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**BRITISH TRADE WITH  
LATIN AMERICA IN THE  
NINETEENTH AND  
TWENTIETH CENTURIES**

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# BRITISH TRADE WITH LATIN AMERICA IN THE NINETEENTH AND TWENTIETH CENTURIES

Victor Bulmer-Thomas

British trade with Latin America did not begin with Independence in the 1820s.<sup>1</sup> Through both legal and illegal channels, Britain had been supplying Latin America with goods and slaves before Independence and directly purchasing modest quantities of exports. However, the Iberian colonial system – even after the Bourbon reforms in the 18th century – limited British economic influence substantially and ruled out all forms of inward investment. Thus, Independence is rightly seen as something of a watershed in economic relations between Britain and Latin America.

Superficially, Britain and Latin America appeared to be made for each other in the 19th century. With its strong manufacturing base, a consequence of nearly two centuries of industrial modernisation, Britain was well-placed to supply the newly independent countries<sup>2</sup> with manufactured imports. Britain was also a major source of capital exports and in a strong position to meet the Latin American demand for foreign savings. Meanwhile Latin America, freed from the obligation to sell its primary products through Iberian outlets, was able to expand its exports to meet the growing demand in Britain for food and raw materials.

This apparent complementarity between Britain and Latin America proved more difficult to establish than was at first anticipated. Britain operated a system of colonial preference until the mid-19th century and market access for Latin America's exports suffered accordingly.<sup>3</sup> Even after the repeal of the Corn Laws in 1846 and the adoption of free trade by Britain, its colonies continued to operate a system of imperial preference, favouring British imports over those from other industrial countries. Thus, British exporters faced a playing field tilted towards the colonies and, not surprisingly, often preferred the rich pickings in the dominions to the more 'neutral' markets in Latin America.

On the Latin American side, each country inherited from its colonial past a rich array of cottage industries that could only survive the full blast of international competition through tariff protection. Since the tariff was the major

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<sup>1</sup> Although British *investment* in Latin America will be mentioned in this paper, it is not the main subject. For an excellent analysis of UK investment flows to Latin America in recent years, see IRELA/IDB (1998).

<sup>2</sup> Those countries that remained colonies in the 19th century (e.g. Cuba and Puerto Rico) also had much more freedom than before to buy from the cheapest source. Thus, it is not generally necessary to distinguish between republics and colonies after the 1820s.

<sup>3</sup> See Miller (1993).

source of public revenue for Latin American countries in the 19th century, all governments – even those in favour of free trade – provided some degree of protection for their artisan industries, and the protective wall in the interior provinces was raised even further by high transport costs. Thus, cottage industries survived for many years in Latin America, limiting the scope for British manufactured exports.

British influence on the Latin American economies in the first half of the 19th century has, therefore, almost certainly been exaggerated – as we shall see below. The experience in the second half of the century, however, was much more positive and this is explored in the second part of the paper. Latin American countries slowly overcame the instability associated with the first decades of Independence and new sources of exports were developed for which the British market was, in most cases, well-suited. As the economies grew, the opportunities for British exports of goods, services and capital increased.

By the time of the First World War, Britain had been overtaken by the United States as a trading partner in most countries and its aggregate performance was heavily influenced by trade with Argentina – the most important market in Latin America – where British influence remained substantial. These trends continued after the war and by the 1930s British trade and investment in Latin America was crucially dependent on developments in Argentina.

As Britain lost its leading position in Argentina after the 1930s, its trade links with Latin America were reduced, and this theme is developed in part three. By 1970, as shown in part four, Britain was underperforming in many Latin American markets and no amount of official hand-wringing and exhortation appeared to make any difference. With the loss of the Argentine market following the Falklands/Malvinas war in 1982, British trade links with Latin America reached their nadir. In addition, the threat of debt default in the 1980s, and the loan-loss provisions made by British financial institutions, seemed to mark a permanent withdrawal of British capital from the region.

Since 1990 there has been a significant increase in British exports to Latin America, but this has not prevented a further decline in the British share of imports in most Latin American countries. The reasons for this apparent paradox are explored in part five, where it is shown that the apparent improvement in British export performance is above all due to the exceptionally rapid growth of Latin American imports since 1990 – a growth that was not sustainable in the long run and which has been eroded since 1997 by the impact of the Asian financial crisis.

## **The First Phase: From Independence to Mid-Century**

The struggle for independence in Latin America, coinciding as it did with the Napoleonic Wars in Europe, provided Britain with its first opportunity to break the Iberian grip on commercial trade. British merchants, facing the closure of

many of their traditional markets in continental Europe, were quick to take advantage of this. As Napoleon's troops marched into Spain in 1808, no less than 40 per cent of British exports were despatched to Latin America – a figure that has never been matched either before or since.<sup>4</sup>

The initial enthusiasm soon gave way to disillusionment as many of these exports failed to find a buyer. The purchasing power of the Latin American elites had been wildly exaggerated and many of the goods sent out to the region were quite inappropriate. British merchants were quick to settle in the coastal ports through which the bulk of foreign trade passed, but their hopes of short-term profits were generally not met. Many returned to the United Kingdom or moved elsewhere, leaving only a small number to handle the diminished trade.<sup>5</sup> By 1860 UK exports to Latin America were 7.0 per cent of total UK exports (see Table 1) – a respectable figure, although a far cry from the high share of 50 years earlier.

**Table 1. British Exports to Latin America as a Percentage of Total UK Exports**

	1860	1913	1938	1960	1980	1990	1995
	7.0	11.0	8.0	4.5	2.2	1.3	1.4
Country Shares (%)							
Argentina	12.9	40.8	53.8	24.3	16.3	2.8	11.7
Brazil	31.4	22.6	14.4	11.1	20.6	25.1	30.2
Chile	12.1	10.8	4.6	7.8	5.3	9.8	8.1
Colombia	5.7	3.1	9.3(d)	5.4	3.9	4.7	6.5
Mexico	3.6	4.0	2.4	12.0	17.7	20.0	11.8
Peru	10.0	2.7	2.9	4.7	1.3	2.2	2.6
Venezuela	2.1	1.4	(f)	16.1	12.4	15.7	8.6
Rest of South America (a)	7.2	8.1	6.9(e)	8.9	13.9	10.3	12.8
Central America	1.4	2.0	2.9	4.0	3.9	4.3	4.8
Rest of Latin America (b)	13.6(c)	4.5	2.9	5.7	4.7	5.1	2.8
<b>TOTAL</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Notes:**

(a) Includes Bolivia, Ecuador, Panama, Paraguay and Uruguay.

(b) Includes Cuba, Haiti and Dominican Republic.

(c) Includes Puerto Rico.

(d) Includes Ecuador and Venezuela.

(e) Includes Bolivia, Paraguay and Uruguay.

(f) Included in figure for Colombia

**Sources:**

Platt (1972); Miller (1993); Atkinson (1989); IMF (1997).

<sup>4</sup> See Platt (1972), p.28.

<sup>5</sup> See Platt (1972); Miller (1993).

Recognition of the independent republics by Britain and other countries in the 1820s led, in some cases, to commercial treaties that might have paved the way for better trading conditions. However, with the exceptions of Brazil and Chile, the first decades of Independence were marred by chronic political instability. The spectacular economic growth forecast by so many at the onset of Independence failed to materialise and British exports in 1850 were still only half the levels registered forty years earlier.<sup>6</sup> Britain enjoyed a high share of Latin America's imports at mid-century – over 50 per cent in the case of Brazil (the main market)<sup>7</sup> – but better opportunities elsewhere had reduced the share of British exports to Latin America to less than 10 per cent. Britain was the main source of Latin America's imports, but it had become a minor market for British exports.

There were several reasons for the lack of dynamism in the first decades after Independence. High tariff barriers in Latin America excluded many British goods despite their international competitiveness; British exporters enjoyed preferential access in colonial markets, where there was a natural desire to favour British imports over those from other countries; and there was a reluctance among British firms to adjust product lines to the needs of the small Latin American markets. The main reason, however, for the lack of dynamism was the slow growth of the Latin American market for imports.

That slow growth was a consequence of the supply-side bottlenecks that Latin American economies faced after Independence. While land was in abundant supply, labour and capital were scarce. The new republics – or empire in the case of Brazil – had turned to Britain in the 1820s to provide the foreign capital needed to recapitalise the mines and stabilise government revenue, but commercial misjudgement, greed and corruption had led to default on almost all these loans by the end of the decade. It took a generation to wipe out this collective memory, leaving Latin America without access to the international markets, as London was the dominant financial centre at that time.

If Latin America had been able to rapidly expand its exports to Britain, the situation would have been much improved. However, British colonial preference (before the 1850s) gave an advantage to exports from the colonies for all products except those, such as guano, where Latin America had a regional monopoly for a time. Furthermore, one of Latin America's most important exports – silver – was less in demand once Britain went onto the gold standard in 1815. And Latin America's exports were held back by the very same supply-side bottlenecks that limited the growth of the economies as a whole. UK imports from Latin America fluctuated in those years as a percentage of total UK imports, but never rose above ten per cent (see Table 2).

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<sup>6</sup> See Platt (1972), pp. 28 and 30.

<sup>7</sup> See Bulmer-Thomas (1997).



**Table 2. UK Imports from Latin America as a Percentage of Total UK Imports**

Year	Percentage	Year	Percentage
1804/6 (a)	2.3	1929 (b)	10.6
1814/6 (a)	8.7	1938 (b)	7.7
1824/6 (a)	4.7	1950 (c)	7.8
1844/6 (a)	6.0	1960 (c)	6.7
1854/6 (a)	6.4	1970 (c)	3.7
1880 (b)	4.5	1980 (c)	2.1
1900 (b)	5.2	1990 (d)	1.1
1913 (b)	9.9	1995 (d)	1.6

**Notes:**

(a) Miller (1993), p. 77, quoting Davis (1979).

(b) Miller (1993), p. 107, derived from Mitchell and Deane (1962).

(c) Atkinson (1989).

(d) IMF (1997).

During those first decades of Independence, British prestige and influence was considerable. Recognition of Latin American Independence by the British government was considered crucial for their survival by the new republics and Britain was much admired for its industrial and naval superiority. The Monroe Doctrine may have been promulgated in 1823, but Britain never felt restrained by it and, indeed, the Doctrine itself was an attempt to block Britain and other European powers from exerting the hegemonic role previously taken by Spain and Portugal. Inevitably, this has given rise to a controversy over the extent to which this influence was used to promote British economic interests at the expense of both rival producers and the Latin American countries themselves.

There is certainly some evidence of British abuse of power. The first trade treaties with Brazil were one-sided affairs designed to give Britain a privileged position for its manufactured exports; British diplomacy was largely responsible for the creation of Uruguay in 1828 and force was used in the 1840s to defend the fledgling republic from the territorial ambitions of General Rosas in Argentina; British diplomats manoeuvred intensely to ensure influence over any inter-oceanic route that might be built in Central America and to keep open the waterways of South America to British shipping. Britain became increasingly irritated at Brazil's failure to end the trade in slaves and force was used on occasions.

It would be wrong, however, to assume from this that British influence made much difference to Latin America's economic development. With the exception

of Brazil before 1844, Latin American tariffs did not favour British imports and some countries – notably Mexico – were able to adopt a tariff structure that was overtly protectionist without provoking British ire. British diplomacy at this time was more concerned with limiting the influence of other powers, such as France and the United States, and less with securing privileged positions for its economic agents. This arose less from principle and more from the knowledge that British competitiveness in the export of goods and capital would be sufficient to secure the advantage, provided that other foreign powers were not favoured.

British diplomacy was not unsuccessful, but by mid-century it had already been eclipsed by the United States in the countries north of Colombia. The Mexican-American War (1845-46), with its transfer of territory to the United States, had shown European powers the advantages of geographical proximity. The Clayton-Bulwer Treaty of 1850 limited British territorial ambitions in Central America and ensured that Britain would not have control of any inter-oceanic route that might be built. Even in Cuba and Puerto Rico, still ruled by Spain, it was US commercial influence – not British – that was expanding most rapidly. By mid-century British trade with Latin America was already heavily concentrated in the southern cone, with exports to Argentina, Brazil and Chile exceeding those to all other countries in Latin America. Thus, a pattern of British trade was soon established that was to survive well into the 20th century.

## **The Second Phase: From Mid-Century to the 1920s**

In the mid-19th century a series of changes took place that allowed economic relations between Britain and Latin America to flourish. Now at last the potential identified by so many commentators on either side of the Atlantic at the time of Independence could blossom. The ‘natural’ complementarity between the world’s greatest industrial power and a region blessed with the capacity to produce cheap raw materials and foodstuffs finally materialised. With no European wars to distract Britain and a Latin America – with the tragic exception of the War of the Triple Alliance in the 1860s – largely free from military conflict, both partners were free to seek an economic division of labour that maximised the gains from trade without the interference of strategic or security considerations.

The first change was Britain’s commitment to the abolition of colonial preference and the adoption of zero tariffs. This extreme version of free trade has few parallels in economic history and was to last, with only minor exceptions, until the 1932 Ottawa Conference re-established imperial preference. British importers were now free to purchase goods from the cheapest source and this provided an opportunity for Latin America that had previously been absent. Sugar exporters were the main beneficiary and British imports from Cuba and Puerto Rico rose accordingly. However, free trade also meant that the protection previously provided to local farmers disappeared; Latin American produce could now replace high-cost British farm output of temperate products. Argentina, Chile and Uruguay began to respond and the initial success

encouraged the entry of British capital into South American farming. A virtuous circle was soon created with Argentina as the main beneficiary.

The second change was the commitment of Latin American countries to export-led growth. Latin American elites were persuaded by the economic gains to be reaped from trade, demonstrated by Ricardo's law of comparative advantage and eloquently expounded by John Stuart Mill. Unlike Britain's commitment to free trade, this did not imply zero tariffs and – for both revenue and protective reasons – tariffs remained in place. However, Latin American governments lost their enthusiasm for the protection of their cottage industries and this created new opportunities for the export of British manufactures. These opportunities increased as improvements in infrastructure in general, and the transport system in particular, eroded the implicit protection given to domestic producers in the interior provinces.

The third change was the return of foreign capital. Latin American governments once again tapped the London bond markets and, despite widespread default in the 1870s and the Baring crisis in 1890, continued to do so up until the First World War. The flow of portfolio capital was followed by direct foreign investment, with Britain leading the field among the industrial countries. The main attraction was railways, with British capital being used to develop Latin America's first railway in Cuba in the 1830s; but almost all sectors received some attention. And trade inevitably followed capital flows, with British exports to each country closely correlated to the extent of British investment.<sup>8</sup>

The fourth change was migration of British labour. Although this never reached the scale achieved by other European countries, such as Italy, Spain, Portugal or Germany, it was important for its quality. British migrants brought with them skills and capital and this gave them an influence out of all proportion to their numbers. The small British communities generated an English-language press throughout Latin America, which was an additional way in which their influence spread to the local elites.<sup>9</sup> And the flow of labour was not all in one direction. Once the age of steam travel arrived, the journey to Europe became less daunting and a number of Latin American leaders spent time in the United Kingdom.<sup>10</sup>

In the light of all these changes, British economic hegemony in Latin America might have seemed assured. However, Britain began to lose market share in Latin America after 1870, as shown in Table 3. Furthermore, the decline would have been more serious if Britain had not succeeded in keeping a strong grip on the Argentine market – by far the most important Latin American economy in terms of foreign trade by the end of the century. By 1913, for example, Britain's share of Latin America's imports was 50 per cent higher than its share of non-Argentine Latin American imports (see Table 3), a tribute to

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<sup>8</sup> See Platt (1972), Fig. V, p. 281.

<sup>9</sup> See Marshall (1996).

<sup>10</sup> See Decho and Diamond (1998).

both Britain's presence in the Argentine market and the size of that market itself. Thus, British economic supremacy was not as great as might have been expected and, although the high shares recorded in mid-century could not be permanently sustained, the relative decline does require some explanation.

**Table 3. Latin American Imports and Exports: Percentage from and to UK: c.1850-1938**

Year	Imports	Imports Excluding Argentina (b)	Exports	Exports Excluding Argentina (b)
c.1850(a)	31.3	30.4	31.0	30.2
c.1870(a)	32.0	30.9	32.4	33.5
c.1890(a)	27.1	23.7	12.0	11.0
1913	24.8	16.0	20.7	16.9
1938	12.2	10.0	15.9	10.6

**Notes:**

(a) I have used Bulmer-Thomas (1994) for Latin America's exports in these years and also assumed Latin America's exports and imports to be equal. I have used Platt (1972) for UK exports and imports to/from Latin America. I have then adjusted UK imports from Latin America by deducting transport costs and UK exports to Latin America by adding transport costs estimated at 25% c.1850, 12.5% c.1870 and 10% c.1890.

(b) Argentina has been excluded from both the numerator and denominator, i.e. the figures refer to non-Argentine Latin American imports/exports from/to UK as a percentage of total non-Argentine Latin American imports/exports.

The first problem was British export dependence on textiles. Britain's success in importing raw cotton and wool for the fabrication of textiles was phenomenal. Even as late as 1910-13, Britain still held 70 per cent of world trade in cotton textiles despite competition from the rest of Europe, the United States, India and Japan.<sup>11</sup> Inevitably, British manufactured exports were skewed towards textiles, which in 1880 accounted for 62.3 per cent of the manufactured total and were still nearly 50 per cent in 1913.<sup>12</sup> While Latin American governments were content to see the decline of their cottage textile industries, Britain's dependence on textile exports was a source of strength. However, the modern textile industry was one of the first candidates for import substitution and Latin American efforts to promote the industry led inevitably to a decline in imports from Britain. Only Argentina bucked the trend, continuing to rely very heavily on imports of textiles to the benefit of trade with Britain.<sup>13</sup>

The second problem was foreign – particularly US – competition. Latin

<sup>11</sup> See Platt (1972), Table XI, p. 176.

<sup>12</sup> See Platt (1972), Table III, p. 73.

<sup>13</sup> In 1910-11, Argentina still only had six textile factories compared with 137 in Brazil and 139 in Mexico. See Platt (1972), Table XIII, p. 182.

America, freed from colonial powers, was a 'neutral' market for exporters. For those countries without imperial possessions, this was one of the few foreign markets where they were assured a reasonably level playing field. The United States, a major industrial power by the mid-19th century, was quick to seize the opportunities provided by geography and rapidly replaced Britain as the main source of imports in the northern republics. Only in Argentina was the US advance halted and this was due to a variety of factors: high transport costs, competition from Britain (particularly in textiles) and the trade friction between Argentina and the USA as a result of their export of similar agro-industrial products.<sup>14</sup>

If Britain had fought harder – outside Argentina – to preserve its market share, it might have succeeded despite its dependence on textile exports. At the very least, it would have slowed down the rate at which market share was being lost. However, Britain faced a captive market in most of its colonies and dominions, where purchasing power was often much higher than in Latin America. These markets were not neutral, with tariff and other preferences being given to British exporters. Thus, Britain could expect to capture anything between 50 and 90 per cent of these markets except for Canada, where US competition was too strong. And these were large markets dwarfing those of most Latin American countries. Australia, for example, in 1912 had total imports of £78 million with Britain supplying 50 per cent.

The relative decline in British trade with Latin America was concealed by the strong performance in the Argentine market (see Table 4). A high market share in the country with the highest level of imports was bound to reflect well on the aggregate statistics, particularly as the level of Argentine imports was also growing rapidly for most of the period after 1850. The emphasis on Argentina was underpinned, and reinforced, by the scale of capital flows to that country. By 1890, on the eve of the Baring crisis, nearly 40 per cent of British investments in Latin America were in Argentina and this had changed little by 1913 despite a doubling of the value of the total capital stock in the region.

British pre-eminence in foreign investment in Latin America was not in fact seriously challenged before the First World War. It has been estimated that in 1913 British investments were worth £999.2 million compared with £339 million for the USA, £329 million for France and £185 million for Germany. Thus, Britain had a far higher share of foreign investment (c. 50%) in Latin America in 1913 than its share of foreign trade (c. 25%) – a pattern that has continued to this day. While this is not surprising, given the dominance of London as a world financial centre, it is remarkable that perhaps a quarter of all British foreign investments were to be found in Latin America.<sup>15</sup> Although this was less than the proportion for the United States, it was more than for France or Germany.

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<sup>14</sup> While the USA exported manufactured goods, it also produced and exported the raw materials in which Argentina had found its comparative advantage. US tariffs to protect its farm industry were a constant source of irritation for Argentina.

<sup>15</sup> See Platt (1972), pp. 288-9.

**Table 4. Argentina's Share of UK Trade with Latin America (%)**

Year	UK Exports to Argentina	UK Imports from Argentina
1870	11.8	5.9
1890	28.4	25.5
1910	35.4	42.6
1920	37.5	59.4
1930	46.5	55.6
1938	53.9	52.3
1950	25.0	47.1
1960	25.5	47.1
1970	15.7	19.5
1980	16.4	10.8
1990	2.7	7.7
1995	10.6	10.1

Sources: derived from Platt (1972); Miller (1993); Atkinson (1989); and IMF (1997).

British investment in Latin America was curtailed by the First World War, and the emergence in the 1920s of New York as a major financial centre deprived London of its near monopoly on new issues. The United States began to challenge British hegemony in capital flows to Latin America, although a large part of the stock remained in British hands. With the onset of the 1929 depression, and a further round of defaults, British investors began to rue their heavy dependence on the Latin American market.

### **The Third Phase: From the Great Depression to the Debt Crisis**

By the end of the 1920s, Britain still held a strong position in the trade and inward investment of Latin America. However, trade performance was very dependent on Argentina, both as a source of demand for British exports and as a source of supply for British imports (see Table 4). And the investment portfolio was geared towards government bonds and public utilities (including transport). In the next 20 years, British influence was to be sharply eroded as a result of the impact of the Great Depression and the Second World War.

Import-substituting industrialisation (ISI) did not begin with the 1929 depression, but it was given a significant boost by the tariff and exchange rate changes forced on Latin American governments by the collapse of commodity prices. The value of imports fell to a quarter of their pre-depression level and

exports from all industrial countries to Latin America were affected. Default on the external debt by all Latin American countries except Argentina, the Dominican Republic and Haiti released foreign exchange that could then be used to increase imports from their low point in 1932, but it was many years before they returned to their pre-depression level.<sup>16</sup>

Most countries did not abandon the promotion of primary product exports altogether and the region's exports recovered after 1932 as the net barter terms of trade improved. Access to the British market, however, became more difficult with the adoption of imperial preference at the 1932 Ottawa Conference, while the United States made strenuous efforts under Secretary of State Cordell Hull to establish a series of bilateral trade treaties giving partial market access to Latin American exports. Germany under Hitler adopted its own form of preferential trade, offering Latin American primary product exporters higher prices in return for payment in inconvertible *aski*-marks that could only be exchanged for German goods. The playing field, never completely level, became tilted against exports to Britain for the first time in almost a century. By 1938 (see Table 3), Latin America's exports to Britain had fallen to 15.9 per cent of total exports – half the level of 1850.

Argentina was the Latin American country most affected by imperial preference, closely followed by Uruguay. The prospect of trade diversion in favour of the empire led to the 1933 Roca-Runciman Treaty giving Argentina a guaranteed quota in the British market for her main exports in return for Argentina's preferential treatment of British manufactured goods.<sup>17</sup> However, the treaty generated strong nationalist feelings against Britain and could not reverse the decline of British influence that had begun with the depression.

The reasons for this are complex, but can be summarised as follows: Argentina promoted ISI aggressively in the 1930s and the under-developed textile industry was an easy target; this led to the decline of imports in a sector where Britain was still strongly represented. The UK quotas for Argentine exports may have given a lifeline to some agro-industries, but they were never increased and in some cases were reduced as other suppliers responded to the opportunities provided by imperial preference. Britain still enjoyed a high share of Argentine imports, helped in part by tariff preferences under the Roca-Runciman Treaty, but those imports had ceased to grow. Argentina continued to service its external debt, mainly owed to the United Kingdom, but British firms were no longer able to invest in Argentina and existing British investments became seriously under-capitalised.

Argentina's withdrawal from world trade began in the 1930s. British trade dependence on Argentina inevitably affected Britain's trade performance with the whole of Latin America. By 1938, the last normal year before the Second World War, the UK share of the region's imports had fallen to 12.2 per cent (see Table 3) – almost exactly half of its share in 1913 – and imports no longer

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<sup>16</sup> See Bulmer-Thomas (1994), Chapter 7.

<sup>17</sup> A similar treaty was signed between Britain and Uruguay.

played the same role in the regional economy as a result of the strengthening of ISI. The share of exports destined for Britain also fell and would have fallen further without the special treatment given to Argentina. The Roca-Runciman Treaty was an important factor in the preservation of the United Kingdom as a major export market for Latin America.

British influence in Latin America was further undermined by the Second World War, although this was assumed by most to be a temporary affair. The threat posed by the German navy to sea routes across the Atlantic made trade with Latin America hazardous and imports from the region were limited to those deemed essential for the war effort. However, despite the difficulty of payment (mainly in inconvertible sterling), the British market was one of the few European markets left open to Latin America and the United Kingdom was still receiving more than ten per cent of the region's exports by 1945. It was in the area of imports that Britain was eclipsed, with the UK share of Latin America's imports falling to 3.6 per cent in 1945.

Post-war European recovery, particularly after the adoption of the Marshall Plan in 1948, at first suggested that the optimists were correct. Britain had rebuilt its share of Latin America's imports to 6.8 per cent by 1950 with 7.1 per cent of British exports going to the region and 7.8 per cent of UK imports coming from the region (see Table 2). However, these impressive figures proved to be unsustainable: in the next forty years, the trade shares – looked at either from Britain or Latin America – declined steadily. Just before the debt crisis and the war with Argentina in 1982, only two per cent of Latin America's imports came from Britain (far below Britain's five per cent share of world imports) and only 2.2 per cent of British exports went to Latin America (see Table 1).

This relative decline of the trade links between Britain and Latin America has been the subject of much analysis.<sup>18</sup> Britain was being pulled towards Europe even before it joined the European Economic Community (now European Union (EU)) in 1973. Imperial preference was replaced by the Lomé Convention under the EU, giving preferences mainly to former British and French colonies and excluding Latin America.<sup>19</sup> Britain failed to modernise its economy in response to the challenge from other European countries and the rising Asian economies. Regional integration in Latin America after 1960 also led to some trade diversion at the expense of Britain.

There is some truth in all these arguments, but they would be incomplete without reference to Argentina. In 1950, Argentina still accounted for nearly half (47.1 per cent) of UK imports from Latin America and a quarter of her exports to the region (see Table 4). With the slow growth of the Argentine economy and its semi-closure to foreign trade, Britain inevitably lost market share in Latin America despite numerous trade missions and export drives. And with the war with Argentina in 1982, Anglo-Argentine trade came almost to a halt for nearly

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<sup>18</sup> See, for example, Atkinson (1989).

<sup>19</sup> Haiti and the Dominican Republic, however, were allowed to join the Lomé Convention at the end of the 1980s.



ten years, leaving Brazil as the dominant trade partner for Britain in Latin America.<sup>20</sup>

The relative decline of British trade links with Latin America was matched to a lesser extent by the eclipse of British investments. The 1938 nationalisation of the oil industry in Mexico, where British companies were well-entrenched, had been strongly resisted. However, the post-war British government was in no position to resist as Latin American governments expropriated British interests in water, gas, electricity and transport companies since the Attlee administration was doing the same in Britain. The jewel in the crown, the Argentine railway, was nationalised in 1948 by the Perón government using inconvertible sterling balances accumulated during and after the war.

British outward investment after the war was at first held back by exchange control and the dollar premium. However, Britain – in common with other developed countries – showed a marked preference for direct investment in advanced economies. The traditional British pattern of investing in Asia, Africa and Latin America gave way to a new pattern favouring North America and the European Union. By 1981 these two regions accounted for nearly 60 per cent of the book value of UK outward direct investment compared to about one-third in 1962.<sup>21</sup> Yet Latin America's share (including the Caribbean) was still six per cent at the beginning of the 1980s – almost three times greater than Britain's share of Latin America's imports.

This imbalance between British trade and investment shares in Latin America has already been noted for the earlier period. When British portfolio investment – including bank loans – is included, the difference becomes even more striking. British banks were heavily involved in the build-up of commercial loans to Latin America in the 1970s and were highly exposed at the time of the debt crisis. While Britain has underperformed with Latin America in trade terms (see next section), it has not done so in terms of investment. This is partly a reflection of the City of London's role as a major international financial centre (second only to New York), but is also an indication of the large number of British-based multinational companies (MNCs). These companies are now responsible for almost all direct foreign investment worldwide and their presence in Latin America must be seen as part of their global strategies to preserve or increase market share.

## **An Econometric Test of UK Export Performance**

The assumption that Britain has underperformed in its exports to Latin America is widely held. Successive British governments have lamented the low level of trade with the region and contrasted it both with past trade performance and current investment flows to Latin America.<sup>22</sup> Indeed, the assumption is so widely held that no questions were asked when the previous Conservative government

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<sup>20</sup> See Bulmer-Thomas (1997).

<sup>21</sup> See Atkinson (1989).

<sup>22</sup> See, for example, Bonsor (1996). See also Foreign Affairs Committee (1997), p. xxii.

announced in 1995 that it was seeking to double its share of Latin American imports in the next few years.

Although underperformance is widely assumed, it has never been tested. Yet exports can be predicted and compared with actual performance using a number of international trade models. In this paper I use a standard gravity model to estimate British bilateral exports to all countries in all years from 1960 to 1990.<sup>23</sup> The dependent variable is British exports to country 'x' and the independent variables are as follows:

i) Population in country 'x'; it is assumed that British exports *ceteris paribus* will be greater the larger the population in country 'x'.

(ii) Gross Domestic Product (GDP) per head in country 'x'; it is assumed that British exports *ceteris paribus* will be greater the higher the GDP per head in country 'x'.

(iii) Distance from Britain to country 'x'; it is assumed that British exports *ceteris paribus* will be lower the greater the distance to country 'x'.

(iv) Partner Island Dummy; if country 'x' is an island, the dummy variable assumes a value of 1 (otherwise 0) on the assumption that island economies have higher levels of trade *ceteris paribus*.

(v) Common Language Dummy; if country 'x' uses English as the main language, the dummy variable assumes a value of 1 (otherwise 0) on the assumption that a common language makes for higher levels of British exports *ceteris paribus*.

(vi) Partner Land-Locked Dummy; if country 'x' is landlocked, the dummy variable assumes a value of 1 (otherwise 0) on the assumption that landlocked countries have lower levels of trade *ceteris paribus*.

(vii) European Community (EC)/European Union (EU) dummy; the dummy takes a value of 1 from 1973 when Britain joined the European Community. The assumption is that membership of the EC (EU after 1992) leads to higher British exports with member countries *ceteris paribus*.

The model was tested using a Tobit Regression. This is preferable to Ordinary Least Squares Regression in cases where there are limited dependent variables (as happens with bilateral trade as it cannot fall below zero). All variables were estimated using logarithms and the results are presented in Table 5 for 1960, 1970, 1980 and 1990.

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<sup>23</sup> I am grateful to Hernán Vallejo for providing the data and running the regressions on which this section is based.

**Table 5. Tobit Regressions for Gravity Model of UK Exports**

Year	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1960	85	0.65*	1.03*	-0.43*	0.17	1.42*	-0.68	na	-9.70*	0.3697
1970	117	0.62*	1.14*	-0.46*	0.34	1.04*	-0.63*	na	-9.85*	0.4083
1980	145	0.77*	0.94*	-0.84*	0.37	1.29*	-0.73*	-0.45	-7.79*	0.3799
1990	148	0.77*	1.04*	-0.67*	0.05	1.11*	-0.43*	-0.28	-10.1*	0.4431

**Notes:**

- (1) Number of Observations.
  - (2) Population.
  - (3) GDP per head.
  - (4) Distance.
  - (5) Partner Island Dummy.
  - (6) Common Language Dummy.
  - (7) Partner Landlocked Dummy.
  - (8) European Community/European Union Dummy.
  - (9) Constant.
  - (10) Pseudo-R squared.
- \* Significant at 1% level.

The estimated coefficients all have the predicted sign with the exception of the EU/EC dummy, which is negative (although not significant). This suggests that EC/EU membership had been anticipated by British exporters so that entry in 1973 did not bring a quantitative leap in exports. The Partner Island Dummy coefficient has the predicted sign, but it is not significant.

The model results can then be used to predict the value of British exports to all Latin American countries for each year. The results are presented in Table 6 for 1960, 1970, 1980 and 1990. The overall impression of underperformance is confirmed, but the picture is much more complex than originally expected. In particular, it appears that British underperformance, far from being a 'permanent' feature, is of relatively recent origin.

As late as 1960, Britain was in fact 'overperforming' in its exports to Latin America, as the first section of Table 6 makes clear. Much of this was due to Argentina, but what is interesting about the 1960 results is that British exports were equal to, or above, the predicted levels in all except two markets (Central America and Haiti/Dominican Republic). Exports to Mexico were in line with predicted values and for the region as a whole exports were 10.9 per cent above predicted values. While this may seem surprising, it is quite consistent with Table 1, where Britain is shown as exporting 4.5 per cent of all its exports to Latin America in 1960 – a very high ratio compared with more recent years.

Table 6. Actual and Predicted UK Exports to Latin America (\$)

	1966				1970				1980				1990		
	Observed (\$mm)	Predicted (\$mm)	Percentage Difference (d)	Observed (\$mm)	Predicted (\$mm)	Percentage Difference (d)	Observed (\$mm)	Predicted (\$mm)	Percentage Difference (d)	Observed (\$mm)	Predicted (\$mm)	Percentage Difference (d)	Observed (\$mm)	Predicted (\$mm)	Percentage Difference (d)
Argentina	118.0	83.9	+28.9	106.0	140.5	-32.5	402.0	253.0	+37.1	65.0	496.5	-663.8			
Brazil	54.0	51.2	+5.2	146.0	106.4	+27.1	507.0	684.1	-34.9	589.0	1381.0	-134.5			
Chile	38.0	27.6	+27.4	49.0	49.0	0	130.0	108.5	+16.5	231.0	123.6	+46.5			
Colombia	26.0	24.1	+7.3	31.0	31.1	-0.3	97.0	146.1	-50.6	111.0	160.1	-44.2			
Mexico	58.0	56.1	+3.3	82.0	132.0	-61.0	437.0	630.7	-44.3	469.0	791.0	-68.7			
Peru	23.0	16.4	+28.7	24.0	37.0	-54.2	108.0	86.3	+20.1	51.0	121.3	-137.8			
Venezuela	78.0	75.4	+3.3	81.0	95.8	-18.3	306.0	354.1	-15.7	370.0	243.7	+34.1			
Rest of South America (a)	24.6	18.5	+24.8	48.5	30.6	+36.9	204.5	111.1	+45.7	187.4	121.6	+35.1			
Central America	19.3	32.0	-65.8	37.1	48.9	-31.8	95.5	139.4	-46.0	123.6	136.9	-10.8			
Rest of Latin America (b)	6.8	12.0	-76.5	10.8	21.8	-101.8	33.3	87.3	-162.2	46.7	70.7	-51.4			
<b>TOTAL (c)</b>	<b>445.7</b>	<b>397.2</b>	<b>+10.9</b>	<b>615.4</b>	<b>693.1</b>	<b>-12.6</b>	<b>2320.3</b>	<b>2600.6</b>	<b>-12.1</b>	<b>2243.7</b>	<b>3646.4</b>	<b>-62.5</b>			

**Notes:**

(a) Includes Bolivia, Ecuador, Panama, Paraguay.

(b) Includes Haiti and Dominican Republic.

(c) Excludes Cuba and Uruguay.

(d) Defined as  $[(\text{Observed}) - (\text{Predicted})] / [(\text{Observed}) \times 100]$ .

The 1960s were years of intense import-substituting industrialisation (ISI) in Latin America coupled with the construction of regional integration schemes. This encouraged trade diversion at Britain's expense, while Britain herself began to concentrate more on Europe. By 1970 (see Table 6) British exports to Latin America were underperforming, although the degree of underperformance was a modest 12.6 per cent. This time, however, British exports to Argentina were below the predicted value as their composition (predominantly consumer goods) made them vulnerable to ISI. By 1970 British exports to Mexico were also underperforming – a position from which they have never recovered. One factor was the boom in *maquiladoras*, bringing with it a huge increase in imports from the USA rather than Britain.

Britain was still underperforming in 1980, although the overall degree of underperformance (12.1 per cent) was similar to 1970 (12.6 per cent). British exports to Argentina had recovered, but this was almost certainly due to the import boom inspired by the overvalued currency during the *Proceso* government. Britain, however, was underperforming for the first time in the crucial Brazilian market, where ISI was being pushed to extreme levels. UK exports were now below the predicted level in all markets except Argentina, Chile, Peru and the rest of South America.<sup>24</sup>

The results for 1990 were truly dismal for British exports. The overall degree of British underperformance widened to 62.5 per cent and there were only three markets (Chile, Venezuela and the rest of South America) in which Britain overperformed. The underperformance was in part the result of the extremely low level of exports to Argentina (a consequence of the trade embargo that was only lifted in mid-1990), but Britain also underperformed massively in exports to Brazil and Mexico. Throughout Latin America the impact of the debt crisis was still being felt in 1990, with the need for trade surpluses generated through import restrictions in order to provide resources to service the debt.

The overall picture presented in Table 6 is therefore quite complicated. As late as 1960, British exports to Latin America were still higher than predicted by the gravity model. Most of the overperformance is explained by exports to Argentina, but even without Argentina, exports were still in line with predicted values. By 1970 British underperformance was established, but the degree of underperformance was modest. Indeed, if 3.9 per cent of British exports had gone to Latin America in that year rather than the observed 3.5 per cent, there would have been no underperformance.

Much the same was true in 1980. The boom in bank lending allowed imports to accelerate to unsustainable levels, creating opportunities for British exporters. Argentina, Chile and Peru, where exchange rate policies were particularly favourable to imports, all represented markets where British exporters

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<sup>24</sup> 'The rest of South America' includes the Colón Free Trade Zone (FTZ) in Panama, used by British – and other – exporters as a point of distribution for other countries. The Colón FTZ boomed in the 1970s and this may explain why underperformance in 'the rest of South America' in 1960 and 1970 subsequently becomes overperformance.

overperformed. At the aggregate level, Britain only needed to raise its exports to Latin America from 2.2 per cent in 1980 to 2.5 per cent to have avoided underperformance.

By 1990 underperformance was much more marked. The export ratio of 1.3 per cent (see Table 1) would have had to be raised to 2.1 per cent to avoid the charge of underperformance. Much of the poor performance was due to the trade embargo with Argentina and the huge trade surplus built up by Brazil, although the level of exports to Mexico was also very disappointing.

The underperformance hypothesis is therefore upheld, but the degree of underperformance has not been as severe as is widely assumed. In particular, a doubling of Britain's share of Latin America's imports – which British governments since 1995 have set as their objective – would go beyond what is required to eliminate underperformance. A more modest increase in market share of approximately 50 per cent would have been sufficient for predicted and observed export values to be approximately equal even in 1990.

The econometric test outlined in this section is, as far as I know, the first of its kind for UK exports to Latin America. The gravity model used in the test is well established in the literature on international trade, and the results are both robust and plausible. It should not, however, be applied mechanistically. The independent variables capture structural features of partner economies, but they do not reflect policy changes. When, for example, a partner country lowers tariffs this will lead *ceteris paribus* to higher British exports, although the model does not predict this. In the last ten years, Latin American countries have adopted trade liberalisation with tariff and non-tariff barrier reductions. Thus, the impact on British exports of the trade policy changes in Latin America since 1990 needs to be analysed from a different perspective. This is the issue examined in the next part of the paper.

## Performance since 1990

The 1990s have at last seen a reversal in the trend for British exports to Latin America. As Table 1 shows, for the first time since 1950, the ratio of British exports to Latin America has increased. The increase has been very modest (1.4 per cent in 1995 compared with 1.3 per cent in 1990), but nonetheless welcome.

The reasons for the improvement in performance are not hard to find. The end of the trade embargo has seen a big increase in British exports to Argentina (see Table 7); these now represent some ten per cent of all British exports to Latin America (see Table 4) compared with almost zero in the aftermath of the South Atlantic conflict. British exports to Brazil have also surged as ISI policies have been replaced by trade liberalisation with lower tariffs and an end to non-tariff barriers. Indeed, the switch in trade policies has led to a major increase in British exports to many markets in Latin America (see Table 7).

Latin America's imports have almost trebled since 1990. The return of capital

flows, including flight capital, the lowering of trade barriers and the growth of the regional economies have all created opportunities for British exporters. Indeed, it would have been very surprising if British exports had failed to respond and the increase in the share of British exports destined for Latin America since 1990 (see Table 1) is unremarkable given that total Latin American imports have been growing much faster than total British exports.

**Table 7. UK Exports to Latin America: 1990-96 (\$Million)**

	1990	1996	Percentage Change
Argentina	65	520	+700
Brazil	589	1323	+125
Chile	231	259	+12
Colombia	111	283	+155
Mexico	469	496	+6
Peru	51	98	+92
Venezuela	370	281	-24
Rest of South America (a)	187	378	+102
Central America	123	157	+28
Rest of Latin America (b)	46	96	+109
<b>TOTAL</b>	<b>2242</b>	<b>3891</b>	<b>+74</b>

Source: IMF (1997).

**Notes:**

(a) Includes Bolivia, Ecuador, Panama, Paraguay and Uruguay.

(b) Includes Cuba, Haiti and Dominican Republic.

The British share of the fast-growing Latin American import market is, therefore, a better guide to British export performance. Here the picture since 1990 has been very disappointing (see Table 8). With the exception of Argentina, where market share has risen as a result of the end of the trade embargo, trade shares have tended to fall. A small increase in market share in Brazil has been almost the only bright spot in an otherwise dismal picture. In Mexico, which now accounts for 40 per cent of all Latin America's imports, the British share has declined from 2.0 per cent in 1990 to a negligible 0.8 per cent in 1996. Indeed, Mexico now occupies the place formerly held by Argentina in terms of Latin America's imports, but in the case of Mexico it is the USA – not Britain – that has the dominant market share.

The paradox of increased export share with declining import share can only be explained by the exceptionally fast growth of Latin American imports. Consider, for example, the case of Colombia. British exports have doubled since 1990, while the UK share of Colombia's imports has fallen by nearly a quarter (see Table 8). As Latin America's imports grow more slowly, as is now happening in the wake of the Asian financial crisis, the ratio of British exports

destined to Latin America may again decline.

The British failure to maintain, yet alone increase, its market share since 1990 is disappointing in view of the greater attention paid to the region by successive British governments. A pilot scheme for Venezuela (Proyecto Venezuela) was adopted, designed to emulate the successful British model for Kuwait in the early 1990s and the Link Into Latin America (LILA) scheme was launched in 1995. British ministers have been frequent visitors to Latin America in recent years and John Major became the first British prime minister to make an official visit to the region in 1992. Trade missions have become more sophisticated and export credits are once again available for almost all markets. Yet it is clear from Table 8 that the strategy has failed.

**Table 8. UK Shares of Latin America's imports (%): 1990-96**

	1990	1996
Argentina	1.0	2.4
Bolivia	1.3	0.7
Brazil	2.0	2.3
Chile	2.5	1.6
Colombia	2.6	2.1
Costa Rica	1.5	1.6
Cuba	2.7	1.4
Dominican Republic	1.1	0.9
Ecuador	1.7	1.6
El Salvador	0.9	0.9
Guatemala	1.8	1.1
Haiti	1.7	1.9
Honduras	1.4	0.7
Mexico	2.0	0.8
Nicaragua	0.8	0.8
Panama	1.0	0.6
Paraguay	3.8	2.0
Peru	2.6	1.3
Uruguay	3.0	1.6
Venezuela	3.0	2.6

Source: IMF (1997).

Part of the problem, as in the 1960s, has been the rise of regional integration schemes. As Latin American countries import proportionally more from each



other, they must import proportionately less from other countries. Tariff reductions in Latin America have not been particularly helpful for the consumer goods, such as whisky, which still account for a high share of British exports. Yet other countries outside Latin America, notably the United States, have preserved their share of the fast-growing Latin American import market, forcing us to conclude that the poor performance lies with Britain rather than with Latin America.

There is no shortage of hypotheses for explaining Britain's poor performance. It has been argued that imports from Britain are now sourced in some cases from British subsidiaries in the USA, where they are classed as US exports. The cost of export credit is said to be high in comparison with Britain's competitors in Europe. British exporters have a preference for markets in which English is spoken.<sup>25</sup> British exports are biased towards Commonwealth countries, where the playing field is tilted in Britain's favour by history and cultural ties. Britain's comparative advantage lies in service exports, which are not recorded in the trade statistics with Latin America. There is, no doubt, some truth in all these explanations, but it is impossible, with the limited research published thus far, to establish the relative importance of each hypothesis.

The main source of consolation for Britain is that the UK share of inward investment remains high and is much higher than its share of Latin America's imports. This historical pattern, observed since Independence, reflects Britain's strength as a financial centre and an exporter of capital. And the changes in the British economy over the last 20 years have reinforced these trends; the elimination of exchange control in 1979, the privatisation programme in the 1980s and the growth of country funds in the 1990s have allowed the United Kingdom, with its financial centres in London and Edinburgh, to compete with the United States as a source of capital for Latin America.

These divergent trends – weak in trade, strong in investment – are likely to continue in the future. Britain will find it very difficult to increase its share of the Latin American import market, given the importance of Mexico (where the UK is particularly weak) and of MERCOSUR (where the UK may suffer from trade diversion). A Free Trade Agreement between the EU and both Mexico and MERCOSUR might improve the situation, but these agreements will take many years to come to fruition. It is in the area of investment – both direct and portfolio – that Britain will find the best opportunities and here it is encouraging to see the growth of interest among British companies in recent years.

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<sup>25</sup> This is supported by the coefficient on the Common Language Dummy in Table 5.

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