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THE NEW ROLE OF THE STATE IN LATIN AMERICA

All Latin American states were economically very vulnerable, as the impact of the depression showed in a most dramatic way. They exported either agricultural produce or minerals and ores whose prices were falling even before the depression, and after 1929 they declined very rapidly. Exports receded and therefore imports had to be curtailed severely. Debt service and the flight of capital reduced the means available for imports even more. There were two 'buffers' which shielded the states of Latin American to some extent. First, many imports were non-essential and could be omitted easily, and second, large numbers of unemployed workers and agricultural labourers would go back to the countryside and simply fade away. The fate of those people has hardly been studied and they tend to be forgotten in the relevant literature. Presumably they returned to subsistence agriculture, but as pointed out earlier, subsistence agriculture may be a myth which hides suffering behind a smokescreen of bucolic charm. Nevertheless, both buffers enabled indigenous businessmen to accumulate capital and to invest in the home market, thus overcoming the effects of the depression. The first buffer stimulated import substitution, the second one helped to keep wages low and to shift the burden of the depression to the rural poor. The deteriorating terms of trade of the periphery were paralleled by a similar shift of the terms of trade to the disadvantage of the rural people. Latin American economists have highlighted the importance of the depression as a turning point in the economic development of

Latin America. By uncoupling themselves from the world market and concentrating on the home market, the Latin Americans had reduced their dependence on foreign countries and cultivated some inner strength. Import substitution is stressed heavily in this respect while the conditions of the rural poor are conveniently forgotten. There is no doubt that the governments of many Latin American states felt compelled to foster self-reliance and to adopt measures in favour of indigenous industries, etc. Some progress was made in this direction, but it was also accompanied by an increase in state interventionism and a general distrust of the old ideas of free trade. The enthusiasm for import substitution and internal development of the economists associated with the Economic Commission for Latin America has influenced the interpretation of the economic history of the 1930s to such an extent that a more sober historical analysis tends to be neglected. These economists, so to speak, magnified the roots of import substitution in the 1930s as they looked back at them from the position of a subsequent period when import substitution had definitely made a mark. But the recovery from the depression was to a much larger extent due to the revival of exports than these economists tended to believe. However, even though import substitution may have to be given a lesser weight when assessing the economic history of Latin America in the 1930s, the emergence of state intervention was certainly a dominant feature of this period. It also played a role in export promotion by means of multiple exchange rates or bilateral trade agreements. The diversification of agricultural production was another sphere of active state intervention. Agricultural import substitution was in some states perhaps as important as industrial import substitution.

‘REACTIVE’ AND ‘PASSIVE’ STATES

Not all Latin American states were equally active in the field of interventionism. C.F.Díaz Alejandro has therefore distinguished between ‘reactive’ and ‘passive’ states: the first ones used a whole panoply of interventionist measures, the others just waited for an improvement of conditions in the world market. Such passive states were quasi-colonies like Cuba or ‘banana republics’ like Honduras whose sovereignty was very much restricted. But even among the reactive states there were many differences with regard to the instruments used. Some of them devalued their currencies, imposed customs duties, stepped up state expenditure and tried to reflate the economy (e.g. Brazil and Columbia). Others were satisfied with only one measure, like Peru, which devaluated its currency and then waited for a recovery of the export market. The type of reaction was conditioned by the respective country's previous history, by the export commodities it had to offer and by the availability of the instruments of intervention. In countries whose export sector was limited to certain enclaves dominated by foreign companies which had to weather the storm of the depression by themselves, there was hardly any scope for state intervention. This was the case with Peru, which mostly exported oil and ores. The coffee-exporting countries like Brazil and Columbia, were faced with an altogether different situation as the production of these commodities was in indigenous hands. Finally, Argentina, which exported grain and beef and competed with European and North American producers in this respect was in a category by itself, and could not be compared to any of the other Latin American countries.

In reviewing the reactions of the different Latin American states we shall start with the 'super-reactive' ones, the coffee-exporters Brazil and Columbia. They were obliged to protect the interests of the indigenous coffee planters who were also potential investors in the home market, whereas states whose exporters were mostly foreigners, as in Peru, could hardly hope that these people would be interested in investing in import substitution and thus help to develop the home market. Therefore interventionism did not make much sense in such cases and the governments stuck to the old ideology of free trade. Moreover, the states which depended on foreign exporters were used to deriving their revenue from moderate export taxes, they hardly taxed their own people, and therefore had no information and no instruments of state intervention. In this respect Brazil and Columbia were very different from most other Latin American countries.

BRAZIL AND COLUMBIA

Brazil had introduced a certain amount of state intervention even before the depression. This was aimed at stabilising the coffee price by means of the state-supported procurement of surplus coffee. It was managed by a special bank which gained a great deal of influence over the economic fate of the nation. In addition, Brazil as a sovereign state could, of course, control its own currency and monetary policy though it had to respect the views of foreign creditors to some extent. The early 1920s had been a period of easy money, followed by a deflationary policy in 1923. By that time

Brazil already had a textile industry of its own and there were other industries as well. The textile industry had made a good deal of profit in the early 1920s. The appreciation of the currency in the deflationary period (1923–26) had both a positive and a negative impact on this industry: positive to the extent that imported textile machinery was cheaper, and negative because of the increase of competition from foreign textiles. Initially the positive effect made itself felt, investment increased and textile machines were imported, but this led to the creation of overcapacities and to keen competition in the home market. In combination with the negative effect mentioned above, this led to a steep fall in textile prices. Subsequently there was once more a period of easy money and of a depreciating exchange rate which gave a reprieve to the textile industry. But it was only due to the devaluation at the time of the depression that the textile industry could recover and fully utilise the capacities which had been installed earlier. Other industries also benefited from this development. The index of industrial production (1928=100) receded to 91 in 1930, but it subsequently rose very steadily and reached 160 in 1936.

In spite of this industrial success story coffee production remained by far the most important sector of the Brazilian economy. The volume of exports remained more or less the same, but their value had declined by 50 per cent. The government at first continued its policy of buying up surplus coffee so as to support the export price, but this scheme collapsed in 1931. Storage room was no longer available and thus surplus coffee was simply burned. The radical devaluation then improved the chances of the coffee exporters once more. At the same time the government propagated the cultivation of cotton so as to diversify agricultural production.

In 1934 Brazil concluded a bilateral trade agreement with Germany which can be summed up by the formula ‘coffee for machines’. This was a new kind of international barter trade which circumvented the shrinking of world trade due to the contraction of credit and the imposition of exchange controls. In this context it was very important for Brazil that the United States, its largest trading partner and creditor, would tolerate such new arrangements. The attitude of the United States differed in this respect from that adopted by the British in their relations with Argentina. Of course, there were also dissident voices in the United States recommending the imposition of an import duty on Brazilian coffee so as to bring the recalcitrant debtor to heel. But Cordell Hull, secretary of state in the Roosevelt administration, pursued an internationalist policy and nothing was done to obstruct Brazilian trade policies. Hull was interested in enhancing the political stature of Brazil as a leading power in Latin America, the more so as the United States had been caught on the wrong foot in 1930 when it had supported the opposition to Vargas.

The coup led by Getulio Vargas in 1930 had been no social revolution but simply the replacement of one kind of political elite by another. The losers were the 'liberal' coffee planters of Sao Paulo who had up to then controlled Brazilian politics. Vargas had been the governor of Rio Grande do Sul, a border province with a social and economic profile quite different from that of the central coffee region. Small landholders and cattle breeders predominated in Rio Grande. They produced mostly for the Brazilian home market and had to compete with Brazil's southern neighbours. The provincial government had a tradition of interventionism and active modernisation informed by the positivism of Auguste Comte. Vargas represented that tradition and emerged as a strong contender for the presidency in the elections of 1930, which he lost. His supporters were not confined to his home province, for the political alternative which he projected was also attractive to army officers who were inspired by revolutionary nationalism. With their help Vargas was able to stage a successful coup. The impact of the depression served as a catalyst in bringing about this political constellation.

Vargas was a clever manipulator rather than a revolutionary firebrand. He acted as an umpire balancing various interests, showing his hand only when his power was directly challenged. At first he continued the subsidies to the coffee planters, but at the same time he had to assert national control over banking and exchange rate policies and this alienated the 'liberals' of Sao Paulo. They had resented the loss of political power and now they were even more incensed by being overruled in the financial and economic sphere. Thus in 1932 they rose in rebellion. Vargas suppressed this rebellion and had remained *persona non grata* in Sao Paulo ever since. In 1934 he introduced a new constitution, and was then elected president by indirect election. In 1935 a communist-inspired popular front did him the favour of opening a direct attack on him. He crushed it and got a great deal of political mileage out of magnifying the communist danger. In his anti-communist crusade he was supported by a proto-fascist movement, the so called 'integralists', who attracted sympathies among army officers and the middle classes. Their ideology was rural and retrograde. They stressed Brazilian nationalism and the need for strengthening the Catholic church. Their programme had a vague social appeal, and some sections of the church supported them for all these reasons.

Vargas feigned sympathy with the 'integralists' until 1937 when he staged another coup and eliminated them, too. Having established his authoritarian control over the country, he could proceed with his modernising interventionism which he had imbibed in his earlier years in Rio Grande. In this he was ably assisted by Oswaldo Aranha, an old friend from Rio Grande, who served as his chief political planner and administrative reformer in his first cabinet, and was then instrumental in forging links with the USA as ambassador in Washington. He had been sent there initially in 1934 in order to get him out of the country, where he did not quite fit into the system. He was also averse to the new turn of events in 1937 when Vargas established his 'Estado Novo'. Nevertheless, he joined the new cabinet as foreign minister in 1938. As a convinced anti-fascist Aranha favoured an alliance with the United States whereas Vargas wanted to hold the balance between pro-German and pro-American pressure groups in Brazil. The issue was finally settled by the outbreak of the war, when Aranha's policy prevailed.

Brazil was able to use all the instruments available for crisis management in the depression. The convertibility of the Brazilian currency was effectively suspended at the end of 1929, but the gold standard had not yet been abandoned—this happened only at the end of 1930. Brazil also suspended international debt service, imposed controls on foreign exchange, adopted a reflationary monetary policy, supported the import-substituting indigenous industry and diversified its main export products. Not all of these measures were equally successful, but in general Vargas could be fully satisfied with his crisis management. The other side of the coin was, of course, that the poor had to adjust to the harsh conditions imposed upon them by the depression. No attempt was made to help them by means of state intervention. The emerging bourgeois state led by Vargas did not aspire to becoming a welfare state.

Crisis management in Columbia was to some extent similar to that of Brazil, but there were also some interesting differences. In both countries coffee accounted for 70 per cent of exports and both countries had an incipient industry capable of going in for more import substitution. But in contrast with Brazil, Columbia also had oil, in which the American oil companies were very much interested. However, the oil economy remained an enclave which had no important influence on the Columbian economy in general. In the 1920s Columbia had a windfall of $20 million, as it was compensated for the loss of Panama which the Americans had snatched away from it, so as to be able to control the Panama Canal. Without the interest of the American oil companies in Columbian oil, the US government would hardly have agreed to pay such generous compensation. The inflow of this money, which started in 1921, led to the 'Dance of the Millions' in Columbia. A good deal of this money was spent on importing consumer goods, but nevertheless investment goods had a share of 30 per cent of total imports. This helped the import-substituting industries such as the textile industry, etc. The potential for further progress along those lines was great and the impact of the depression fell on fertile ground in this respect.

The shock of the depression led to a changing of guards in Columbia. The conservative planters, the 'Cafeteros', lost power to liberal politicians representing the emerging bourgeoisie. President Olaya (1930–34) immediately followed Great Britain in leaving the gold standard, devalued the Columbian peso against the US dollar by 70 per cent, and introduced tough foreign exchange controls and a protectionist policy. The devaluation led to a steep increase in real wages in 1932, but this benefited only those workers who had not been fired when the country was hit by the depression. The masses of the unemployed returned to the countryside and clashed with the 'Cafeteros' who did not want to accommodate them. But the government was able to overcome this unrest. In 1934 President Olaya, who could be called liberal-conservative, was replaced by a liberal-socialist successor whose policies will be discussed in Chapter 14, which is devoted to the political consequences of the depression. The new constitution which he introduced in 1936 was a remarkable document due to its emphasis on social justice. It proved to be very difficult to achieve the goals set by that constitution, but it was nevertheless important that an attempt was made to raise political consciousness in this way.

Columbia's main export, both before and after the depression, was coffee. In this it shared the same fate as Brazil. One might have expected that the two countries would have got together and adopted a common policy of output and export restrictions as India, Ceylon and the Netherlands Indies had done with regard to tea, but this did not happen. The Columbian coffee producers preferred to let the Brazilians go ahead and burn their coffee so as to improve the chances for Columbian coffee exports. They had adopted the same attitude with regard to the Brazilian price stabilisation policy in earlier years and thus enjoyed a free ride. Moreover, Columbian coffee was of a better quality and therefore always had an edge over Brazilian coffee in the world market. Columbia also benefited from a bilateral trade agreement with Germany of the 'coffee for machines' type. It thus experienced an upswing from 1934 onwards and could afford substantial investments in its industry.

CHILE AND PERU

In contrast with the coffee exporters, Chile and Peru mostly exported ore, and Peru also exported oil. They were both hit very hard by the depression. Chile was even rated in statistical terms as the country most affected by the depression in the whole world. International trade in general receded only by 25 per cent during the depression years, but Chile's exports were reduced by 76 per cent and its imports by 82 per cent. Peru was similarly affected, but on taking a second look we see that the two countries were not hit so terribly hard by the depression as the figures concerning their external trade would indicate. The reasons for this were not the same in Chile as in Peru. Chile had a substantial industry even before the depression, and this industry experienced only a slight recession and otherwise continued to grow throughout the depression years. Peru was underdeveloped when compared to Chile, but since its export sector was dominated by foreign companies, their losses, caused by the depression, had little direct effect on Peru. Nevertheless Peru experienced a major political crisis.

Chile had departed from the gold standard in June 1931, and had asked its foreign creditors for a moratorium on its debts. The Chilean peso depreciated in the course of these events, and the deflationary policy maintained until June 1931 was given up. It was followed by a reflationary policy which soon became an inflationary one. Within two years money supply (M1) doubled. A shortlived socialist government, which was in office only from June to September 1932, explicity ordered the central bank to print money so as to revive the economy. This met with some success, but not for the socialist government, whose days were numbered. The index of industrial production (1929=100) fell to 76 in 1931 and then rose again to 123 in 1937. Chile also profited from a reviving demand for copper and other ores which it exported. Ore output had dwindled rapidly before 1932 but almost regained its pre-depression level in 1937.

Peru experienced a similar recovery, but this was due to somewhat different reasons. In the 1920s Peru had undergone a fundamental structural change of the composition of its exports. In earlier years cotton, copper and silver had been predominant, but in the 1920s oil had become of foremost importance. In this period Peru was ruled by President Leguia who was in the pay of the foreign oil companies and ran the country so as to suit their interests. He secured his regime by corruption, but the depression deprived him of the means for continuing this game and he was overthrown in August 1930. This was followed by a civil war which lasted for three years. No crisis management was possible at that time. Peru benefited only from the fact that it had declared its insolvency and devalued its currency at the first impact of the depression. When the civil war was over, prices for the export products recovered. In the meantime Peru had also revived its cotton exports which had amounted to one third of all exports as late as 1925. The immediate impact of the depression had also curtailed the cotton export (1928=100, 1931=61), but by 1934 the index reached 168—a phenomenal revival for this type of export.

ARGENTINA AND MEXICO

These two countries deviate in many respects from the pattern set by the countries discussed so far. Argentina's main exports, beef and wheat, its enormous war profit during the First World War and its special relationship with Great Britain were all without parallel in Latin America. Mexico, on the other hand, was unique due to its early revolution after the overthrow of the dictator, Porfirio Díaz, in 1911 and the constant tensions, as well as the intimate contacts with the United States.

Argentina was almost complementary in its agricultural production to Great Britain which had concentrated on industrial production and had greatly reduced its internal output of grain. British wheat production had receded from an average of 2 million tonnes during the First World War to 1 million tonnes in 1931. The number of British cattle amounted to about 7 million, which was only half that of France. Therefore the British were good customers of the Argentinian grain producers and cattle breeders. On the other hand Argentina was a much appreciated client of the British capital market. For this reason Argentina tried to remain in the good books of its British creditors and did not suspend debt service, although it did introduce foreign exchange controls and allowed its currency to depreciate. Argentina was by far the richest country in Latin America and had a large amount of gold reserves. Nevertheless, it suspended the convertibility of its currency as early as December 1929, which amounted to abandoning the gold standard in practice. In the years 1927 to 1929 the value of Argentinian exports had always amounted to about $1 billion, and the imports were also substantial, but there had been a positive balance of trade to the tune of $150 to $200 million in those years. These external trade figures were about twice as high as those of Brazil and four times higher than those of Mexico. The value of Argentina's exports fell less than that of the coffee exporting countries in the depression years and its imports also remained fairly high. There was only once a negative balance of trade, of about $100 million, in 1930. In the years from 1932 to 1934 Argentinian exports were worth about $370 million, and the positive balance of trade amounted to about $125 million.

In spite of enjoying such a comfortable position, Argentina concluded a bilateral trade agreement with Great Britain in 1933 which was not at all favourable for the Argentinians. Great Britain exploited its position as a creditor and included preferential tariffs for British industrial products in this agreement. As a compensation, Argentinian beef was granted free access to the British market. The British could hardly have bought their beef more cheaply elsewhere, so this concession was a sham. But the Argentinian cattle breeders were so interested in this guarantee that they did not care for the consumers and industrialists who were affected by the preferential treatment accorded to British products in this agreement. The United States protested in vain, and Keynes showed his mercantilist colours by defending this bilateral agreement. He argued that a British worker who ate Argentinian beef could well expect that his job would be secured by the export of British industrial products to Argentina. It is understandable that import substitution did not have much of a chance in Argentina under such conditions although this rich country would have had the means to sponsor industrial growth by investing in production for the home market.

Mexico was very poor compared to Argentina. Like Peru it depended on foreign companies for its oil and ore exports. Unlike other Latin American countries Mexico had a great deal of experience in state intervention. But as far as monetary policy was concerned it followed a very orthodox line even in the midst of the depression. It initially did not even make use of the fact that it had a bimetallic currency, as it produced silver and had silver coins in circulation. The exchange rate was determined by the relation of the silver peso to the US dollar rather than to gold. Nevertheless the Mexican government tried to stick to the strict rules of the gold standard and was also very eager to balance its budget. Thus it continued a severely deflationary policy even when it practically abandoned the gold standard in July 1931. At that time Mexico demonetised gold because its gold reserves were depleted. Finally the finance minister resigned at the end of 1931 and his predecessor returned to office. He followed a policy of easy money and reflated the economy. This he did by means of a very simple measure. He resumed the coining of silver pesos which also yielded a revenue to the government due to the collection of seignorage on the minting of coins.

Mexico's balance of payments was burdened by its debt service, but its balance of trade remained positive throughout the years of the depression. In the years from 1927 to 1929 this positive balance amounted to about $100 million, from 1930 to 1933 it was reduced to half that amount, but in 1934 it increased once more. Mexico was lucky because both silver and oil prices went up in 1934. The poor peasants and agricultural labourers, whose ranks were swelled by Mexican workers who lost their jobs in the United States, had to bear the brunt of the depression. Population increase also contributed to the reduction of per capita income which regained its 1925 level only in 1940. In spite of his spectacular expropriation of the foreign oil companies in 1938, President Cardenas (1934–40) could not do much for the alleviation of poverty in Mexico. He clashed with Great Britain and the United

States due to this expropriation and appeared as a national hero because of that, but the immediate economic gains of this measure were rather modest. However, it certainly marked the peak of state intervention in Latin America in this crucial decade.

These six case studies of 'reactive' states have illustrated the common features as well as the differences in the fate of Latin American states in this period. We shall not discuss the many 'passive' states, because they do not provide examples of state intervention as induced by the depression. Several of them were ruled by dictators, but they were of the usual kind so often produced by Latin American states. Their actions did not illustrate state intervention but merely corruption, of the kind which President Leguia had practised in Peru.