

During the 1930s, long before the IMF, the British Empire coped with a debt crisis in a small country. This is a tale of the choice between debt and democracy. It shouldn't be forgotten.

The Newfoundland Lesson

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As the frequency of developing country debt crises will testify, there is often a contradiction in the modern era between democracy and debt. Voters elect governments that pursue populist policies which lead to debt crises. The countries then turn to the International Monetary Fund for help. The IMF attempts to impose conditions that set the stage for economic slumps. The governments became highly unpopular and sometimes suffer counter-revolutions. The recent histories of Indonesia and Argentina are case studies in such a process. But there are other less dramatic examples in Latin America, Africa, and Asia of tension between democracy and IMF-driven austerity.

What has been missing from contemporary debates about the IMF's role is any memory of what the world was like before its creation. There were numerous defaults by Latin America countries during the 19th century. They sometimes occurred because of political revolutions and sometimes because of collapsing export prices. On three occasions, the United States deployed military forces to collect debts from troubled countries (Haiti, Dominican Republic, Nicaragua) or to keep away European powers threatening to do the same. But the most extraordinary debt restructuring of the pre-1945 era was not in Latin

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America. It was in a dominion of the British Empire, the country of Newfoundland. During the early 1930s, Newfoundland experienced a form of political punishment and national humiliation for its debt problems which is unsurpassed by any other country since the emergence of government debt markets in the 17th century.

FROM SOVEREIGNTY TO TAKEOVER

Newfoundland was first explored by the Vikings one thousand years ago and then again by John Cabot for

The commission's proposed solution to the crisis has no parallels in any other sovereign debt restructuring. It proposed that Newfoundland should give up both independence and democratic self-government.

Britain in 1497. The British established settlements to exploit the island's fishing resources and Newfoundland became Britain's oldest colony. The King authorized the governor to establish the island's first parliament in 1832, the same year as the great reform bill which democratized Britain's parliament.

Newfoundland became the first self-governing dominion of the empire in 1855, twelve years before Canada, forty-five years before Australia, and fifty years before South Africa. In the late 19th century, Newfoundland negotiated trade agreements with the United States over the protests of Canada and enjoyed all the other traditional trappings of sovereignty.

Newfoundland's history took a unique turn during the early 1930s compared to all other dominions of the British

Empire because of its public debt. The government had borrowed heavily to finance military expenditures during the First World War, to finance the construction of a railway, and to cover operating deficits incurred on the fiscal account throughout the 1920s. By 1933, there was a public debt of over \$100 million compared to a nominal national income of about \$30 million. Newfoundland's major export was fish. As a result of economic crisis and defaults in the Catholic countries of Latin America, there had been a sharp decline in the price of fish. The decline in export prices coupled with the other effects of the Great Depression made it impossible for the government to continue borrowing. In 1933, the budget deficit was \$3.5 million or over 10 percent of the island's GDP.

The Newfoundland government turned to the British government for help and London obliged by appointing a royal commission under Lord Amulree (Viscount William Worrender McKenzie) to investigate the country's economic situation. The commission traveled to the island and held numerous hearings before producing a report that condemned Newfoundland's fiscal policies for creating an unsustainable debt burden. The report said,

"The twelve years 1920–1932, during none of which was the budget balanced, were characterized by an outflow of public funds on a scale as ruinous as it was unprecedented, fostered by a continuous stream of willing lenders. A new era of industrial expansion, easy money, and profitable contact with the American continent was looked for and was deemed in part to have arrived. In the prevailing optimism, the resources of the Exchequer were believed to be limitless. The public debt of the island, accumulated over a century, was in twelve years more than doubled; its assets dissipated by improvident administration; the people misled into the acceptance of false standards; and the country sunk in waste and extravagance. The onset of the world depression found the island with no reserves, its primary industry neglected and its credit exhausted. At the first wind of adversity, its elaborate pretensions collapsed like a house of cards. The glowing visions of a new Utopia were dispelled with cruel suddenness by the cold realities of national insolvency, and today a disillusioned and bewildered people, deprived in many parts of the country of all hopes of earning a

livelihood, are haunted by the grim specters of pauperism and starvation.”

The commission’s proposed solution to the crisis was the most radical ever to occur in a dominion of the British Empire and has no parallels in any other sovereign debt

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restructuring. The royal commission proposed that Newfoundland should give up both independence and democratic self-government. In its place, the British government would establish a special six-man commission and royal Governor to govern the country until there was economic recovery and it could return to responsible self-government. The commission would not be responsible to the people of Newfoundland but to the Dominion office in London. The Dominion office, in turn, would be responsible to the House of Commons.

The notion that a self-governing community of 280,000 English-speaking people should give up both democracy and independence in order to avoid debt default was unprecedented but the commission stressed that the alternatives would be worse. It said,

“No part of the British Empire has ever yet defaulted on its loan obligations; in the absence of any precedent, the consequences which would follow from a default by Newfoundland must remain to some extent a matter for speculation. But if no precedent can be drawn from the history of the Empire, instruction may be derived from the experiences of other countries, and it is clear from these that any play of default such as that outlined above could be approved with the greatest apprehension.

The fulfillment of a private money contract depends, of course, in the last resort on the capacity of the debtor to pay, and the law provides accordingly for the bankruptcy of an insolvent debtor. But bankruptcy is at best an ugly word and carries a stigma which a nation even more than an individual would do well to avoid. Directly or indirectly, national bankruptcy is liable to affect the fortunes of every citizen.”

Despite the extreme nature of the commission proposals, they were accepted by both the people and the government of Newfoundland for three reasons. First, the country truly was on the verge of default and the political elite did not regard default as a real policy option. Second, public confidence in Newfoundland’s own government had been eroded by scandals during the late 1920s and early 1930s. In 1932, a group of demonstrators had actually occupied the parliament house and chased the prime minister through the streets in order to lynch him. In the election that followed, the ruling Liberal Party was reduced to only two seats out of twenty-seven while the conservative United Newfoundland Party took twenty-three. When the vote came to terminate parliamentary democracy, the Liberals left the assembly and the government won with no dissenting votes. Third, as a result of the lack of confidence in

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the local politicians, many Newfoundlanders concluded that a British-appointed commission might provide a better public administration. Some members of the parliament were also seduced with promises of jobs in the new British administration.

A “HOLIDAY FROM POLITICS”

The willingness of Newfoundlanders to take a “holiday from politics” was probably less shocking in the early 1930s than it would appear today. As a result of the Great Depression, many countries abandoned democracy during the

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1930s and turned to strong men to provide order, clarity, and direction. In the hearings of the Amulree Commission, some Newfoundlanders proclaimed that their country needed a Mussolini. A British publishing company commissioned a series of books entitled *If I Were Dictator*. They sold well. But until 1933 there was still no precedent for a dominion of the British Empire giving up both sovereignty and democracy to resolve a debt problem.

There were a few precedents before 1933 for countries sharing sovereignty to resolve debt problems. The United States established a fiscal protectorate in the Dominican Republic in 1907 in order to control the customs house and then occupied the country in 1916. The United States also intervened in Haiti and Nicaragua to control the customs house and obtain revenue for debt servicing. After World War I, the League of Nations played a major role helping the new Republic of Austria to restore financial stability after the dissolution of the Hapsburg Empire. With the consent of the Austrian parliament, the League appointed a resident commissioner to approve all spending legislation, supervise the central bank, and monitor economic reforms. The League Report explained how the Commissioner’s power worked.

“The successful accomplishment of the reform program, on which Austria’s prosperity and value of her assets depend, would necessarily be a difficult and painful task. The scheme therefore included the appointment of a Commissioner

General, whose duty was to ensure, in collaboration with the Austrian government, that the program of reforms was carried out and to supervise its execution. He would derive power from his control of the disposal of the loan.”

The Royal Commission did not refer to the Austrian or Central American precedents, but it was highly critical of Newfoundland’s form of democracy. It said,

“As a general statement, it is not too much to say that the present generation of Newfoundlanders have never known enlightened self-government. The process of deterioration, once started, could not be controlled. The simple-minded electorate was visited every few years by rival politicians, who, in the desire to secure election, were accustomed to make the wildest promises involving increased public expenditure in the constituency and the satisfaction of all the cherished desires of the inhabitants. The latter, as was not unnatural, chose the candidate who promised them the most. This might be said of other countries, but in Newfoundland the cajoling of the electorate was carried to such length that, until the recent crisis brought them to their senses, the electors in many cases preferred to vote for a candidate who was known to possess an aptitude for promoting his own interest at the public expense rather than for a man who disdained to adopt such a course. They argued that, if a man had proved himself capable of using his political opportunities to his personal advantage, he would be the better equipped to promote the advantage of his constituents; an honest man would only preach to them.

“The country was thus exposed to the evils of paternalism in its most extreme form. The people, instead of being trained to independence and self-reliance, became increasingly dependent on those who were placed in authority; instead of being trained to think in terms of the national interest, they were encouraged to think only of the interests of their own district.”

This political culture coupled with the dependence upon fishing created the preconditions for economic catastrophe during the early 1930s. As the report elaborated,

“This political system, combined with the effects of the credit system in the fishing industry, weakened the fibre of the people and left them wholly unprepared for the intensive economic depression which was soon to cast its shadow over the Island. In 1929, the price of the fish was such as to yield the fisherman a fair margin of profit. In

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1930, prices began to fall; in 1931, they were lower still and by 1932 they had reached the lowest level recorded in the present century. Even in 1930, the average fisherman was unable to do more than balance his account with the merchant. By the end of the season of 1932, he was hopelessly in debt to the merchant and had been reduced to abject poverty. During the winter of 1932, no fewer than 70,000 persons or 25 percent of the population were in receipt of public relief, other than poor relief or relief for the aged poor. Such relief was distributed in kind, i.e., in rations of pork, flour, tea, and molasses of the maximum value of \$1.80 per head per month. Even at this modest rate, the amount expended in relief during the year 1932–1933 was \$1.1 million or one-seventh of the revenue of the country.”

NO LOCAL BANKS OR CURRENCY

The 1933 debt crisis was not Newfoundland's first brush with economic calamity. There had also been a major financial crisis in 1895 when the two largest banks in the country failed. The bank failures destroyed many local businesses and left the government without adequate funds to make a payment on the public debt. The prime minister turned to London for help. Britain provided some emergency grants for relief but declined to take responsibility for the debt unless the country accepted a royal commission to propose political reforms which might include a confeder-

ation with the other dominion of British North America, Canada. Newfoundland's politicians decided such a commission was too risky to consider. A new prime minister took office and turned to Canada, proposing discussions about a possible union of the two countries on their terms rather than Britain's. But the talks foundered because of disagreements about who would take responsibility for the debt. Canada asked Britain to assume responsibility for the debt but London declined. The crisis was finally resolved by the colonial secretary, Robert Bond, traveling to Montreal, New York, and London to raise private loans for the government. Mr. Bond pledged \$100,000 of his money as collateral for one loan in Montreal and then was able to obtain a loan of \$850,000 from private bankers in London at an interest rate of 3.5 percent.

Newfoundland eventually recovered from the banking panic of 1895 and Mr. Bond went on to become one of the country's most highly regarded prime ministers. But the 1895 crisis set in motion changes which contributed to the crisis of the early 1930s. The collapse of the local banks opened the door for Canadian banks to take over the country's financial system. The Newfoundland Parliament enacted legislation making the Canadian dollar special legal tender. Newfoundland people also ceased to invest in the government's securities and so by 1930 about 95 percent of the public debt was held outside of the country. The primary owners were Canadian banks and investors. Two Canadian bankers served on the Amulree commission which proposed the end of Newfoundland's democracy. One of the bankers had arrived shortly after the crisis of 1895 and established the Bank of Nova Scotia there. New-

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foundland's lack of local banks and a local currency increased her vulnerability to the economic shocks of the early 1930s. The government had no alternative to foreign

banks in funding itself. The market for Newfoundland securities had also slumped sharply before the Amulree Commission. When other fish-exporting countries devalued their currencies, Newfoundland remained pegged to the Canadian dollar and thus could not resist deflation with currency depreciation. There were proposals to establish a Newfoundland currency pegged to the British pound (which had been devalued in 1931) but it was too late for such proposals to work effectively.

World War I had also imposed a great burden on the island's economy. Newfoundland borrowed \$40 million to finance its role in the war. A large share of its mercantile fleet also was diverted for military purposes and never returned. As Lord Amulree explained in a speech defending his report, the province had suffered great losses during the war.

“First of all it had lost its mercantile fleet. Before the war all of its products, including fish, were sent in its own sailing vessels to Europe and South America. These vessels were mainly built in the Dominion. There were a large number—some hundreds—of shipwrights, carpenters, sail makers, fitters and other skilled craftsmen engaged in building and repairing these vessels, and the mercantile fleet employed a large number of sailors. We had it roughly stated that perhaps as many as 4,000 or 5,000 people were engaged in that occupation. But during the war the bulk of those vessels were lost at sea, and others got worn out, and they have not been replaced.

“Meanwhile, the great competitors of Newfoundland in fish—Norway and Iceland—have adopted a new system of sending their fish to the market—namely by steamer. The advantage that the steamer gives us is that you can more or less fix the date of the arrival of the cargo, whereas in the case of the sailing vessel the time was indefinite. That of course was a great thing in the competitive market. Another difficulty which the Newfoundlander found in regard to his vessels was that the insurance rate for a sailing vessel was enormous compared with the insurance rate for a steamer. One way or another, for these and other reasons, the whole of the mercantile fleet has disappeared and all the fish cargoes are carried in foreign bottoms, not British bottoms but bottoms of a foreign country.”

The British parliament accepted the proposals of the Amulree commission and passed legislation suspending Newfoundland's status as a self-governing dominion. The Labour Party strongly opposed the Newfoundland proposals on grounds that they were undemocratic and that it was morally indefensible to rescue bondholders who had made a bad investment. The Welsh Labour M.P., David Grenfall, said,

“If you invest in coal mines in this country you may lose money, as many investors have lost their money. If you invest in steel or railways you stand a chance of losing. Why should this (moneylending) class be subjected to special government protection, and why should we and the poor people of Newfoundland be pledged bodily, physically, socially, to guarantee the claims of the bondholders?”

The Labour leader, Clement Attlee, suggested that default was preferable to giving up democracy. Referring to Britain's own default on its wartime loans from the United States, he said “All the best countries default nowadays.” But in the early 1930s it was impossible to imagine a British dominion defaulting. In 1932, the provincial pre-

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mier of New South Wales, Jack Lang, had proposed to default on the state's debts. He was promptly dismissed by the royal Governor and went on to lose an election for the provincial parliament. As with Gough Whitlam in 1975, the voters upheld the prerogative of the crown to dismiss prime ministers threatening the law or unable to obtain sup-

ply. In the world of the early 1930s, it was commonly accepted that democracy should be subordinate to debt.

OTHER MOTIVES

Some Newfoundland historians believe that Britain had motives other than just avoiding default in reassuming responsibility for the country's administration. Professor John FitzGerald of Memorial University says that Britain

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also had a strong interest in Newfoundland's potential role as an aviation center. During the early 1930s, trans-Atlantic aviation was starting and it was clear that Newfoundland could play a potentially important role providing a base for both civilian and military traffic. In fact, the British began construction of the large airport at Gander only six months after they regained control of the island.

In the debate over the Newfoundland legislation in the House of Lords, Lord Amulree focused on the potential role of aviation in the island's future development. He said,

“I need not remind your Lordships of the very important centre which Newfoundland may become in the matter of aviation. Only last July an agreement was reached between the British government and certain American interests whereby it is hoped that next summer there will be a regular aerial service between New York and St. Johns via a Canadian port. That only leaves the gap between Newfoundland and Great Britain to be filled up, and then we shall have a connecting link throughout the various parts of the Empire. We have already got an aerial service to the

Cape, to India and Far East, and next year we must hope that the Australian government will complete the gap as far as they are concerned.”

The aviation issue has not generated much discussion among historians but it provides an interesting analogy between the resolution of Newfoundland's debt problem and many recent IMF programs. In the modern era, the United States has always used the IMF to prevent countries with American military bases from defaulting. In 1933, it was obvious to some farsighted people that Newfoundland's geography would someday make her an important military asset as well as a center for commercial aviation. As a result, it was in their self-interest to gain control over the island's government in order to take advantage of the island's aviation opportunities. With the outbreak of war in 1939, it was not long before Newfoundland emerged as a vital military center. Britain gave the United States the right to construct a large base on the island while Canada opened a base in Labrador. It is possible that a Newfoundland government might have been less willing than the British government to permit such large military centers or at least charged a higher price for the rights.

DICTATORSHIP IN NEWFOUNDLAND

The Commission of Government took over responsibility for Newfoundland's affairs in early 1934. There was an immediate recovery in business confidence and the city of St. Johns was able to complete a debt offering which had stalled before the commission reported. It took some actions which offended public opinion, such as closing the national museum, but pursued other reforms which had a positive impact on the economy. It reduced tariffs, modernized the post office, and improved the professional quality of the civil service. It also experimented with promoting agriculture because of a perception that fishing alone would not be able to sustain reasonable living standards for many people. It introduced a salt subsidy to help bolster the incomes of the fishermen as well. But despite its best efforts, the commission could not fundamentally transform the country's economic situation because of the continuing low price of fish and the fact that all other resources were controlled by foreign business interests. In 1936, the island had total exports of \$28 million. Foreign companies generated newsprint exports worth \$13.2 billion and mineral exports worth \$6.4 million. The value of fishing and lobster exports from local people was worth only \$8 million.

In 1939, a member of the Commission of Government, T. Lodge, published a book, *Dictatorship in Newfoundland*, about his experience and ideas for the future. He stressed the ambiguous nature of the commission's mandate in striving to govern without the formal consent of the governed. He said,

"The Secretary of State (for the Dominions) appears to contemplate that the Commission Government should go on for a generation. It is inherently improbable either that the people of Newfoundland will acquiesce for a generation in complete disenfranchisement, or that the mother of Parliaments will be content to watch the indefinite continuance of something which might plausibly be described as negation of political freedom. Few would deny that the Commission has steadily lost popularity during the first five years of its existence. It is not surprising that this should be so. Its advent was hailed as promising new heaven and earth, and in the nature of things this promise could never have been fulfilled. Nevertheless, though no one would deny a decline in popularity few would maintain that the alternative of a return to responsible government would yet be welcomed by the general public.

"There is an uneasy feeling prevalent that there is something wrong with the system, without any general unanimity as to the direction in which any modification should be sought. Except in a very limited circle, there is little theoretical criticism of the undemocratic character of the government. Indeed, the academic objections to the constitution are somewhat unreal. The Newfoundlander may have lost his right to record a vote at four yearly intervals and thereby to choose between two sets of politicians. He is still able to bear upon his rulers a direct influence far more potent than any influence exerted by an individual elector in England. If he has a grievance he considers entitled to bring it to the personal notice of the Commissioner concerned and, within the limits of what is physically possible, his rights in this respect are admitted and respected.

"The weakness which the system has revealed is the weakness common to all non-democratic forms of government—that which is consequent to the absence of any responsible criticism. In so

far as the individual criticizes any measure he does so free from any risk of being called upon to shoulder the responsibility for carrying out an alternative. The two daily newspapers of the island have steadily given a qualified support to the Government, but that support has tended to become more and more grudging. Each considers itself entitled to criticize freely without any duty of advocating any precise alternative to the policy criticized."

Lodge closed the book on a philosophical note about the unpleasant nature of the choices which Britain had confronted in 1933.

"The immediate material benefits which the Commission have brought are obvious. The spiritual price which is paid is less clear but just as real. To have assumed responsibility for the good government of Newfoundland from altruistic motives and to have achieved economic rehabilitation might have cost the British taxpayer a few million. It would have added to the prestige of the British Empire. To have abandoned the principle of democracy without accomplishing economic rehabilitation is surely the unforgivable sin."

Newfoundland remained under the control of the Commission of Government through World War II. Britain dispatched delegations to the island in order to promote discussion about its political future. The major issue was should Newfoundland return to self-government or become a province of Canada? There was an initial consensus that Newfoundland should regain some elements of self-gov-

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ernment but still give Britain a veto over economic policy. The British government was reluctant to accept such an ambiguous outcome, so it promoted a national convention to debate the island's future. The commission also began discussions about a \$100 million reconstruction program, including \$39 million for economic development and \$30 million for communications. The new Labour government under Clement Attlee was horrified at the prospect of expending such large sums in Newfoundland at a time of great fiscal austerity at home.

"WE ARE NOT A NATION"

The convention met in 1946. The proponents of the confederation were led by a pig farmer and radio commentator, Joey Smallwood. He argued, "We are not a nation. We are merely a medium-sized municipality, a mere miniature borough of a large city." He argued that Newfoundland had become a poor and backward part of North America which needed confederation with Canada to recover. The supporters of self-government responded with strong emotional arguments invoking the island's past achievements and need to remain independent. A small minority also favored much closer links with the United States in return for granting it military leases. The war had transformed Newfoundland society by attracting thousands of American servicemen and encouraging 28,000 of them to take local wives. Britain consistently supported the cause of confederation by refusing to make any significant debt concessions to Newfoundland if it resumed self-government. Canada, by contrast, offered to assume responsibility for 90 percent of the island's public debt and leave only 10 percent for the local government.

The convention offered the people two proposals. They would be a continuation of Commission government for five more years or a return to responsible self-government with the restoration of institutions abolished in 1933. The Commission voted by 29–16 against recommending confederation with Canada. The British government then used its powers to intervene and force the issue of confederation on the referendum ballot. Britain had long favored confederation and did not want to lose a critical opportunity for promoting it. The country then entered a referendum campaign which was highly polarizing on the basis of both religion and geography. The Catholic Church strongly supported the return of self-government, as did the city of St. Johns. Other regions were more sympathetic to confederation. In the first vote, 44.6 percent favored a return to self-government, 41.1 percent favored confederation with Canada, and 14.3 percent favored continuation of the commission of government. Seven weeks later another referendum was held. This time, confederation received 52.3 percent of

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the vote compared to 47.7 percent for responsible self-government, a majority of 6,989 votes.

As Newfoundland had no parliament to ratify a treaty with Canada, the British government appointed civil servants to negotiate the treaty of union. The British North America Act actually required a country wishing to federate with Canada to be solicited by the parliament of the country but the British decided to overlook this provision of the law in order to complete the process. On April 1, 1949, Newfoundland therefore became the first dominion of the British Empire ever to become the province of another country without having the action ratified by its own parliament. The confederation treaty was an act of Britain and Canada, not Newfoundland.

The Newfoundland political history of the 1930s is now considered to be a minor chapter in the history of Canada. There is practically no awareness of the extraordinary events which occurred there. The British parliament and the parliament of a self-governing dominion agreed that democracy should be subordinate to debt. The oldest parliament in the British Empire after Westminster was abolished and a dictatorship was imposed on 280,000 English-speaking people who had known seventy-eight years of direct democracy. The British government then used its constitutional powers to steer the country into a federation with Canada.

NEWFOUNDLAND'S LEGACY: THE IMF

If the IMF had existed in 1933, it would have granted emergency debt relief to Newfoundland and the country would have never given up democracy or independence. Indeed, democracy is now a pre-condition for IMF aid. But as no institution such as the IMF existed in 1933, Newfoundland was compelled to choose between democracy and default.

The interesting question which lingers today in the debate about sovereign debt restructuring is how to draw the

line between the IMF imposing policies on national governments and their capacity for pursuing effective action independently. If the Amulree Commission were to be dispatched to Buenos Aires today, it would be fascinating to read its commentaries on Argentina's political institutions and capacity for responsible self-government. The Argentine record has been so abysmal it would not be difficult to imagine the Commission proposing either the restoration of Spanish imperial rule or the establishment of an Argentine protectorate under the nominal rule of the IMF.

In fact, the late Professor Rudiger Dornbusch of MIT wrote an article in April, 2002, proposing a neo-colonial solution to the Argentine economic crisis. He said,

“Argentinians must humbly acknowledge that without massive external support and intrusion they can't get out of the mess. What kind of external support? It goes well beyond funding. At the heart of Argentina's problems is a crisis of trust as a society and confidence in the future of the economy. No one group is willing to concede the power to resolve the claims and fix the country to any other local group. Somebody has to run the country with a tight grip; dictatorship is neither likely nor desirable. But since everybody thinks—often correctly—that everybody else is selfish and corrupt, there is no social pact that can be reached. Without this social pact, day-to-day cannibalization of social and economic capital will continue. Ever more gruesome outcomes are on the horizon.

“Argentina now must give up much of its monetary, fiscal, regulatory and asset management sovereignty for an extended period, say five years. After World War I, the League of Nations recognized the fundamental problem of a dysfunctional society in Austria. It resolved that issue, along with financial support, by having—with the consent of parliament—a resident Commissioner General, appointed by and responsible to The League of Nations.”

“It worked! And here is what Argentina must accept to do in exchange for new loans. Commissioners should come from distant, disinterested small countries (Finland, the Netherlands, Ireland for example) where people have understood that economic institutions safeguard stability and are the foundation of prosperity.

“Specifically, a board of experienced foreign central bankers should take control of Argentina's monetary policy. This solution would have many of the reputation-virtues of a currency board, without the costs of having to adopt a monetary policy tailored to somebody else's needs. The new pesos should not be printed in Argentina's soil.

“Another foreign agent is needed to verify fiscal performance and sign the checks from the nation to the provinces. Much of the fiscal problem has to do with fiscal federalism in designing and enforcing a sharing of responsibilities and resources in a way that is financially affordable. Tax evasion and corruption—and the government's acceptance of this state of affairs—has to be suppressed in the most radical fashion. Foreign micromanagement is not feasible but agreed incentive mechanisms and a sharing of experience are. Argentina is not the first country to experience tax collection issues, effective answers are available and must be imposed. A reformed, more professional civil service will be particularly helpful.”

Instead of following Dornbusch's advice, the IMF recently agreed to extend its loans to Argentina without obtaining any significant concessions to promote reform. The IMF decided to defer reform until after Argentina's presidential election in April. After Argentina's fragmented and strife-ridden exercise in democracy, it is unclear if the winner, Néstor Kirchner, will have any mandate for reform. There is a significant risk that Argentine democracy will be incompatible with effective policy action and thus prolong the country's economic woes. Unemployment could rise to 30 percent and poverty could engulf another large share of the population. Argentina may be a country where the only viable model for genuine economic rehabilitation is the Newfoundland model.

The story of Newfoundland during the 1930s continues to be a unique tale of how the British Empire coped with a debt crisis in a small country. But it is a tale which should not be completely forgotten because it is also a reminder of why, in the aftermath of World War II, the nations of the world created the International Monetary Fund. They did not want countries to ever again confront a choice between debt and democracy.

It is a legacy worth pondering as we contemplate the future of policies for helping troubled countries cope with the demands of the global financial marketplace. ◆