10th UNCTAD DEBT MANAGEMENT CONFERENCE

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Debt Issues of the Trade and Development Report

by

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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Sovereign defaults in history: the 19th century experience

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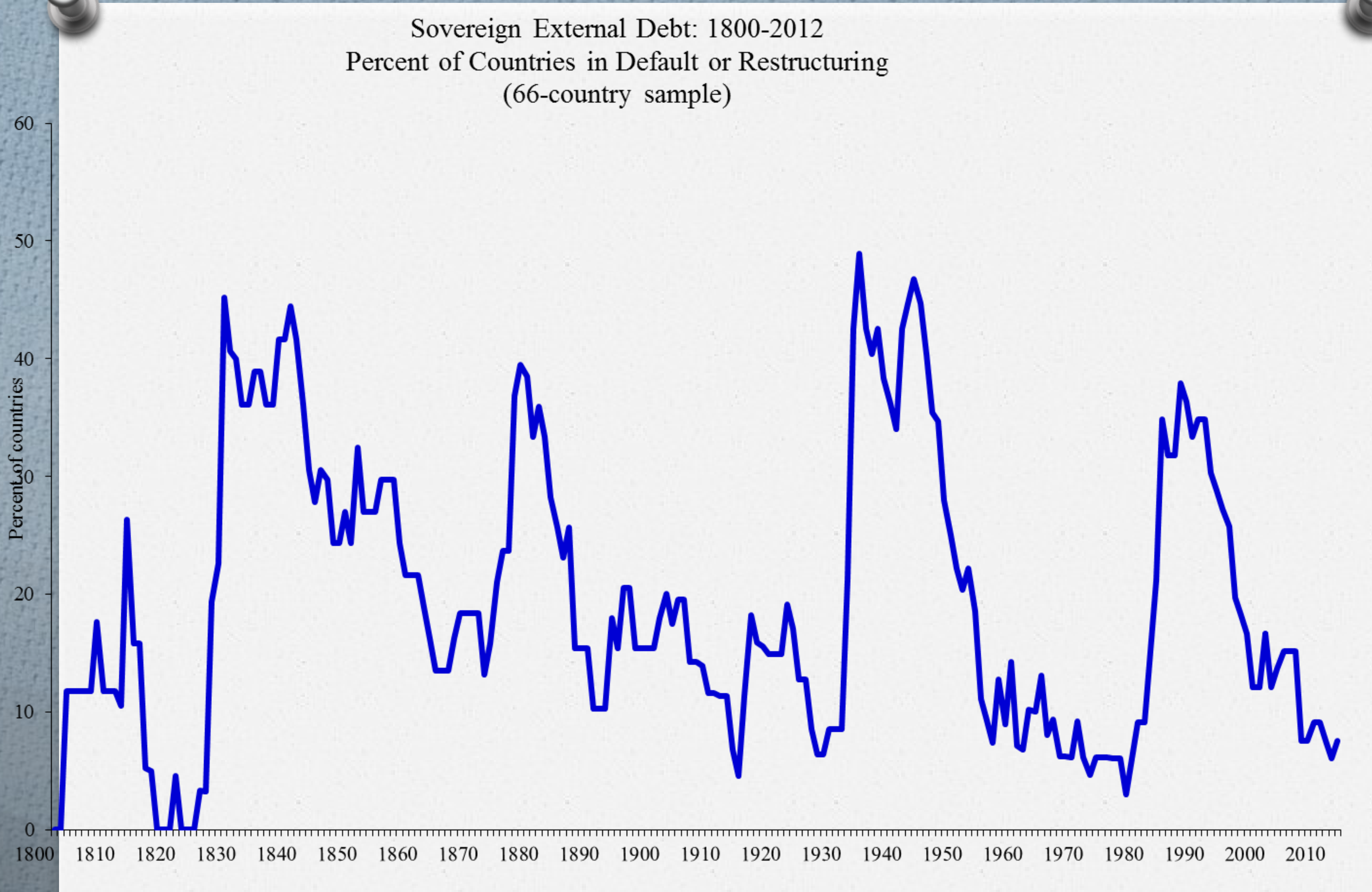
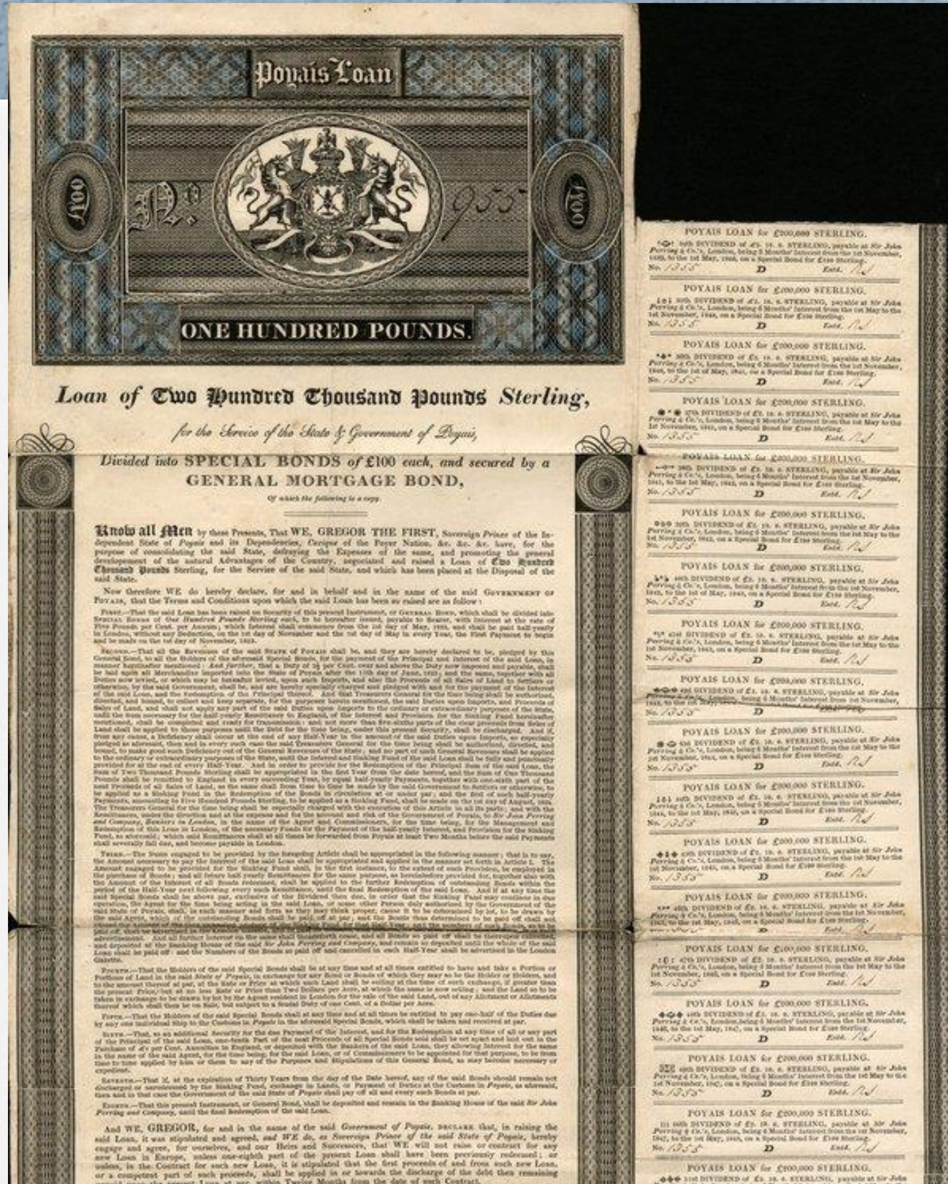
FACULTÉ DES SCIENCES DE LA SOCIÉTÉ

UNIVERSITÉ DE GENÈVE

Sovereign defaults in history




Poyais Loan

No. 955

100

ONE HUNDRED POUNDS.

Loan of Two Hundred Thousand Pounds Sterling,

for the Service of the State & Government of Poyais,

Divided into SPECIAL BONDS of £100 each, and secured by a GENERAL MORTGAGE BOND,

Of which the following is a copy.

Know all Men by these Presents, That WE, GREGOR THE FIRST, Sovereign Prince of the Independent State of Poyais and its Dependencies, Cacique of the Poyer Nation, &c. &c. &c. have, for the purpose of consolidating the said State, defraying the Expenses of the same, and promoting the general development of the natural Advantages of the Country, negociated and raised a Loan of Two Hundred Thousand Pounds Sterling, for the Service of the said State, and which has been placed at the Disposal of the said State.

POYAIS LOAN for £200,000 STERLING.

19th century
London Stock Exchange

- The context:
  - Main financial centre in the world
  - Free capital flows and limited government intervention
- The market
  - Sophisticated financial intermediaries
  - Dynamic legal framework (General Purpose Committee acting as a Court of Arbitration)

Success or failure?

- Success:
  - Continuous expansion of the market
  - Promoted international (bilateral) trade
  - Capital invested in infrastructure
- But:
  - High frequency of defaults
  - Difficult access to the market
  - Defaults could be costly

Legal framework

- Information availability and creditors' rights
- Hold-outs excluded since 1827
  - Simple majority of bondholders were required to agree (*de facto* a "Collective Action Clause")
  - No discrimination between bondholder groups possible

Gunboat diplomacy

- To a certain extent; but British government refused intervention unless other geopolitical interests at stake
  - Averted moral hazard – no "privatized gains and socialized losses"

Active market

- Agreements between governments (absolute sovereign immunity) and bondholders associations
  - Corporation of Foreign Bondholders since 1868; could monitor custom duties, agents at ports; but corruption and insider trading
- Falling rescheduling times
- Variability of haircuts; lowest when certain merchant banks were implicated

Reschedulings and conditionality

- 1890s – decade of defaults
  - Argentina
  - Uruguay
  - Portugal
  - Greece
  - Brazil

Conditionality since 1890: influence on economic policy

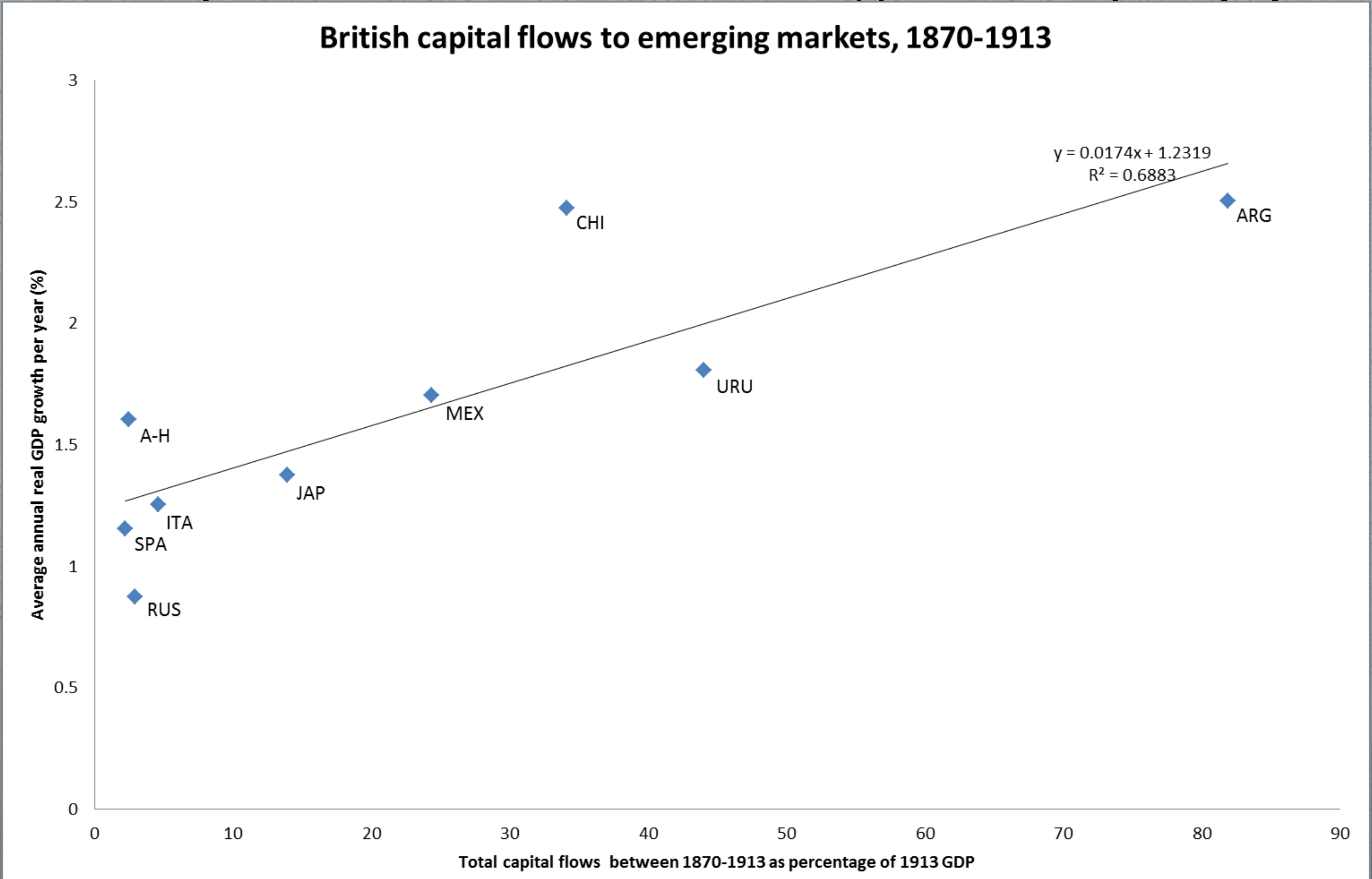
- 1890: Rothschild committee required a set of conditions to Argentina's government
  - Restrict money supply,
  - Fiscal balance,
  - Increases in tariffs (payments in gold) and debt monitoring

- Success?
  - Compliance: (almost) total – though agreement renegotiated in 1892
  - Economic growth: output losses in the short-term, but positive in the long-term

Other cases

- ✓ Greece 1893 (Hambro)
  - Compliance: None
  - Economic growth: low in the short and medium-term. New bail out in 1898
  - Establishment of an International Financial Commission
- ✓ Brazil 1898 (Rothschild)
  - Compliance: total
  - Economic growth: low in the short and long term. New bail out in 1914

Capital flows and economic growth 1870-1913



Did sovereign debt markets promote economic development?

- They sustained the export sector
- Consensus on macroeconomic management
- But a relatively closed markets

Sovereign debt reschedulings

- Profitable market; permitted expansion of sovereign debt market
- Legal loopholes remained (ex. debt and State succession; use of force; arbitration clauses)
- Consideration of repayment capacity only occasional