ESSAYS IN INTERNATIONAL FINANCE

No. 32, January 1959

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This is the thirty-second in the series ESSAYS IN INTERNATIONAL FINANCE *published by the International Finance Section of the Department of Economics and Sociology in Princeton University.*

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LATIN American countries have long been a laboratory of different exchange-rate techniques. Their exchange authorities have employed widely varied and complex exchange-rate devices in controlling their international payments. What is not generally appreciated, however, is the extent to which these systems are in a state of flux with regard to both effective rates and the type of rate system employed.

Over the years, it is also possible to discern broad trends in the exchange-rate policies of the area as a whole. These similarities are perhaps attributable to the fact that experience with a superior rate system in one country tends to be taken into account by others when they decide on changes in their own systems. An even more important factor making for such similarities, however, is the frequent parallelism of economic and institutional circumstances influencing the policy makers of the various countries.

This paper traces two broad trends in Latin American exchange-rate policies since World War II—a pronounced and widespread trend toward an increased use of flexible exchange rates, and a more gradual trend toward the simplification of previously highly complex rate systems. The reasons for these trends will be analyzed in terms of the conflicts of economic policy objectives and management difficulties of the earlier systems that have shown up during the postwar period. Finally, some possible broader implications of the Latin American experience for future exchange-rate policies in the world in general will be suggested.

I. EVIDENCE OF THE TRENDS

Table I is designed to show the main outline of the trends in the exchange-rate systems used by the Latin American republics in the years 1947-1957. Only the broader varieties of Latin American exchange-rate systems are described in the left-hand column of the table. The finer

* The author is grateful for the helpful comments of H. L. Sanford, M. N. Trued, and J. Levin.

TABLE I

Latin American Exchange-Rate Systems, 1947-1957[a]

Categories of Rate Systems	*End of 1947*	*End of 1952*	*End of 1957*
1. Single fixed rate	Cuba Dominican Republic El Salvador Guatemala Haiti Honduras Mexico	Cuba Dominican Republic El Salvador Guatemala Haiti Honduras Mexico	Cuba Dominican Republic El Salvador Guatemala Haiti Honduras Mexico
2. Fixed multiple rates	Bolivia Brazil Colombia Uruguay Venezuela	Brazil Venezuela	Venezuela
3. Fixed multiple rates for trade transactions; fluctuating rate for financial transactions.	Argentina Chile Costa Rica Nicaragua	Bolivia Nicaragua Paraguay Uruguay	Nicaragua Uruguay
4. Mixed multiple fixed rates and fluctuating rates for trade transactions; fluctuating rate for financial transactions.	Ecuador Paraguay Peru	Argentina Chile Colombia Costa Rica Ecuador	Argentina Brazil Colombia Costa Rica Ecuador
5. Single fluctuating rate for trade transactions; fluctuating rate for financial transactions.		Peru	Chile Peru
6. Single fluctuating rate			Bolivia Paraguay

[a] The Table covers all Latin American republics except Panama, which has been omitted because the bulk of the Panamanian money supply consists of United States notes and coins.

NOTE: In the classification of a vast variety of exchange-rate systems into a few categories, some difficult choices had to be made in borderline cases. For example, exchange-rate discrimination between different international transactions was very limited in Brazil in 1947 and 1952, consisting mainly of a small surtax on the selling rate for all but "essential" payments. Hence, the country might have been classified under category 1 rather than 2 at those dates. In another such

case, Colombia was operating with fluctuating (but multiple) rates for a 9-month period including the end of 1957; fixed rates for some transactions were reinstituted in early 1958. This case might have been covered by the inclusion of another category—between 4 and 5—in the Table.

SOURCES: International Monetary Fund, *International Financial Statistics*, 1948-1958, various issues; and *Annual Report on Exchange Restrictions*, 1950-1958, various issues.

differentiations—such as whether the multiple rates applied only to exports, or only to imports, or to both—are left out of account. Furthermore, the table does not escape a certain arbitrariness typical of most classifications. Thus, it may be questioned whether it is appropriate to place various Central American countries and Mexico in the same category of "single fixed rate," given the fact that most of the Central American countries have had the same exchange rate throughout the postwar period while Mexico devalued its exchange rate (in several steps) by over 60 percent between 1947 and 1957.* (Some additional qualifications are given in the note to the table).

Despite these qualifications, the table does demonstrate that, with the exception of most of the smaller countries in Central America and the Caribbean, there has been a fairly steady trend among the Latin American countries toward an increased use of flexible exchange rates, as well as a gradual trend toward more simplified rate systems. In terms of the table, the countries accounting for the bulk of Latin America's trade and payments have moved "southeastward." Thus, Brazil moved from category 2 at the end of 1952 to category 4 in 1957; Chile from 3 to 4 between 1947 and 1952, and then to 5 by the end of 1957; Colombia from 2 to 4 between 1947 and 1952; and Argentina from 3 to 4 between 1947 and 1952. The reverse "northeasterly" movement has been virtually unknown, but there are a few countries (even aside from those with a single fixed rate throughout the period) that have not made a change in the type of rate system used—e.g., Nicaragua and Venezuela.†

The second of the trends mentioned above—that toward more simplified rate systems—is not as obvious in the table as is the first; nor is it as easy to define conceptually. While it may be accepted readily that countries moving from categories 2 to 4 into categories 5 and 6 have

* The par value of the Mexican peso stood at $0.20597 at the end of 1947 and at $0.08 at the end of 1957. In further contrast with the other countries in the same group of the table, Mexico actually operated with a fluctuating exchange rate for some months of the postwar period (1948-1949).

† An examination of the rate systems applicable at dates intermediate to those given in the table would not change the results. The shifts would of course be more gradual than those shown at five-year intervals.

simplified their rate systems, such cases have not been very frequent. The greater number of changes has been from categories 2 and 3 into categories 3 and 4, and it is evident that to add one or more fluctuating rates for selected trade and/or financial transactions to an earlier system of fixed multiple rates does not necessarily simplify the system as a whole.*

An accurate measure of the relative complexity of various exchange-rate systems should probably take into account not only the *number* of effective rates applicable to a country's exchange transactions, but also the *volume of transactions* taking place at each rate. For example, it might (and should) be asked which is more complex: a rate system with four effective rates, in which one particular rate applies to 95 percent of total exchange transactions; or a rate system with three effective rates, in which one-third of the exchange transactions take place at each of the rates? Though there are no simple answers to questions of this type, the principal emphasis in this paper will be on the number of effective exchange rates. Thus, countries reducing the total number of their exchange rates will be presumed to have simplified their rate systems. In citing instances, however, we shall ignore rate simplifications that represent wholly or mainly an abolition of purely nominal rates and concentrate on cases in which rate consolidations actually resulted in fewer rates for the bulk of a country's international transactions.

II. REASONS FOR THE TRENDS AND THE EXPERIENCE UNDER VARIOUS EXCHANGE-RATE SYSTEMS

Multiple and fluctuating exchange rates have been analyzed frequently, if not exhaustively, in recent years.† Most of the discussions, however, have been in terms of the advantages and disadvantages of particular rate schemes *per se*, or in terms of comparisons between various possible rate schemes. The factors accounting for changes from one rate system to another have been treated less fully. For expository purposes, the following explanation of the trends in Latin American exchange-rate policies will also run in terms of individual (or groups of)

* As will be noted in more detail later, the immediate effect of such changes has usually been to increase rather than reduce the complexity of the rate system, and it was only later partially offset by consolidations of the effective rates into fewer groups.

† The standard references for multiple exchange rates are E. M. Bernstein, "Some Economic Aspects of Multiple Exchange Rates," *International Monetary Fund Staff Papers*, September 1950, pp. 224-237; and E. R. Schlesinger, "Multiple Exchange Rates and Economic Development," *Princeton Studies in International Finance*, No. 2, Princeton 1952. Both multiple and fluctuating rates are discussed in R. F. Mikesell, *Foreign Exchange in the Postwar World*, New York 1954, especially Chapter 19.

rate schemes. The major emphasis, however, will be placed on the reasons for the observed trends through the various stages or categories of rate systems. The presentation is designed to show the factors behind the passing through (or remaining in) the various intermediate stages between fixed multiple rates and a single fluctuating rate, instead of the possible alternative of changing from one of these rate systems to the other in one step.

I. DECLINE OF FIXED MULTIPLE-RATE SYSTEMS

Objectives of Fixed Multiple Rates

The objectives of fixed and multiple rates have been many and varied. Only a brief summary of the most frequent types of reasoning in support of such systems will be offered at this point; a fuller discussion of the interrelations and conflicts among these objectives will come later.

(a) Penalty selling rates of exchange for selected transactions permit a necessary reduction in exchange expenditures to be concentrated upon those goods and services for which the home demand is relatively elastic, so that a moderate devaluation of the average of all selling rates will reduce the demand for exchange substantially.* Partial devaluation may, therefore, serve as a substitute for the imposing or tightening of quantitative import restrictions.

(b) Preferential selling rates of exchange for selected imports permit a lessening of the impact of devaluation upon the domestic price level by avoiding (or minimizing) the devaluation of those rates that apply to "essential" items of mass consumption.

(c) Penalty buying rates for selected exports enable the authorities to exempt exports with a relatively inelastic supply from a devaluation of the average buying rate. Thus, the authorities may avoid generating windfall profits for the exporters of such goods

*The terms "selling" and "buying" rate of exchange are used here as they apply to exchange transactions from the point of view of the exchange authorities and of authorized exchange dealers (including commercial banks). Such institutions and individuals *sell* exchange to *importers* and other users of exchange, while they *buy* exchange from *exporters* and other suppliers of exchange. (These definitions are in accord with International Monetary Fund terminology.)

A penalty selling rate of exchange is one that exceeds the average selling rate in terms of local currency per unit of foreign currency, while a preferential selling rate is one that is below the average selling rate. Correspondingly, a penalty buying rate is one below the average buying rate, and a preferential rate is one above that average rate. (These definitions, which follow economic rather than legal criteria, are the ones used by E. M. Bernstein, *op.cit.*, p. 232.) The relevant averages are of course weighted (and not simple) arithmetic averages of the effective exchange rates.

and hold in check their demand for local and imported goods and services. Furthermore, where a country is a non-atomistic supplier of an export commodity, the incidence of the tax implicit in a penalty rate for the commodity may fall at least in part upon the foreign customer.*

(d) Preferential buying rates for selected exports assist those exporters who are hardest pressed competitively and may help to lessen dependence on one or a very few export commodities by stimulating new types of exports.†

(e) Maintaining fixed though multiple rates rather than one or more fluctuating rates preserves most of the basic advantage of a single fixed rate, namely, the relatively smaller risk of future exchange-rate changes in a fixed- as against a fluctuating-rate system.

(f) A substantial spread between the average buying and selling rates of a multiple-rate system provides a good source of government revenue.

Why are these arguments no longer as convincing to the authorities of many of the Latin American countries as they were a decade ago? In all likelihood, the two main parts of the answer to this question must be sought in the accumulation of substantial experience with the enormous difficulties of administering fixed exchange rates under persistent large-scale inflation; and in a gradual recognition of the fact that the administrative matching of specific commodity groups and specific rates under multiple-rate systems involves very difficult choices between conflicting policy objectives—choices so difficult, indeed, that the gains in terms of attaining any one of them have often been more than offset by the gains forgone in other directions.

Fixed Multiple Rates and Inflation

The persistence of large-scale inflation in all the larger Latin American countries has been one of the principal characteristics of the area throughout the postwar period.‡ Much could be said about the relative

* Some of the relatively rare cases in which a Latin American country holds a monopolistic or oligopolistic position in an export market will be mentioned later. The corresponding theoretical case on the import side is left out of account because all Latin American countries, taken individually, are atomistic buyers in world markets.

† It is assumed in this argument that the granting of preferential rates for selected exports (i.e., devaluation of the applicable exchange rate) will not result in a significant lowering of the foreign-currency price of these exports. Thus, it applies only in those cases in which a country is an atomistic supplier of the commodities in question. Most Latin American countries, however, do occupy such a position in world markets for the vast majority of their export products.

‡ Inflation has of course been one of the major economic problems in practically all areas of the world throughout much of the postwar period. In many Latin Ameri-

importance and interaction of the major contributing factors—the addition of "modern" types of government capital expenditures for development projects to the "traditional" large outlays for military and social welfare schemes; the continued institutional and administrative weaknesses in tax policy and revenue collection; the demands of rising industries for liberal credit policies; the increased power of organized labor in many of the countries; and the lag of voluntary savings, which is in part a consequence of inflation itself. At the moment, however, our interest centers upon persistent inflation as a practical problem for exchange-rate policy.

In this connection, the main point is that persistent inflation has invariably led to or accentuated an overvaluation of the existing fixed rates, even if these had been appropriate at sometime in the past. Thus, although the assignment of only a relatively few commodities and types of exchange transactions to the "minor" (i.e., more depreciated) rates might initially have sufficed to restore equilibrium in the balance of payments if the excess demand for exchange arising from domestic inflation had been curbed, the failure to curb inflation led sooner or later to renewed pressures on international reserves. The typical first reaction to a loss of reserves took the form of one or both of the following: reimposition or tightening of quantitative restrictions on exchange transactions, or transfer of additional commodities and types of exchange transactions into the "minor"-rate categories.*

Both of these measures, it will be noted, amount to an admission of defeat in terms of several of the above-enumerated objectives of fixed multiple-rate systems. Where quantitative restrictions were renewed or intensified, for example, multiple rates were not in fact a substitute for administrative allocation of exchange; and where commodity reclassifications were undertaken, the stability of the exchange-rate structure on the pivot of the "basic" rate was not preserved. Even more important,

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can countries, however, the inflations of the past decade have far exceeded in virulence and continuity those experienced in other parts of the world. (Comparative data on price and money-supply increases in a large number of countries over the postwar years can be found in the International Monetary Fund's monthly *International Financial Statistics.*)

* These, as well as subsequent statements relating to historical developments in postwar Latin American exchange-rate policies, are in part a synthesis of voluminous material from individual country sources, which will not be cited here because of their specialized nature. Two major sources covering the broad outlines of exchange-rate policies and regulations in all or most Latin American countries are the International Monetary Fund's *Annual Report on Exchange Restrictions* (since 1950); and the First National City Bank of New York's *Summary . . . Exchange and Foreign Trade Regulations* (annually since 1943).

however, these measures raised additional serious difficulties, with the quantitative restrictions in particular proving unworkable in country after country.

The Latin American experience of the past decade well illustrates the high correlation between the degree of overvaluation of an exchange-rate system and the difficulty of administering the quantitative exchange restrictions associated with it. Thus, so long as the excess demand for foreign exchange that cannot be satisfied from current exchange resources is relatively small—say, 5 to 10 percent—reasonably nondiscriminatory criteria for the allocation of exchange may be found.* The continuation of inflation along with the existing exchange-rate structure, however, gives rise to insurmountable problems. The gap between exchange resources and the demand for exchange widens as rising internal prices together with rising money incomes broaden the range of potentially importable goods, while exportable goods are increasingly diverted to the home market, or produced in reduced volume, or both.† Large windfall profits can be reaped by the recipients of import licenses since internal price controls cannot be made effective, at best, for more than a few staple commodities. These profits in turn provide the leverage for extensive illegal connivance between importers and the administrators of exchange-control machinery. Finally, faced with intense pressures for larger exchange allocations, there is an almost irresistible temptation for the exchange authorities to overestimate future exchange availabilities and to issue licenses in excessive volume. Thus, a state of complete disorder in the international payments of the countries con-

*It will be understood that difficult problems arise in the measurement of these quantitative relationships. Thus, the term "current exchange resources" should probably be defined to include not only actual exchange purchased by the authorities (and authorized dealers) during a given period, but also such reductions in the country's official exchange reserves as may be compatible with a clearly foreseeable future increase in export prices, the seasonal pattern of exports, etc. In measuring demand for exchange, on the other hand, actual requests for exchange during a given period represent only one of the relevant factors. Suppressed demand for exchange associated with import restrictions so severe that they cannot be maintained for long, as well as other factors making for predictable increases or declines in the demand for exchange, should also be taken into account.

†The relative likelihood of these two possibilities depends to a considerable extent on whether or not the principal export goods are also important items of home consumption. Where this is the case, the rise in money incomes and the gradual increase in the degree of overvaluation of the applicable exchange rate will be associated primarily with a diversion of exports to the home market. Where the principal exports are not consumed in volume at home (and the income elasticity of demand for these goods is low), the combination of rising costs and fixed exchange rates will express itself primarily in reduced production, the extent of the reduction depending upon the elasticity of the supply. The structure of exports and home demand in most Latin American countries is such that the second case is more likely than the first. It will be understood, however, that the two cases are not mutually exclusive. Both effects may therefore occur simultaneously.

cerned has frequently been the end result of fixed multiple rates and persistent inflation.*

The unsettling effects of frequent commodity reclassifications within a system of fixed multiple rates need not be labored. To some extent, such reclassifications are an alternative to quantitative restrictions and thus provide welcome relief to the administrators of these restrictions. On the other hand, they amount to a step-by-step devaluation. Thus, all the disadvantages of a "pre-devaluation atmosphere"—anticipatory price increases, the withholding of previously imported and of exportable goods from the market, and the prevalence of other types of speculative activity—are incurred at each turn. Quite frequently, the so-called "basic" rate finally became a nominal rate that applied to few, if any, actual transactions, which amounted to a retreat not only from rate stability but also from pursuit of the objective of dampening the impact of devaluation-caused price increases of "essential" imports.†

Conflicts of Policy Objectives in Multiple-Rate Systems

Persistent inflation has thus been the principal factor in discrediting the stability aspect of fixed multiple-rate systems. A growing recognition of the inherent conflicts of policy objectives in the classification of exchange transactions according to differential exchange rates, on the other hand, appears to have been the major factor in the slow trend away from extreme rate multiplicity. It should be noted, even prior to discussing these conflicts of policy objectives, that our explanation of this trend is in some contrast with other possible explanations. Thus, it might be suggested that Latin American countries may now be more

* The usual subsequent course of events has been the accumulation of a "backlog" of commercial debts abroad, which could be settled only with the assistance of official foreign lenders in a consolidation operation. In the most striking such case on record, Brazil accumulated unpaid bills variously estimated at from 500 million to 1 billion dollars prior to the virtual abandonment of its highly overvalued fixed rates in 1953, the settlement of which required large medium-term loans by the Export-Import Bank and British and German official agencies. Similar occurrences have been recorded during the postwar period on one or more occasions in Argentina, Chile, Colombia, and several of the smaller South American countries.

Although sometimes viewed by cynics as a means of augmenting the flow of private and official capital to underdeveloped countries, this method is in fact extremely damaging to the long-term credit standing of all borrowers, official and private, in the countries concerned. Moreover, it tends to result in a considerable (although probably non-measurable) deterioration of the terms of trade for the affected countries because of the addition of "special-risk" allowances to the normal price quotations of foreign suppliers.

† This process can be traced in the records of exchange regulations of the countries that have used fixed multiple rates during a substantial part of the postwar period. It is instructive to observe how in a majority of cases, through a series of changes in controls, the "basic" rate finally became purely nominal, applying to hardly any category of exchange transactions.