



## Constructive Versus Dollar Diplomacy

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*The American Economic Review*, Volume 13, Issue 1 (Mar., 1923), 68-76.

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## CONSTRUCTIVE VERSUS DOLLAR DIPLOMACY<sup>1</sup>

There are two preliminary qualifications which are required by the broad scope of the title to this paper. First, the discussion is intended to relate to American financial intercourse with nations dependent on foreign capital for their economic development. Second, the nations herein considered are exclusively of the Western Hemisphere and so-called Latin America. By way of at once explaining and disposing of a title more journalistic than scientific, it may be said that the difference which the title seeks to contrast is one of emphasis rather than of substance. Both dollar diplomacy and what is herein outlined as constructive diplomacy indicate an intention to pursue a concrete objective in the relations between this nation and the states under consideration, as opposed to the opportunistic formalities of conventional diplomatic intercourse. The creed of dollar diplomacy was unequivocal. Foreign investments, without shame or hypocrisy, were to be taken as the basis of American policy towards nations of doubtful capacity to maintain law and order and stability of government credit. The method of dollar diplomacy was to be direct and decisive. Obligations once assumed by these states or investment once permitted by them by implied or specific consent, there were to continue in them the negative duty of refraining from detrimental acts, and the positive duty of maintaining law and order and compliance with obligations entered into. Breach of either duty was to summon into action the coercive power of the United States. While never so categorically expressed, the principles of dollar diplomacy as revealed in the several incidents in which it was proposed or employed conformed to the foregoing statement. Public opinion has never sanctioned this view of the relation between the United States and weaker nations with which its nationals happen to have commercial or industrial dealings. It was a policy developed from a futile attempt to distinguish between the political and economic relations with weaker states; one resting on a conventionalized idealism and the other on force.

Constructive diplomacy, on the other hand, discards force and substitutes for the exercise of coercive measures to protect ill-advised adventures, supervision over the terms and conditions of investments before they are made. It is no less pragmatic. It stands squarely on the recognition of the superiority of economic relations to political etiquette in determining the actual policy of the United States towards Latin-American nations.

Having proceeded thus far, it is necessary to pause for a moment

<sup>1</sup>This paper was read at the Thirty-fifth Annual Meeting of the American Economic Association held in Chicago, December 29, 1922.

to take advantage of the privilege of qualifying generalizations, which it is understood attaches to participation in these discussions. A policy of diplomatic procedure necessarily presupposes the existence of the status of equality between states. In certain cases, notably in Haiti, Santo Domingo and Cuba, either under treaty or arbitrarily, the status of legal equality has been abrogated. In such cases intervention and the use of force may be entirely compatible with constructive service. In none of the instances cited has an investment or financial interest been the controlling cause of intervention. These republics are rather sociological experiments than states, and the expectation of ultimate good to be accomplished and the absence of any provable unworthy motive on the part of the United States will be held to justify whatever drastic measures the intervening government has taken with respect to them. The qualification to be made therefore is this: these troublesome republics are temporarily without the scope of diplomatic intercourse, and are where they are because of their own mismanagement. Nothing that the United States could have done with respect to them, short of intervention, would probably have altered the existing situation.

Having accorded such satisfaction to logic as possible, we may, if you will, resume our consideration of the larger phase of the subject.

While the question of American participation in the rebuilding of the old-world civilization has been under debate, important strides have been taken by American banks and industries in the development of the new world, and the foundations laid for a fresh venture in international coöperation.

The total of Latin-American government, state, municipal and corporation bonds issued in the United States is about \$435,000,000. During the eighteen months ended June 30, 1922, \$334,000,000 of Latin-American securities were floated in the New York market as against \$80,000,000 in London. On a single day in October of this year, of sixty different kinds of foreign bonds traded in on the New York Stock Exchange, about one half were Latin-American. Before the war American participation in Latin-American finance was secondary to that of England, France and Belgium.

In addition to official intervention in the island republics, American experts are performing quasi-governmental functions in Peru, Nicaragua, Panama, and until recently in Honduras. A similar arrangement is about to be effected in Bolivia and Colombia.

For the first time in its long history of reorganizations, the Mexican debt has been reorganized under the guidance of a committee of international bankers in which American bankers took a leading part. All Latin-American countries are borrowers abroad and virtually all of them have turned from Europe to borrow in the American market,

or to attempt to do so. In the field of Latin-American government finance it is unlikely that the American banks will soon again have important competition from Europe, except to a limited extent from England. Consequently, during the coming years there will doubtless be a steady stream of dollars exported to the South, and with every dollar there will go just so much of practical American concern for the economic development and political well-being of those countries. This growth of the financial relations between Latin-American republics and the United States is, perhaps, the most potential result of the post-war financial status of this country. Incalculable opportunities for American commercial expansion exist in Latin America provided there is developed in the United States sufficient skill in employing its creditor position for the permanent development of the resources and people of the borrowing nations. If this can be accomplished, it is quite conceivable that commercial gains with Latin America will amply compensate any concession made by this country from choice or necessity in the adjustment of the interallied debt. At all events, we are apparently at the moment of a great sweep southward of our economic frontier, an occasion which presents an unprecedented opportunity for international coöperation towards a great social end. How shall we meet this opportunity?

In the first place, there is the Monroe Doctrine. For a century it has in general permitted the Latin-American states to experiment in self-government without the political interference of Europe. Frequently, so-called republican governments have been republican only in the sense that they were not dynastic. But, on the whole, general political progress has been made, notably by those states which have arisen to the power rank. Less progress has been made in industrial or other forms of economic development, in the sense that these represent progress in national capacity to use natural resources and to satisfy national needs. Having facilitated the political development of these states, the United States is now face to face with the opportunity of taking a leading part in their economic development. What are to be the consequences to America and to the republics of this participation? With hundreds of millions and ultimately billions of dollars invested in the securities of these countries will the benevolent attitude of America toward their destiny undergo an alteration? What will happen if Latin-American investments suffer because of prolonged political and administrative disorganization in the affairs of any government which happens to be an important debtor to American investors? Is there before us an extension of the kind of responsibility assumed by the American government in Haiti and Santo Domingo, to other republics whose governmental ineptitude may be advertised by non-compliance with debt obligations? Not if steps

already taken by the State Department to forestall difficulties can be intelligently supplemented.

The caption of the leading article in a current issue of the business men's official organ in the United States proclaims that "Our Dollars Go Guarded Overseas," meaning that the United States Government exercises this guardianship. This article emphasizes the undoubted fact that the drift of American diplomatic policy is today determined by economic interest. Forms of government are of less concern than economic policies, particularly where legitimate investment interests are affected by such policy. There was a time in Latin America when violation of the political provisions of their constitutions through revolutionary usurpations of power caused us most concern. Now we hear more of confiscation of property rights in the discussion of our Latin-American relations. We shall hear less of outraged Latin-American patriots pleading for Washington's support to right their national wrongs and more of outraged and disappointed investors insisting on what is generally described as a strong policy. That is to say this will occur unless, as I have suggested, the steps taken by the State Department to prevent trouble are supplemented along some such lines as I shall presently venture to propose.

In view of the growth of foreign government financing in the United States and its obvious important bearing on foreign policies, the State Department since March of this year has invited submission to it of all plans of American houses regarding prospective foreign loans. It requests the coöperation of investment bankers in keeping the government informed regarding public flotations of foreign issues "so that it might express itself regarding them, if that should be requested or seem desirable." The Department specifically declines to pass on the merits of foreign loans as business propositions, or to assume any responsibility whatever in connection with loan transactions. Nevertheless it may undoubtedly be taken for granted that no important issue will be made by any responsible house without submission to the Department and that none of which it disapproves will be offered to the public. Undoubtedly in the conferences which attend these submissions important constructive recommendations to both parties to the transaction can be made by the Secretary and his advisers. Through official channels the State Department has ample facilities for acquiring authoritative information regarding all the circumstances which would affect a particular issue of any government security or important local commercial enterprise. The expert knowledge acquired by the Department in the course of its contact with these matters will enable it to suggest ways of meeting particular financial problems. Already the Department is requested to suggest competent experts to assist governments, desiring to secure credit, to carry out fiscal reform

which will improve their credit position, or to plan how to use most effectively the proceeds of prospective financing. Unofficially, through the Pan American Union, of which he is the presiding officer, the Secretary of State may establish helpful advisory relations with Latin-American states respecting financial and economic questions, which need not be subjected to the restraints of official dealing. For the future guidance of bankers and investors the Department will no doubt in course of time make known its views respecting the conditions to which, from its knowledge of the facts based on its experience in considering proposals and its contact with the countries concerned, it believes that Latin-American financing should conform. The American people have not only a practical financial interest in such intelligence, but a deep concern as well because of their desire to see the progress of the Latin-American republics facilitated in every way. Pending such an official declaration we may construct for purpose of discussion the possible outlines of such a policy.

To clarify the intention and significance of proposals to be submitted, the general features of two recent Latin-American financial plans may be reviewed with appropriate brevity. The first is a proposal never carried out, yet formulated in the terms of a contract, tentatively executed. Though now a dead letter, it illustrates effectively the dangers involved even in sincere attempts to offset the inherent weakness of a credit risk by drastic provisions, not only financially burdensome, but likely to arouse national passions. The plan attempted to accomplish five things: to stabilize currency; to provide a national banking system; to refund matured obligations; to stabilize foreign exchange and finally to provide a fund for needed public works. The banker was to supply a certain number of millions of dollars in exchange for the bonds of the government, which were to mature in less than thirty years, to bear interest at 6 per cent, and to be amortized in annual instalments beginning the third year after issue—the bonds were to be secured by a specific assignment to the banker of all the revenue of the republic, and by the assets of a currency reserve fund to be established.

The banker was to receive  $5\frac{1}{2}$  per cent of the principal amount of the loan as his underwriting commission, a charge not regarded as excessive in financing of this character.

To reorganize the currency, there was to be created a commission of three members, all appointed by the republic, two of whom were to be satisfactory to the banker. This commission was to receive the proceeds of the loan and to apply them to the following purposes. It was to invest about 80 per cent thereof in United States government securities, to be used in guaranteeing bank bills to be issued by the national bank which was to be established, which in turn were to be used

for payment up to a prescribed amount of the outstanding obligations of the government, and up to another specified amount in the prosecution of public works. In case of default in interest or sinking-fund payments on the bonds, the reserve held by the commission was to be made available for such arrears.

The government undertook to subscribe one half the capital of a national bank to be established by the banker and the republic, but with all the common stock owned by the republic. However, the board of directors of the bank was to be controlled by the banker who also reserved the right to approve the powers and authorities to be conferred on the bank by subsequent legislation. The manager of the bank was to be appointed by the republic subject to the approval of the banker as well as of that of the banker-controlled board of directors. The bank was to be made the sole fiscal agent of the republic, to have sole power to collect and receive the national revenues, to be the sole depository for government funds in the republic, to have the sole right to issue non-metallic legal tender. Such currency was to be accepted as legal tender for all purposes within the republic excepting for the payment of principal and interest on the debt created under the agreement. These notes were to be authenticated by the currency commission, seated in New York, and holding the reserve in United States government securities. This reserve was to be applied for their redemption after the complete repayment of the loan.

Should the government resolve to coin and issue metallic currency, the minting was to be done by the bank on account of the republic.

The bank was to be exempt from all and any kind of taxation either present or future.

Whenever, through some special circumstance as, for example, crop failure, a general economic disturbance might be threatened, the republic on the advice of the bank agreed to restrict the importation of non-essentials.

The contract provided for the yearly payment by the republic to the banker of one per cent of the principal of the loan for the expense of the service of the loan, exclusive of interest and sinking-fund charges and for the compensation of the commission on currency, and an additional one per cent for the compensation of the manager of the proposed bank and for meeting the expenses of its operation.

Finally, the bankers were to be given the option of bidding on all future financing of the republic, including the submission to it of the proposals of other banks.

The plan was skilfully drawn to protect the investors' interest and, conceivably, might have worked out to the ultimate advantage of the borrower. It needs no discussion to explain the opportunities for misunderstandings and national resentment it provided. It is unadvis-

able, to say the least, for any banking house to assume so large a responsibility for the fiscal administration of a nation as was in this case proposed. If financial reorganization cannot be worked out by the country itself, needed assistance and service should be provided by some disinterested body in which both the bankers and the borrowing nation may repose confidence.

The second illustration chosen is the tentative settlement of the Mexican debt question during the past summer as the result of negotiation between the Mexican minister of finance and the International Committee of Bankers, under the leadership of a distinguished American financier.

In this settlement there were three problems to be dealt with: first, the resumption of payments on the foreign debt of Mexico, discontinued for the past ten years because of revolutionary disturbances; second, settlement of the problem of the arrears of unpaid interest; and, third, the adjustment of the questions arising from the government's seizure of the national railways owned by a corporation in which, while the government is the majority stockholder, the interest of foreign bondholders is of predominant importance.

The plan developed was ingenious, justly conceived and admirably devised in technical detail. Debt service payments are to be resumed on a gradually sliding scale; payments of back interest are to be spread over forty years, beginning in 1928. Sinking-fund payments are to be postponed for a period not exceeding five years. Interest payments in the first instance are to be limited to an annual amount paid before the revolution and to be increased in five years to 50,000,000 pesos. The government is to guarantee the railway debt in its entirety, thus bringing the national obligations up to 1,000,000,000 pesos principal and 400,000,000 pesos accrued interest. The railways are to be restored to private management.

No new financing is provided for. The effort was made in this agreement to restore the *status quo ante* the revolution with the exception that questions arising from the seizure of the railways were disposed of by a government guaranty, principal and interest, of the railway indebtedness.

In my opinion, because Mexico cannot ever arrive at economic stability without constructive agrarian reorganization, no settlement of her financial problems will be valid which leaves agricultural reform out of account.

Because the railways are the best available means for developing a modern system of agriculture in Mexico and at the same time the basis of practical coöperation between the nation's creditors and the government, I had hoped that the final settlement would include a coöperative, agrarian program to be executed by the railroad and the government.



Despite the illustrations of the first instance cited, bankers hesitate to go beyond their technical experience in dealing with national finance problems. Well, that is a limitation of banking which somehow must be supplied if international financing in Latin America is to be made generally constructive. In this case, because of the desire of the Mexican government to maintain its tradition of solvency and because of the exceptional facilities afforded by the railway relationships between banker and government, a substantial social-economic foundation might have been laid for a financial plan, that now rests chiefly on future good fortune in the development by foreigners of additional oil resources.

From these illustrations certain elements of a financial program with respect to Latin-American countries may be deduced.

Let the United States government discountenance the assumption by American financial interests of specific governmental functions in any borrowing country, particularly in Latin America.

Let a definite stand be taken against the exaction of any form of monopoly as a condition to any loan made to any of the Latin-American states. These declarations might constitute a modern version of the Monroe Doctrine addressed to ourselves and phrased somewhat as follows: "By virtue of the special status we have claimed and acquired in respect of these sister republics, the government of the United States will look with disfavor on any attempt by any citizen or corporation of the United States, or any person subject to its authority, to acquire monopolistic privileges or to usurp the functions of government, as a condition of any loan made to any country in Latin America."

Beyond this a limit should be imposed on the extent of indebtedness to be incurred by any nation through flotation in the United States, measured by some determined relation to average revenues.

To promote the constructive and non-political use of borrowings an explicit statement should be required of the objects to which the proceeds of the loans are to be devoted. The same principles which govern the use of capital loans by corporations should be applied to government long-term borrowing. To a considerable extent, as will notably be the case in Mexico, progress is impeded because revenues required for social advancement are mortgaged to an extravagant past.

The total cost of the loan to the borrower should be made public, as a safeguard against possible future repudiation on the ground of extortion.

It should be required that all the terms and conditions of the loans be made public in order that both the interest of the borrower and that of the lender may be safeguarded against impolitic provisions, likely to cause international complications.

Increasingly, through the Pan American Union, the Universities, or some other suitable channel, the full facts regarding the social and economic realities of the borrowing countries should be made available to the United States government and to the investing public in order that ill-advised financing may not be encouraged.

There needs to be developed a disinterested body of experts capable of rendering assistance in the solution of the economic and fiscal problems of these poverty-burdened countries. Finally, above all, the test to be applied to Latin-American financing in the United States should be whether the proceeds of the loans are to be employed to develop the fiscal and economic independence of these countries. Thus may the technical and financial strength of America assist in releasing for their own advantage all the unmeasured resources of this extraordinary array of nations.

HENRY BRUÈRE.

### STABILIZATION OF EUROPE

Note: At the evening session, Friday, December 29, 1922, of the Annual Meeting of the American Economic Association, held in Chicago, Professor Irving Fisher discussed the three previous papers, which were grouped together under the general title of "Foreign Financial Problems."

There is a fast growing movement in the United States toward participation in the problem of stabilizing Europe. This movement grows out of the conviction that we need to help Europe in order to help ourselves. Europe is our market and our debtor and in order to sell to her our wheat and obtain from her repayment of the eleven billions she owes us officially and the four billions she owes us unofficially, we must first see her on her feet. We also wish to avoid another world war. These selfish motives reinforce the altruistic impulse to lift our mother country or countries out of the slough of despond.

Having set our faces toward such participation, we are now casting about for the best methods.

In my opinion the very best and most fundamental method is for the United States to join the League of Nations; and I believe that eventually we shall be led to do this. We shall then regain our lost prestige and influence and have an opportunity to exert that influence continuously instead of spasmodically in unwieldy and widely separated international conferences, while any specific conferences needed can be all the more readily arranged. When we take this step, and I fear not before, we shall have gone a long way toward reducing the burden of armaments both on land and sea, by substituting an assurance of peace for a fear of war.

This would go far toward solving our economic problems by removing or reducing a chief economic drain on European resources and would put the United States in a position to act the part of impartial arbitrator of the economic problems which remain. Above all, France would be re-