FOR PARTICIPANTS ONLY

Conference Room Paper No. 5
14 March 1985

ORIGINAL: ENGLISH

Expert Meeting on Crisis and
Development in Latin America
and the Caribbean

Santiago, Chile, 29 April - 3 May 1985

THE EARLY 1980s IN LATIN AMERICA: THE 1930s ONE MORE TIME? */

Carlos F. Díaz-Alejandro

*/ Prepared for the Brookings Institution, Washington, D.C.

The views expressed in this work are the sole responsibility of the author and do not necessarily coincide with those of the Organization.

85-2-193

CONTENTS

		Page
I.	INTRODUCTION	1
II.	SIMILARITIES	2
III.	CONTRASTS	7
IV.	CAVEATS AND CONCLUSIONS	13
	REFERENCES	16

I. INTRODUCTION.

The reader need not be held in suspense: No, the differences between the early 1980s and the early 1930s in Latin America are more significant than their similarities. But the question is pertinent and the comparison could cast light on both historical episodes, while deepening understanding of the cyclical behavior of peripheral, semi-industrialized economies, and about their interaction with the international economy.

Depressions have proven to be more interesting than booms to students of Latin America: the early 1890s, the crisis of 1920-21 and the 1930s have received more attention than booms before and after. Scholarly morbidity is not the only explanation for this apparent bias for gloom: negative external shocks arising from the international economy have long been viewed in Latin America as leading both to short-term economic and political autonomy, with net welfare consequences of crises being moot.

The story of the 1930s in at least the larger or more autonomous Latin American countries has been particularly influential in generating a sanguine attitude toward external shocks. By the 1970s it could be argued that economies and public sectors that weathered remarkably well the shocks of the 1930s were even better prepared, fifty years and much industrialization later, to handle whatever the international economy threw at them in the 1980s.

That optimism was flawed. Available evidence indicates that while the severity of the quantifiable external shock has been milder during the early 1980s than during the early 1930s, the performance of at least several major Latin American economies has been weaker in the recent period. In Argentina, Brazil and Chile, per capita gross domestic product and industrial output do worse in the early 1980s than in the early 1930s (see Diaz-Alejandro 1983, pp. 8-9, Naciones Unidas, 1983b, Table 2). While data do not always allow precise comparisons, Mexico and Venezuela appear to do better during the most recent depressive episode, for obvious reasons. Colombian performance during both crises is relatively strong. While several Latin American countries recovered earlier and faster than the United States during the early 1930s, the opposite has occurred during the early 1980s in all countries.

The rest of this paper is organized as follows: similarities between the two historical episodes well first be discussed, including parallels in their preceeding conditions. Salient contrasts will then be analyzed, both regarding the structures of the Latin American economies, and in their links with the international economy. Conclusions and caveats will close the paper.

II. SIMILARITIES.

Similarities between the 1980s and the 1930s may be found in the booms that preceeded them; in the nature of the external shocks; and in some aspects of the domestic response.

Both the late 1920s and the late 1970s witnessed significant capital inflows into the major Latin American economies. External terms of trade and demand for exports were reasonably good, with precise conditions for each country depending on the commodity lottery. As during other "good times" in the history of these economies, there was a tendency for international reserves to grow and for nominal exchange rates to lag behind the difference between domestic and external inflation. As during the late 1920s, when most Latin American countries sought fixed nominal exchange rates (in the context of the gold standard), during the late 1970s and very early 1980s some countries moved either to fix nominal exchange rates, or to fix their rate of change ahead of time. The combination of external circumstances and domestic policy in both episodes led to real exchange rates that were overvalued relative to the historical norm. It is likely that this phenomenon could also be found during other boom periods in Latin American economic history. It also appears that capital inflows during both the 1920s and the 1970s generated significant expansions in public expenditures, either in the form of public works (during the 1920s), or in investments by public enterprises (during the 1970s).

The deterioration in the commodity terms of trade during the early 1980s has approached, for some countries, the magnitude of the collapse of the early 1930s. Table 1 compares three year averages, persenting percentage changes

Table 1

Percentage changes in commodity terms of trade: The early 1930s compared with the early 1980s.

	1928-29-30 to 1931-32-33	1978-79-80 to 1981-82-83	1975-76-77 to 1981-82-23	1971-72-73 to 1981-82-83
Argentina	-29	-2	-9	-34
Brazil	-32	-31	-42	-45
Colombia	-24	-22	-19	+9
Chile	-38	-28	-32	-53
Mexico	-33	+19	+44	+65
Peru	-30[a]	-12	-6	+11
Venezuela	-21	+21	+47	+281

[a] Refers to percentage change between 1929-30 and 1932-33. Sources and method: Basic data obtained from Naciones Unidas 1976, Naciones Unidas 1983a, and Naciones Unidas 1983b.

between the indicated triennia. Brazil, Colombia and Chile show the closest three-year declines during the two historical episodes; for Brazil the recent decline is steeper if 1975-77 is taken as the base for comparison. For large oil exporters, such as Mexico and Venezuela, the story is quite different, while the deterioration in the terms of trade of Argentina and Peru during the early 1980s looks mild compared with those of the early 1930s. The recent period is both more heterogeneous and less catastrophic regarding the Latin

American merchandise terms of trade than the earlier episode. The longer-term importance of oil and of good or bad luck with other major commodities are highlighted in the last column of Table 1, comparing the early 1980s with the early 1970s, before the first oil shock.

During both the early 1930s and the early 1980s, ex-post real interest rates soared. In the earlier historical episode nominal interest rates both in London and New York remained around their historical norm, while dollar and sterling price levels declined sharply. In the early 1980s the decline in the rate of international inflation has been steeper than that in nominal interest rates. Both episodes witnessed an increase in interest due to foreigner creditors expressed as a share of exports.

Even as real interest rates soared, capital inflows declined sharply during both crises. Those inflows weakened as early as 1929, much before there were hints of possible irregularities in debt service. During the early 1980s, serious declines in the voluntary capital inflow awaited the Malvinas-Falkland war. More or less contemporaneous decreases in terms of trade and capital inflows, of course, have been a feature of peripheral cycles since the nineteenth century.

A severe cut in the volume of imports, from cyclical peak to trough, is shared by both historical experiences. The orders of magnitude are similar for some countries, such as Argentina and Mexico, as may be seen in Table 2. The same Table, however, shows that the import cut of the early 1980s in most cases has not reached the brutality of the early 1930s. Colombia and Peru even show average import volumes for 1982-83 which exceed those of 1979-80-81.

Exchange rate devaluations were a crucial element in the adjustment of early 1930s. Abandonment of gold standard parities came early in some countries, while others waited until they were forced into devaluation by

Table 2

Percentage Changes in Average Annual Import Volumes: The early 1930s compared with the early 1980s.

	Average for 1928-29-30 to average for 1931-32	Average for 1979-80-81 to average for 1982-83
Argentina	-43	-42
Brazil	-56	-23
Colombia	-55	+18
Chile	-64	-40
Mexico	-50	-40
Peru	-50[a]	+2
Venezuela	-58	-22

[a] Compares average for 1929-30 to average for 1931-32.

Sources and method. As in Table 1.

lack of reserves. Steep nominal depreciations far outdistanced the differential between local and international price level changes, so that when 1930-34 is compared with 1925-29, one obtains significant devaluations in the real exchange rate, particularly that applied to imports (the early 1930s witnessed the establishment of multiple exchange rates). Average real import exchange rates rose between 1925-29 and 1930-34 by between 32 percent (Mexico) to 86 percent (Chile), with Argentina, Brazil, Colombia, Peru and Uruguay depreciating within that range (see Diaz-Alejandro, 1982, p. 339, Table 20.4).

The timing of the large nominal devaluations of the early 1980s has also been spread out, and their impact on real exchange rates has also varied from country to country. But the turnaround in real exchange rates from the trend and levels of the late 1970s and very early 1980s has been remarkable, as may be seen in Table 3. The case of Argentina, Chile and Mexico show the clearest pattern of, first, an appreciating trend, followed by abrupt real depreciations. Other countries show weaker or less clear trends, but by 1982 or 1983 most of them registered real exchange rates significantly higher than those for 1976-80.

Both the early 1930s and the early 1980s show that real exchange rates are, sooner or later, sensitive to changes in external terms of trade and changes in capital flows, contrary to mindless interpretations of the purchasing power parity doctrine which became fashionable during the

Table 3

Indices of Real Exchange Rates
(1980=100)

	1976-77-78	1979-80	1981	1982	1983
Argentina	209	113	129	305	
Brazil	77	91	95	98	
Chile	110	107	92	116	
Colombia	112	100	100	100	
Mexico	117	105	92	138	
Peru	94	105	92	98	
Venezuela	108	104	95	92	
South Korea	101	95	102	108	

Sources and method: Basic data obtained form International Monetary Fund, 1984. Nominal exchange rates refer to period average implicit rates, line rf. Those rates were adjusted by inflation in the United States and in the home country, as measured by consumer prices, line 64.

late 1970s in some South American countries. As noted earlier, one may conjecture that the combination during booms of favorable terms of trade, capital inflows and real exchange rates below long term averages is likely to be found in Latin American business cycles since at least last century, and similarly for the opposite phenomena once the boom collapses.

As during the 1930s, large devaluations were accompanied by either the tightening or the introduction of exchange controls, even in countries such as Mexico with a tradition of free convertibility, and even where Central Bank officials were on record as opposing them. After the devaluations there was probably some redundancy in exchange control mechanisms, but public officials burned by capital account shocks and sudden capital flights preferred to keep them around, at least as stand-by policy tools.

An induced increase in public sector deficits during "bad times" is another cyclical regularity common to the early 1980s and early 1930s. In contrast with the early 1930s, however, one cannot find during the early 1980s examples of autonomous increases in the budget deficit comparable to those documented for Brazil, involving the coffee valorization scheme. We now turn to this and other salient contrasts between the two depressive episodes in Latin America.

III. CONTRASTS.

Major contrasts between the 1980s and the 1930s may be found in several characteristics of the Latin American balance of payments, in domestic policies and economic conditions, and in features of the international political economy impinging upon Latin American countries.

Export sectors by the late 1970s were smaller relative to Gross Domestic Product and more diversified than in the late 1920s. Together with more diversified domestic productive structures and larger public sectors, the smaller and more diversified export sectors were supposed to make Latin American economies less vulnerable to external shocks. Diversification refers both to products and to markets: by the late 1970s Brazilian exports, for example, included a large variety of primary and manufactured products, shipped all over the world. The expansion of intra-Latin American trade was noteworthy during the 1960s and 1970s. In contrast with the 1920s, national ownerships of traditional export activities, even in their marketing aspects, was the rule rather than the exception. For countries such as Argentina, Brazil and Chile, these structural changes in their export sectors seem to make their disappointing early 1980s performance the more puzzling.

Viewed from the import side, some of these changes offer clues for explaining the contrasts in performance. The ratio of imports to home production was indeed larger in the late 1920s than in the late 1970s; imports also included then many items than were competitive rather than complementary to domestic production. Import restrictions during the late 1920s were milder in most Latin American countries than during the late 1970s. There was ample room for import substitution when relative prices changed in the early 1930s, as a result of real devaluations and tighter import restrictions. The Brazilian import bill of the early 1980s is not so easily dented, as after many years of extreme protectionism it is made up mostly by close complements to domestic production, which are not as easily substitutable as the textiles, cement and pharmaceutical imports of the late 1920s. Indeed, during the early 1980s the Latin American imports which have proven to be more easily substitutable, or postponable, have been imports from other Latin American countries: intra-Latin American trade has shrunk more than trade with the rest of the world.

Changes in the characteristics of links with international capital markets are more noteworthy than those observed in merchandise trade. During the late 1920s, foreign capital represented a larger share of the Latin American capital stock than during the late 1970s; in the earlier years there was substantial direct foreign investment in export and export-related activities, and the foreign debt was in the form of long-term bonds. Profits and profit-remittances of direct foreign investment in the export sector tended to fluctuate with the terms of trade; bonds, however, represented interest and amortization claims on foreign exchange earnings which were fixed in nominal terms. The external debt accumulated by the late 1970s was in large proportions owed to a few hundred banks, rather than to thousands of bondholders, although bank debt also carried claims on foreign exchange fixed in nominal terms.

Has bank debt made Latin American countries more vulnerable to external shocks than bond debt? Ex-ante the answer appeared moot. Lending banks, being closer to the monetary system of industrialized countries, seemed more vulnerable to pressures from debtors, as in the celebrated Keynesian remark. The consequence of disappointed widows, orphans and other scattered Northern bondholders could be said to have been less threating to Northern financial structures than bankruptcies of their major banks induced by Latin American defaults. By the late 1970s, gunboat and dollar diplomacy appeared irrevocably gone.

As noted earlier, during both the very early 1930s and 1980s service charges on the external debt rose dramatically as a percentage of Latin American exports. Serious irregularities on debt servicing began to appear during 1931, and by 1934 most countries had unilaterally suspended regular amortization and debt payments, while profit remittances lagged and were in many cases controlled by exchange authorities. As of May 1984, interest payments on the Latin American debt had remained current; there has been during the early 1980s sporadic scares but no major defaults. Extraordinary efforts have been made by major countries to maintain punctual interest payments, and to reschedule principal. As bank debt involves shorter maturities than bond debt, the rescheduling process has involved more frequent and frantic negotiations than those carried out with representatives of foreign bondholders during the 1930s.

The burden of adjusting to unexpected shocks was borne to a large extent by foreign direct investors and bondholders in the early 1930s; during the early 1980s a much larger share of that burden has been borne by Latin American countries, with most lenders paying a small price for the mistaken forecasts of the late 1970s. In combination with other circumstances, which will be discussed below, bank debt kept Latin American countries in the early 1980s on a shorter leash than bond debt did in the early 1930s.

The external shocks which began during the late 1920s found most Latin American economies in a reasonable degree of internal balance, at least as reflected in price level stability. Unexpected price deflation became a problem during the early 1930s, a threat partly offset by nominal exchange rate devaluations. In contrast, during the late 1970s most Latin American countries faced rates of domestic inflation much above postwar averages; in spite of output contractions and increases in unemployment, inflation has remained a problem during the early 1980s. Stubborn and, in some cases, accelerating inflation has reduced the options for domestic monetary and fiscal policies during the 1980s, in sharp contrast with the "easier" conditions of the early 1930s, when indexation rules were a rarity. Policy makers in Argentina, Brazil and Mexico cannot disregard during 1983-84 what impact possible expansionary fiscal and monetary policies would have on historically unprecedented inflations.

Domestic political conditions at the start of the two crises show intriguing contrasts: by the late 1920s most Latin American countries had adopted constitutional regimes which kept military involvement in politics discreetly hidden. The late 1970s witnessed highly visible military and authoritarian regimes in several important Latin American countries. The early 1930s saw most constitutional regimes swept aside by a variety of new political arrangements; even when a regime survived, significant changes occurred in political leadership, as in Colombia and Mexico. Economic policy experimentation was encouraged by those trends. The early 1980s demonstrated the shallowness of the claim by authoritarian governments to have wrought fundamental chamges in Latin American economies; as economic "miracles" crumbled, partly due to external shocks but partly as a result of mistaken domestic policies, military incompetence became obvious, even in the military field, encouraging democratization openings. Democratization under delicate economic and social circumstances appears to have resulted in a cautious attitutde toward policy experimentation in the economic areas.

The most significant contrast between the early 1930s and the early 1980s is found in what may be broadly defined as the international political economy, which probably explains several other contrasts already noted. The early 1930s provided clear signals that an international economic order based on the gold standard, free trade and British hegemony, stretching back to the end of the Napoleonic wars, was irrevocably finished. The celebrated sanctity of international contracts was also shaken quite early during the 1930s when Germany suspended reparations and Britain and France stopped servicing World War I loans from the United States. Industrialized nations turned inward, and the London world economic conference was a clear failure. "The end of laissez-faire" was proclaimed by academics, politicians and newspapers. Liberal and democratic ideologies were in retreat, pressured by apparently vigorous fascists and bolsheviks. Economic recovery in industrial countries, often proclaimed to be around the corner, came late and slowly; major economies remained dead in the water. Banking systems, expecially in the United States, underwent massive bankruptcies, and financial and business leaders were targets of ridicule and investigations.

The early 1980s present a very different picture. Post-world-war II international institutions have resisted the crisis, and in some cases have been strengthened, like the International Monetary Fund. The General Agreement on Tariffs and Trade has been buffeted and eroded by protectionist pressures echoing those of the early 1930s, but on the whole protectionist excesses comparable to those of the earlier episode have been avoided. The international banking and financial systems have had several scares, but no major collapses have occurred. The volume of international trade has stagnated, but it has not declined sharply. The volume of Latin American exports, as a result, has done better this time around. Since early 1983 the United States economy has experienced a cyclical upswing, which by early 1984 appeared to have spread to Europe. In both Britain and the United States the early 1980s witnessed an upsurge of neo-laissez-faire ideology, which met with approval from the electorate of those countries, to the surprise of many observers. The United States reestablished vigorous claims to international hegemony, often in an alarming style. Sharp alternatives to democratic neo-liberalism, represented by heirs to the fascists and bolsheviks of the early 1930s, had lost much of their glitter by the early 1980s. In the Mediterranean world, always of interest to Latin America, a prudent social-democratic trend was visible.

The structure of incentives and penalties presented to Latin American policy makers by the international political economy of the early 1980s is

clearly very different from that of the early 1930s. The expected benefits of maintaining external economic links are greater, while the costs of a sharp cut off loom larger. This time around the Center holds, is watchful, and is in a mean mood. There is no visible Kindlebergian hegemonic crisis to provide latitude in policy making. More countries today are in the tricky external situation of the Argentina of the 1930s, a situation which led Argentina to maintain punctual debt servicing. A recovering Center with intact financial institutions, in contrast with the early 1930s, also provides a magnet for savers in the Periphery, limiting policy room in the exchange and monetary fields.

IV. CAVEATS AND CONCLUSIONS.

Data availability, plus the sheer weight of their populations and economies, have biased this paper toward discussion of the large and medium Latin American countries, neglecting Caribbean, Central America and other smaller economies in the region. Heterogeneity in economic and political circumstances among these nations seems greater than during the 1930s. In Central America, external shocks have interacted with convulsed domestic political conditions to produce an economic depression which is probably deeper than that of the early 1930s. On the other hand, the centrally planned Cuban economy of the early 1980s appears more stable than that of the early 1930s, at least as measured by sugar output. Smaller Caribbean islands, which import oil and export sugar to the world market, may have suffered during the early 1980s terms of trade declines as large as those of the 1930s.

Another topic not explored in this paper is the extent to which domestic policies, both during the late-1970s boom and the subsequent recession, dampened the cycle and contributed to a higher growth trend. One may suggest, however, that prudent restrains on external borrowing, avoidance of gross overvaluation and domestic financial excesses, plus absence of runaway inflation during the late 1970s have helped Colombia to weather the early 1980s better than others.

Travellers to South America around 1932 would report that in cities like Sao Paulo textile mills were working three shifts per day, and that the prevailing mood contrasted with the gloom found in North America. During 1984 economic optimism has returned to New York and Washington DC, but not to Buenos Aires and Brasilia. Increasingly, the most optimistic projections for Latin American countries involve reaching by 1990 the per capita incomes reached in 1980, accepting a decade of zero growth and, in contrast with the 1930s, little structural change. Projections delicately rest on how much foreign exchange will be left, after debt servicing, to raise import volumes above the extraordinarily depressed levels of the early 1980s. Events which could upset even modest recovery scenarios are much too easily imagined.

It can be argued that the 1980s conservative political and economic program within major industrialized countries have been surprisingly successful in meeting their objectives. The conservative restoration has extended to the international political economy, in which the mood of the late 1970s has been altered, in favor of a rejuvenated old order. While the depression of the early 1930s had a liberating impact on major Latin American countries, that of the early 1980s has had a chastising, disciplining effect. Much of what has occurred so far is compatible with rational behavior of dominant economic and political forces at the Center, maximizing their economic advantage and political power. But these forces could be misled by hubris into pushing their advantage too far. The structure of carrots and sticks which the international economy offers Latin American countries circa 1984 stills favors maintaining existing external links and playing by the dominant rules of the game, but just barely. Delays in economic recovery or humiliating demands on Latin American policy makers could again make unilateral moratoria and all import-substitution projects look good. A situation where interest on the Latin American external debt amply exceeds new net lending (the 1983 figures were $39 billion and $22 bullion, respectively) cannot be expected to last very long (see Inter-American Development Bank, 1984, p. 19).

It is tempting to conclude that the 1980s are more like the 1890s than like the 1930s in Latin America. But it is more accurate to conclude that while all booms are prosperous in a similar fashion, each depression paints the details of its misery in a different way.

REFERENCES

Diaz-Alejandro, Carlos F. 1982. "Latin America in Depression, 1929-39." Chapter 20 in Mark Gersovitz et.al., editors, The Theory and Experience of Economic Development; Essays in Honor of Sir W. Arthur Lewis. London: George Allen and Unwin, pp. 334-355.

Diaz-Alejandro, Carlos F. 1983. "Stories of the 1930s for the 1980s." Chapter 1 in Pedro Aspe Armella et.al., editors, Financial Policies and the World Capital Market: The Problem of Latin American Countries. Chicago: The University of Chicago Press, pp. 5-35.

Inter-American Development Bank. 1984. External Debt and Economic Development in Latin America; Background and Prospects. Washington, D.C. January.

International Monetary Fund. 1984. International Financial Statistics, February.

Naciones Unidas. 1976. America Latina: Relacion de Precios del Intercambio. Santiago de Chile.

Naciones Unidas. 1983a. Estudio Economico de America Latina, 1982. Santiago de Chile.

Naciones Unidas. 1983b. Balance Preliminar de la Economia Latino-Americana durante 1983. Santiago de Chile.