graham & Powles; B. A. Goldschmidt	Powles, Illingsworth, Wilson	None	1877
	Ecuador		1855		Ecuadorian Commission in London	None	1868
	Venezuela		1840		Reid Irving & Co.	None	1847
Federation of Central America							
	Guatemala	1825	1856	Barclay, Herring, Richardson & Co., and J. A. Powles & Co.	Isaac & Samuel	None	1876
	Costa Rica		1840		Repaid		
	El Salvador		1860		Repaid	None	
	Honduras		1867		Haslewood & Co.	None	1872
	Nicaragua		1874		Repaid	None	1894
Mexico		1827	1831	B. A. Goldschmidt	Baring Bros & Co.	Baring Bros & Co.	
Peru		1826	1848	Thomas Kinder	Anthony Gibbs & Sons	None	1876

Sources: Corporation of Foreign Bondholders, Annual Reports (1874, 1877, 1915), Fenn (1869), Fenn and Nash (1883), Dawson (1990), *The Times* and Flandreau and Flores (2009).

This first lending wave involved merchants and merchant banks from both sides of the Atlantic. For Colombia, Herring, Graham & Powles and B. A. Goldschmidt, contractors and issuers of the first loans, had obtained different concessions for gold mines in Colombia in a parallel activity to the loan issues (Liehr 1989). Powles Illingsworth, who participated in the bonds' conversions, was a merchant house in London but had a permanent presence in Colombia, where their interests were concentrated in the mining sector (Mejía Cubillos 2012). The Powles family had already been active as arms' exporters and providers of short-term loans to Colombia in the 1820s (Flandreau and Flores 2009). In Peru, Gibbs & Sons was a merchant house that had established commercial relations in South America since 1805. They became the sole firm in charge of Peru's guano export between 1840 and 1860, and had provided financial support to the government during periods of financial distress (Mathew 2009). In the case of Buenos Aires, the original contractors were Carlson, Castro & Robertson, the latter being originally Scottish merchants based in Liverpool and having a branch in Buenos Aires (Böttcher 1996). These merchants had commercial relations with Baring, a connection that would lead to the loan issuing of 1824.

Table 2 also summarises the information on defaults and settlement years in the aftermath of the first lending boom of the 1820s. It confirms the fact that almost none of the original issuing houses was present as default mediators or as issuers of the bonds' conversions with which defaults were settled.[14] This is striking if we consider that issuing houses were supposed to act as the financial agents of borrowing governments. They had the responsibility of paying the dividends and coupons of borrowing governments in Britain.[15] As Table 2 suggests, the relations between governments and their financial agents were mostly short-lived, and governments could decide to change for several reasons, or even abandon having any agent.[16] Obviously, financial agents had the same liberty to resign. In a default event, financial agents were also the first windows to which bondholders could address their claims, though they held no legal responsibility as to the fate of the bonds. This structure explains perhaps why original issuers and those in charge of the conversions were almost never the same agents. In fact, other than Baring, no other issuing house was also in charge of any conversion. The last column of Table 2 shows the name of the merchant bank that participated in the negotiations to resume payments when the bank acted either as the direct representative of the bondholders or else jointly with them, as reported either in the CFB Annual Reports or in the press (in particular *The Times*).

[14] Debt settlements could include the conversion of old to new bonds, most of which foresaw a temporary reduction of interest payments, lengthening of maturities and capitalisation of arrears. See Suter (1990, 1992).

[15] On the work of issue houses, see Chapman (1984).

[16] Issue houses and merchant banks could also refuse the agency of governments. There is ample evidence for Rothschild having refused to be the agents for Mexico (see Salvucci 2009); for Colombia in 1826, see Liehr (1989).

Not all Latin American governments had a permanent financial agent in London. Therefore, coupon payments and bonds' conversions were directly assumed by diplomatic representatives. For instance, Ecuador's government had directly negotiated with bondholders, and it was the government's Commission in London that was in charge of coupon payments. This was also the case with most settlements of the Central American defaults, which involved the payment of cash representing a portion of their respective share of the original loan. These negotiations were characterised by the absence of intermediaries, being directly undertaken between governments' and bondholders' representatives. These negotiations were mostly concentrated on the amount of cash to be paid.[17] The private character of these disputes was particularly acute in the case of Nicaragua. Even if the CFB had been already established, the government negotiated directly with specific bondholders (i.e. no public announcement was issued). The Council of the CFB advised against the offer of the government, though a majority of bondholders ended up accepting the offer (Corporation of Foreign Bondholders (Great Britain) Council 1877, 1915).

In line with Flandreau and Flores's (2009) 'reputation' argument of financial intermediaries, we observe that Baring's behaviour towards Latin America's defaults was unusual. The bank had been the most important underwriting bank in London before the 1820s, mainly due to its successful floating of the 1817 and 1818 French loans (Cassis 2015, p. 115). However, during the first lending wave, Baring participated only marginally (their total market share was 10 per cent), the reasons for this being the cautious nature of the new bank's leadership.[18] Even so, the bank did not turn its back on Latin America – quite the contrary. Furthermore, Baring became the only bank that persisted, over decades, in defending the interests of bondholders. The correspondence on Baring's issues reveals that investors held Baring responsible for Argentina's default and it was with this bank that they sought information regarding negotiations with the government.[19]

The record of Baring as capital market 'gatekeeper' and as bondholders' defendant was, nonetheless, far from perfect. Baring had tried to persuade Argentina's government to resume debt repayment since its 1826 default, but did not succeed until three decades later. In 1842, the bank sent an agent, Francis Falconnet, to Buenos Aires where he acted as the principal negotiator with Argentina's government. Falconnet accomplished his mission and reached an agreement for the resumption of partial

[17] For instance, according to *The Times*, in April 1860 the government of El Salvador offered to pay bondholders the equivalent of 20% of the nominal debt and arrears. The offer of the government that was finally accepted by a majority of bondholders was the equivalent of 31% ('Money-market and City intelligence', *The Times*, 13 April and 31 December 1860). The CFB Annual Report for the year 1915 gives a figure of 90%.

[18] This figure comes from Flandreau and Flores (2009). Ziegler (1988, p. 101) argues that Baring almost contracted at least two loans to Chile and Colombia.

[19] See for instance the letters addressed to Baring by bondholders, such as those in ING Baring Archives, HC 4.1.15.

debt service in 1844, when the ongoing war against Uruguay was over. However, this agreement lasted only about a year, due to the Anglo-French blockade of Buenos Aires in 1845 (Ziegler 1988, p. 111). Baring, along with British merchants, complained to the Foreign Office, although the blockade would not end until 1849. The final agreement was not reached until 1847.

Baring also participated in negotiations on defaulted loans to which the bank was initially unconnected, albeit with contrasting experiences. The bank assumed the agency for Mexico in 1826, Chile in 1844, Colombia in 1858 and Venezuela in 1859.[20] The reasons why Baring got involved in these countries are diverse, but were mostly related to commercial interests. In the case of Mexico, Baring had participated in the business of cochineal since colonial times (Ziegler 1988, p. 32). It then became involved in a set of investments related to the mining sector (mainly silver) and agreed to assume the financial agency of the Mexican government in 1826, when the original underwriters went bankrupt (Ziegler 1988, p. 106; Salvucci 2009, p. 101). Baring was an effective mediator between bondholders and the government, and facilitated a first agreement for the resumption of payments with bondholders in 1831. However, the Mexican government was unable to keep its debt service stable (the country was experiencing civil conflict and the separation of Texas) and finally defaulted in 1836. Baring resigned as Mexico's financial agent because the bank was unable to obtain a proper engagement from the government to resume debt service (Costeloe 2003, p. 34).

The correspondence between Baring and its agents in Mexico and Argentina shows that the bank continuously analysed the fiscal situation of the governments, and attempted to adapt (even if temporarily) the debt service that could be realistically requested. In Mexico, Baring further supported the idea of having bondholders' representatives in charge of securing a portion of the Customs houses' revenues in Veracruz and Tampico, and this was part of the agreement of the 1830 conversion plan. In the case of Chile, the final agreement of 1842 was reached under the auspices of Baring (Dawson 1990, p. 206). According to Ferrada Urzúa (1945), the revenues of Chile's government had stabilised and increased in the years prior to the settlement. While Baring considered the bondholders' claims and the annual repayment amounts they required, the bank analysed Chile's domestic conditions and the risks that could eventually entail further debt service interruptions. Even if this strategy did not always succeed, it allowed governments, to a large extent, to reach sustainable levels of repayment. Chile did not interrupt its debt service until 1880.

III

Historians disagree on the final balance that resulted from the cooperation between merchant banks and bondholders during negotiations with defaulting governments.

[20] Baring accepted the agency of Venezuela in April 1859 ('Money-market and City intelligence', *The Times*, 19 April 1859).

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In one instance, a prestigious bank (Rothschild) led the negotiations with Brazil's government in 1898 while consulting the CFB (Flandreau and Flores 2012a). This was a successful case given the expediency of the negotiations and the low level of losses suffered by bondholders. Baring frequently cooperated with bondholders, even if this cooperation took different forms. Behr (1951) describes how Isidor Gerstenberg, the founder and first president of the CFB, initially attempted to involve Baring in the establishment of the new bondholders' association in 1866. The bank refused, raising an argument of a potential conflict of interest, given the bank's relationship with sovereign issuers. Nevertheless, Baring's proximity to bondholders was developed through different paths. An illustrative example is the case of Baring's former agent in Argentina, Francis Falconnet, who subsequently became the (independent) representative of bondholders in Mexico in 1850, after Baring had resigned as Mexico's financial agent. When Baring resumed its attempts to settle Mexico's defaulted loans some years later, the bank became the formal representative of the Mexican Bondholder Committee ('after years of persuasion, it should be added' (Costeloe 2003, p. 84)).

One may wonder whether Baring was also prone to conflicts of interest and promoted debt settlements with the sole aim of facilitating market access to former defaulters. Two of the debt settlements discussed above, Chile and Argentina, seem to contradict this possibility. In the case of Chile, the government undertook the construction of a railway in the aftermath of the debt settlement. While the government explored the possibility of issuing a foreign loan, it was obliged to finance the project by an internal loan. Baring did not enter into any new financial transaction before 1858. By then, Chilean finances had been stabilised and debt service had been met regularly.

In the case of Buenos Aires' default of 1826, the government had sought to reach an arrangement involving the conversion of old bonds along with the issue of a new loan since 1832.[21] Baring rejected such propositions, given its concerns for the weak state of Argentina's public finances. Even in the aftermath of the debt settlement of 1857, Baring again refused to issue a loan on behalf of the Argentine confederation. The correspondence with a promoter is illustrative. A certain José Buschenthal had obtained a concession from Argentina's government to construct a railway between two Argentine provinces, Rosario and Cordoba, for which he asked Baring to issue a loan in London. In a letter dated 19 August 1858, Buschenthal introduced his proposal by recalling a previous attempt of his, to which Baring had supposedly replied that the

> Buenos Aires bonds not being settled, we should find difficulties at noting the new loan in the Stock Exchange, and that it would be better to wait some time.

[21] ING Baring Archives, HC 4.1.9, letter from Zimmerman & Co. to Barings, 22 September 1832.

The reply encouraged Buschenthal to insist:

> Considering the crisis over, the affairs of the Buenos Aires bonds arranged, and the commercial and political state of the confederation prosperous, I think the time came (to resume) the negotiation of the loan.[22]

There were, nevertheless, other cases in which Baring accepted the issuing of a loan just after a debt settlement. Two relevant cases were Venezuela in 1862 and Mexico in 1864. In the case of Venezuela, Baring had expressed its reservations on issuing the new loan along with the conversion of the old, defaulted bonds ('we are embarked, and it is now obligatory to conduct the ship to a safe port or sink with her').[23] However, the bondholders had favoured this issue as the loan was to be used to pay old debts and 'free' the customs revenues from those creditors. Venezuela defaulted in 1864 in the aftermath of a civil war. In the case of Mexico, a loan was issued in 1864, when the political regime in Mexico had transitioned to a monarchy led by Maximilian I (from the House of Habsburg), and supported by the French government which had previously invaded the country in 1861. This new regime led to expectations of a period of political stability and sound public finances. Apparently, Baring had to compete with Rothschild who proposed to issue a loan with a French guarantee (Salvucci 2009). However, Maximilian's regime turned out to be short-lived and financially weak. The retreat of the French from the country led to the fall of Maximilian's government and the repudiation of the loans in 1866.

It is very likely that Baring's approach as default manager was exceptional. According to contemporary documents, it may be safe to assert that conflicts of interest and 'bad' practices were common. In 1875 the British Parliament set up the Select Committee on Foreign Loans to investigate the alleged corruption in the loans issued on the London Stock Market. Its report describes different settlements that were reached only to allow defaulting governments to access the London debt market, even though those settlements were unsustainable from the borrowers' perspective. This was the case with Honduras. According to the report, in the early 1860s the government had accumulated debts from the first (defaulted) loan of 1825, two internal loans, another one from a British merchant house (for the purchase of arms) and a final loan by the British government. The government recognised that additional funds, being required for the construction of a railway across the country, would only be available once an arrangement could be found for the defaulted federal debt.

The resolution contemplated the conversion of a specified sum on the face value of the original bonds and the capitalisation of the arrears, adding up to about 90,000

[22] ING Baring Archives, HC 4.1.38, letter from Buschenthal to Thomas Baring, 19 August 1858.

[23] Baring quote in Berglund (1985). The loan contract and correspondence has been reproduced in Carrillo Batalla (1976).

pounds sterling. The conversion was part of a new issue, which foresaw a total amount of one million pounds sterling. As the author of the report recognised, this sum was simply unaffordable:

It will be easily understood that the Republic of Honduras had not the state of material development, density of population, favourable conditions of finances, organised resources, or industry and commerce, to be in the most appropriate position for the issue of a million sterling with probability of success in the English market; that is, a loan thirty-six times greater than that part of the Federal debt belonging to Honduras, which had just been arranged, and the interest on which the Republic had neither been able to pay, nor to give anything on account of it for forty years.[24]

The question that emerges is whether the Honduras model predominated and if so, whether this was related to Latin America's high propensity to default. Tables 3a–c report all the loans issued by Latin American governments that were issued after a debt settlement and the time elapsed between the end of a default and the renewed access to the market. These tables also show the spreads at issue of the new loans, the time elapsed before they entered into default, and the identities of underwriters. We could expect that investors, knowing that a settlement was reached with the sole purpose of a government being allowed to re-enter the market, also expected that the new bonds had a higher probability of default. Such a prospect would therefore imply that these bonds would offer higher yield premiums. To test this hypothesis, Table 3 is divided into three groups according to returning expediency: (a) the most rapid returning governments that re-entered the market up to four years after a settlement; (b) those that returned 'on average' (5 to 9 years), and finally, (c) those that were slow-returning (12–31 years). Table 3c also includes governments that never returned to the market.

Several features stand out. Among the eight rapid-returning governments, three issued new loans almost at the same time as they settled their previous debts (conversions were undertaken along with a call for new capital). They were also those that defaulted most rapidly (within two to six years; only Venezuela fared worse, defaulting the year after the loan issue). In comparison, the loans for Colombia, Uruguay and Peru did not default until at least one decade after the year of issue. Expectedly, spreads at issue were the highest for this group of countries, even if they showed a strong variation.[25] By contrast, slow-returners display the lowest spreads at issue. Governments that returned to the market more rapidly were also those that had the highest spreads and those that also defaulted more rapidly. The opposite holds for slow returners, even though this group includes loans that did not default (Argentina and Peru) and the case of Chile, discussed

[24] Great Britain. Parliament (1875), p. v.

[25] Spreads at issue were calculated as the difference between the yields at issue (coupon to price ratio) and the UK yields as estimated from Figure 1.

Table 3a. *Rapid returning governments*

Country	Year of settlement[a]	Coupon payer / converter	Year of new issue	Time between settlement and new issue (in years)	Spread at issue	Issuing bank	Year of new default	**Number of years after issue**
Honduras	1867	Haslewood	1867	0	9.3	Bischoffsheim & Goldschmidt	1873	6
Santo Domingo	1888	Peter, Lawson	1888	0	4.5	Capital & Counties Bank	1892	4
Mexico	1864	Baring	1864	0	6.2	Glyn, Mills, Intern. Fin. Co., Crédit Mobilier	1866	2
Colombia	1861	Baring	1863	2	3.8	L. & County Bank	1877	14
Venezuela	1859	Baring	1863	4	6.3	Baring	1864	1
Uruguay	1892	Glyn Mills, Currie	1896	4	4.7	Glyn Mills, Currie	1915	19
Peru	1849	Committee of Bondholders	1853	4	2.3	Murrieta & Hambro	1876	23
Average:					**5.3**			**9.9**

[a]Last year of default.

Sources for Tables 3a–c: Corporation of Foreign Bondholders, Annual Reports (several issues), *The Times* and Flandreau *et al.* (2010).

Table 3b. *Average returning governments*

Country	Year of settlement[a]	Coupon payer / converter	Year of new issue	Time between settlement and new issue (in years)	Spread at issue	Issuing bank	Year of new default	Number of years after issue
Brazil	1898	Rothschild	1903	5	3.3	Rothschild	1914	11
Santo Domingo	1892	Dominion Financial Agency	1897	5	3.8	Brown Jansen	None	Never
Uruguay	1878	I. Thomson, T. Bonar	1883	5	4.1	I. Thomson, T. Bonar	1891	8
Ecuador	1898	Committee of Bondholders	1904	6	2.9	Glyn Mills, Currie	1906	2
Argentina	1857	Baring	1866	9	4.6	Baring, Hope	1890	24
Salvador	1899	Central American Public Works Company	1908	9	4.0	Chalmers, Guthrie & Co.; London Bank of Mexico & South America	1915	7
Average:					**3.8**			**10.4**

[a]Last year of default.

Table 3c. *Slow returning and never returning borrowers*

Country	Year of settlement[a]	Coupon payer / converter	Year of new issue	Time between settlement and new issue (in years)	Spread at issue	Issuing bank	Year of new default	Number of years after issue
Slow returners								
Argentina	1891	J. S. Morgan (Rothschild Committee)	1903	12	2.8	Baring Bros; London & River Plate Bank	None	Never
Nicaragua	1874	None	1886	12	3.7	City Bank	1894	8
Guatemala	1856	Isaac & Samuel	1869	13	5.3	Thomson, Bonar	1876	7
Nicaragua	1895	City Bank	1909	14	3.5	Anglo-South American Bank	1911	2
Chile	1842	George & James Brown & Co. / Baring	1858	16	1.7	Baring Bros	1880	22
Peru	1889	Antony Gibbs	1911	22	2.3	Schröder	None	Never
Salvador	1860	None	1889	29	3.4	London & South Western Bank	1915	26
Costa Rica	1840	None	1871	31	5.5	Bischoffsheim & Goldschmidt	1874	3
Average:					**3.5**			**12**
Never returning to the market								
Guatemala	1895	Deutsche Bank	No further issues					
Bolivia	1879	None	No further issues					
Paraguay	1885	Robarts, Lubbock	No further issues					

[a]Last year of default.

above, and whose partial default took place 22 years after the new loan had been issued.[26]

Regarding the attitude of investors towards rapid-returning governments, it is very telling that the press and bondholder circles often commented when a settlement was reached with the purpose of having a government return to the market, further supporting the idea that these issues were those with the highest spreads at issue. In the case of the Honduras loan – which had a spread at issue of 9.7, the highest from all the loans from Tables 3a–c – the CFB (1915) stated that the settlement was effected in preparation of a loan the governments aimed at floating for the construction of an inter-oceanic railway. *The Times* warned investors: 'Without any disparagement to the honesty of the intentions of the Honduras Government, it may be assumed that its financial ability is too weak and untried.'[27] In the case of Santo Domingo, the negotiations for the settlement of the default had been very complicated, with the estimated bondholders' losses being around 90 per cent.[28] According to *The Times*, and as described in the CFB Annual Report for 1898, the bondholders had initially refused the offer, although they ended up accepting as the government's representative threatened them with repudiation.[29]

Tables 3a–c do not consider the loans issued privately nor the issues that took place in other financial markets, but the message does not seem to be different for these loans. So, for instance, Guatemala's government settled its default in 1856, and privately issued a loan in 1863 (a rapid returner) that defaulted one year thereafter (CFB 1915). The government of Bolivia was unable to borrow in London after its debt settlement of 1879, even though the government managed to issue a new loan in Paris in 1905 (a slow returner), on apparently advantageous conditions. I calculate the spread at issue of 1.55 per cent.[30] The issue took place 26 years after the settlement with British investors. By comparison, Santo Domingo's Paris loan of 1895 (three years after settlement with the CFB, a rapid returner) defaulted four years later.

IV

In this article, I introduced a different explanation of why Latin American governments defaulted so frequently. The market framework that dominated European financial centres provided governments with a readily available source of funds,

[26] I do not consider the issues on behalf of Argentina's government related to the 1890 default and which was intended to repurchase the bonds underwritten by Baring for the Buenos Aires Water Supply Company.

[27] 'Money-market and City intelligence', *The Times*, 11 November 1867.

[28] This estimate follows the methodology used by Suter (1992) with information from the CFB Annual Reports.

[29] 'The Santo Domingo debt', *The Times*, 23 March 1888.

[30] Information for this loan can be found in the *Annuaires de l'Association nationale des porteurs français de valeurs mobilières*.

which they frequently resorted to. Latin America's domestic conditions did not allow governments to secure a stable capacity to repay the debt contracted. Nevertheless, even if most of Latin American bonds were considered as a speculative investment, the price that governments were obliged to pay was equally high. This dependence on foreign finance was also a reflection of the underdevelopment of the region's domestic financial markets.

One may wonder whether financial intermediaries should have better screened the borrowers that accessed London's capital market and prevent defaults. This is how certain banks, such as Baring and Rothschilds, generally operated. However, their market share diminished in periods of high liquidity, and other banks looking for short-term gains were willing to issue high-risk bonds. Even if the London Stock Market and the CFB pressed merchant banks and governments to satisfy the claims of bondholders, they were not responsible for market screening and vigilance. In periods of high liquidity, bondholders were also willing to invest in high-risk assets, while merchant banks were willing to provide intermediation services. This process did not involve the CFB, and investors could only attempt to properly assess the risk from the new bonds. These periods also coincided with rises in Latin America's external debt.

A major implication, as presented in this article, was Baring's strategy of credit withholding, as shown in the cases of Argentina and Chile. This was also the case with Rothschild towards Brazil, which prevented an increase of the government's indebtedness since the late 1880s, as the country was unable to redress its fiscal imbalance and its currency depreciation. These countries were, unsurprisingly, the countries with the lower frequency of defaulting, along with Uruguay, also a 'Baring country'. By preventing these governments from contracting loans they could not repay, their borrowing record also improved.

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