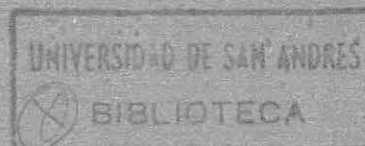


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DEPARTAMENTO DE
ECONOMIA

*Money and Banking in
XIX Century
Argentina*



Roberto Cortés Conde
(Universidad de San Andrés)

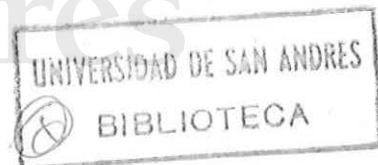
UNIVERSIDAD DE
SAN ANDRÉS

MONEY AND BANKING IN XIX CENTURY
ARGENTINA



By Roberto Cortés Conde
Department of Economics
Universidad de San Andrés
Argentina

Universidad de
San Andrés



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Money and Banking in XIX Century Argentina

I- From Colonial to Independent times.

1. Silver in Colonial times

The late development of banking and the lack of money substitutes in the Spanish colonies in America, an experience different to that of the Anglo American ones (Sylla)⁰ could be explained by the widespread use of specie, mainly the Spanish silver coin (the peso of 8 reales). Spanish America was a producer of silver (Mexico and Bolivia) and the silver coin used there was also known in North America, the West Indies and even the Far East. For the majority of the former Spanish colonies this had changed after the independence in the early XIX Century.

The first decade of Independence

In the Rio de la Plata, independence resulted in the loss of the Potosí mines (in the Upper Perú, Bolivia) whose resources it formerly controlled. As a consequence of the separation of Bolivia from Buenos Aires and the war, the early years of the new government were characterized by a shortage of fiscal resources, that were partially offset by the new income derived from the custom duties, and by a severe monetary contraction (Argentina -in spite of its name- was a producer neither of silver nor of gold), that was alleviated in the Northern Provinces when trade was reinitiated (partially during the war, fully when it was over) with the neighbouring countries.

3. The Confederation of Provinces (1820-1850)

In 1820 a revolution ended the national government and each province (state) claimed the right to have its own administration.

The Province of Buenos Aires, separated from the rest and free from the burden of sustaining a national government (which at that time was mainly aimed at supporting a national army) and with the revenues of the richest custom house, that of the Buenos Aires port, started a period of peace and prosperity that lasted until the Brazilian War (1826).

Buenos Aires, however, did not trade with the neighbouring countries where silver coins came from, as it was the case with the northern and western Argentine provinces. Its main trade was carried out with the United Kingdom and it was done in bills of exchange or gold. There was a severe shortage of specie money to use as means of payment for current transactions. Credit was scarce and the rate of interest very high, which hampered the development of trade and production.¹

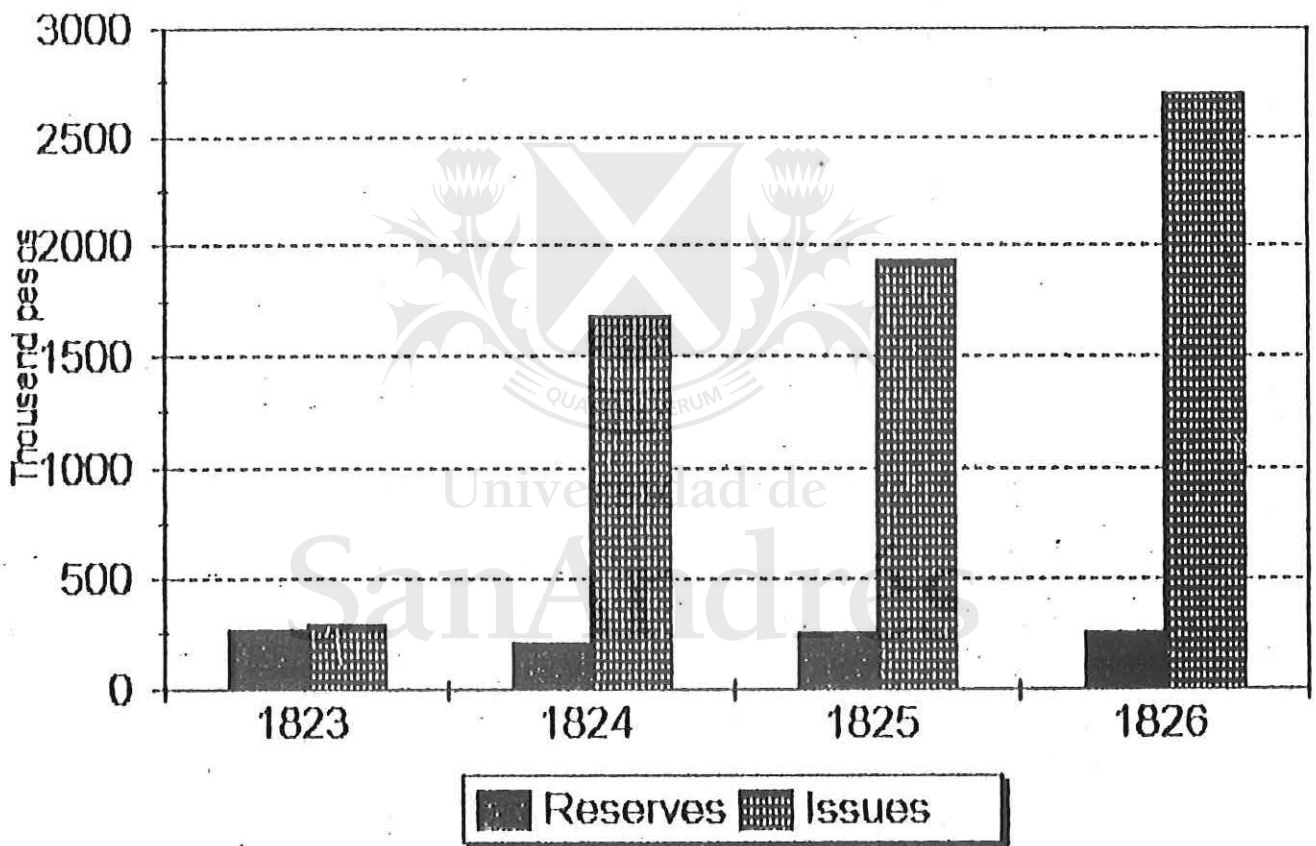
Under those circumstances the idea of founding a bank with the right to issue convertible notes to alleviate the shortage of money gained ample support and was backed by the Provincial government. Then, in 1822, the first bank was founded in Argentina, the Banco de Buenos

⁰Richard Sylla, "Monetary Innovation in America", Journal of Economic History, vol XLII, No. 1(March 1982 pages 21-31

¹ Miron Burgin, Aspectos Económicos del Federalismo Argentino, Buenos Aires, Hachette, 1960, pages 89-94.

GRAPH 1

Banco de Buenos Aires 1823-1826



Aires or Banco de Descuento, chartered by the provincial government as a private bank, but to which it contributed with capital. It was a deposit and discount bank, financial agent of the government; it was exempted from payment of taxes and had the exclusivity of the issue of notes for 20 years.

With such privileges the bank shareholders had no external constraints, neither from the market nor from legal regulations. Starting from the fact that they remained in debt with the Bank for 17 M\$ out of the 20 M silver pesos (or \$F) of the capital subscribed.

The Bank Board, expecting a raising demand of money and trusting on its monopolist position gave generous credits to clients and friends at rates lower than market ones.

The loans were given in banknotes, the amount of which increased a lot between 1823 and 1826. But the Board was wrong on the estimation of money demand because deposits did not go back to the bank at the same pace and the ratio issue/reserves and deposits/reserves fell, leaving it in a very weak position.

See Graph I and the following table
Banco de Buenos Aires

Year	reserves thousand \$	discount thousand \$	res/dep	Notes	res/notes
1823	270	705	0.3829787	291	0.9278351
1824	204	2565	0.0795322	1680	0.1214286
1825	253	2594	0.0975328	1934	0.130817
1826	255	3280	0.0777439	2694	0.0946548

Source :O. Garrigós, *El Banco Provincia*, Buenos Aires, Coni 1873.

The position of the Bank was already difficult when the government, compelled (January 1826) by the needs of the war with Brazil, took over its metallic reserves. At the same time, Congress suspended the convertibility of notes, granted them governmental guarantee and decided to incorporate the the failing Buenos Aires Bank to the newly founded National Bank.²

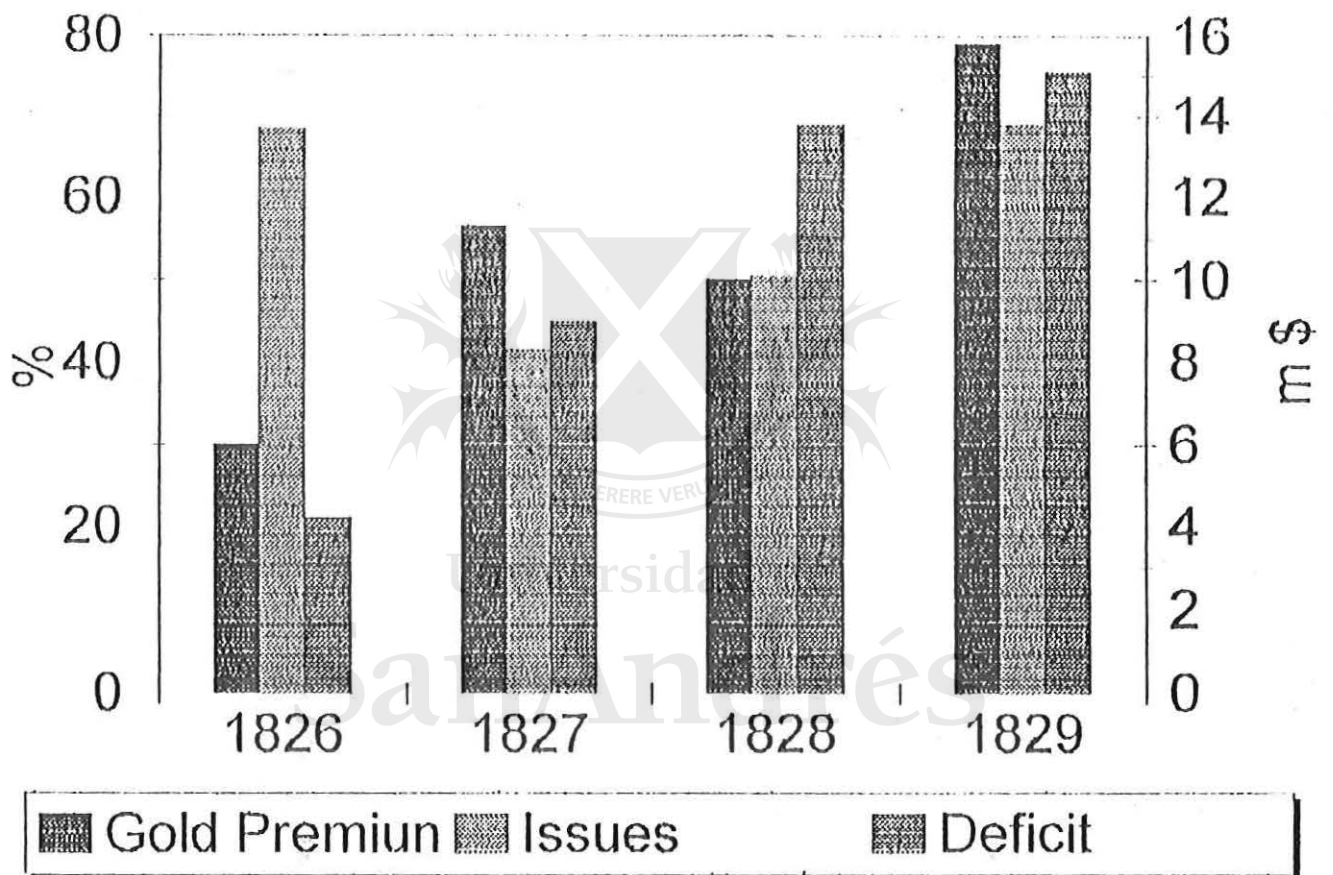
3. The forced circulation "curso forzoso". The National Bank

Although the Bank was founded as a joint venture, private and oficial, it was in fact used as a fiscal instrument of the government. It did not only replaced the Treasury, but commercial discount in the successive years became negligible. In May 1826 the inconvertibility of the notes was confirmed. In 1828 the government granted its notes legal tender status, establishing that they had to be accepted at face value for all obligations, both public and private.

² The political situation was truly complicated. In 1825 a National Congress was convened to dictate a Constitution for the whole Country but instead it formed a national government and federalized the Province of Buenos Aires assuming control of it. The national government lasted until 1827 when the Provice regained its autonomy. During the 1825-27 war, the Buenos Aires port was blockaded by the Brazilian Navy, causing a tremendous fall in custom receipts. The war was financed partially with the Baring loan that was first deposited in the Buenos Aires Bank and then withdrawn to pay for military expenditures, and with the creation of money by the Banco Nacional.

GRAPH 2

B.Nacional Issues, G. Premiun, Deficit
1826-1829



Under inconvertibility and in order to pay for war expenditures, there was a huge increase in notes issued. This was reflected in a rising gold premium.

See Graph 2 and the following table

	Gold premium	B.Nac. Issues	M \$	Deficit M \$
1826	30	6.6		4.2
1827	57	10.3		9
1828	50	9.5		13.8
1829	79	13.8		15.1

Source Garrigós op.cit.

Another thing that was different in the Argentine experience with relation to the United States is that there were no inflationary finances during the war of independence. Inflation started in 1826 during the War with Brazil and had long lasting effects in Argentine life.

See Graph 2a Gold Premium 1826-1852

The National Bank worked only as a governmental agency (which was the reason why its bankruptcy was avoided) and lasted until 1836, when it was liquidated by the Rosas government because it was considered an instrument of a financial conspiracy by the opposition, the Unitario party.

4. The Casa de la Moneda. The Mint created to coin bullion was given instead the task to print notes whatever the treasury required to fill the gap between expenditures and receipts. The Casa de la Moneda huge issues were a consequence of the international military conflicts (those with France and the United Kingdom in 1838 and 1846).

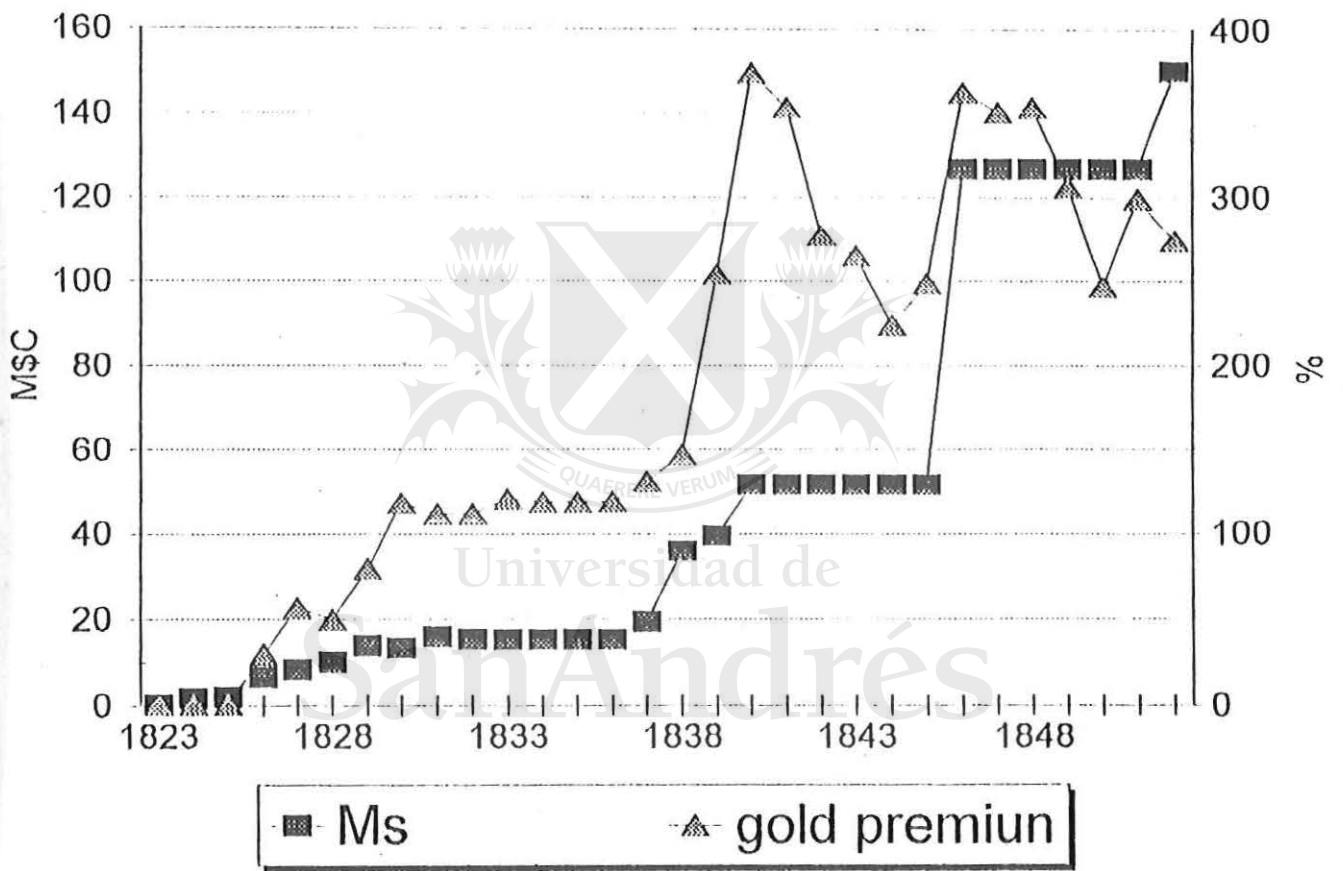
See Graph 3 and the following table

Casa de la Moneda Issues 1836-1861

in M\$	
1836	15.2
1837	19.4
1838	35.9
1839	39.5
1840	51.5
1846	126.5
1852	150
1853	210
1859	285
1861	395

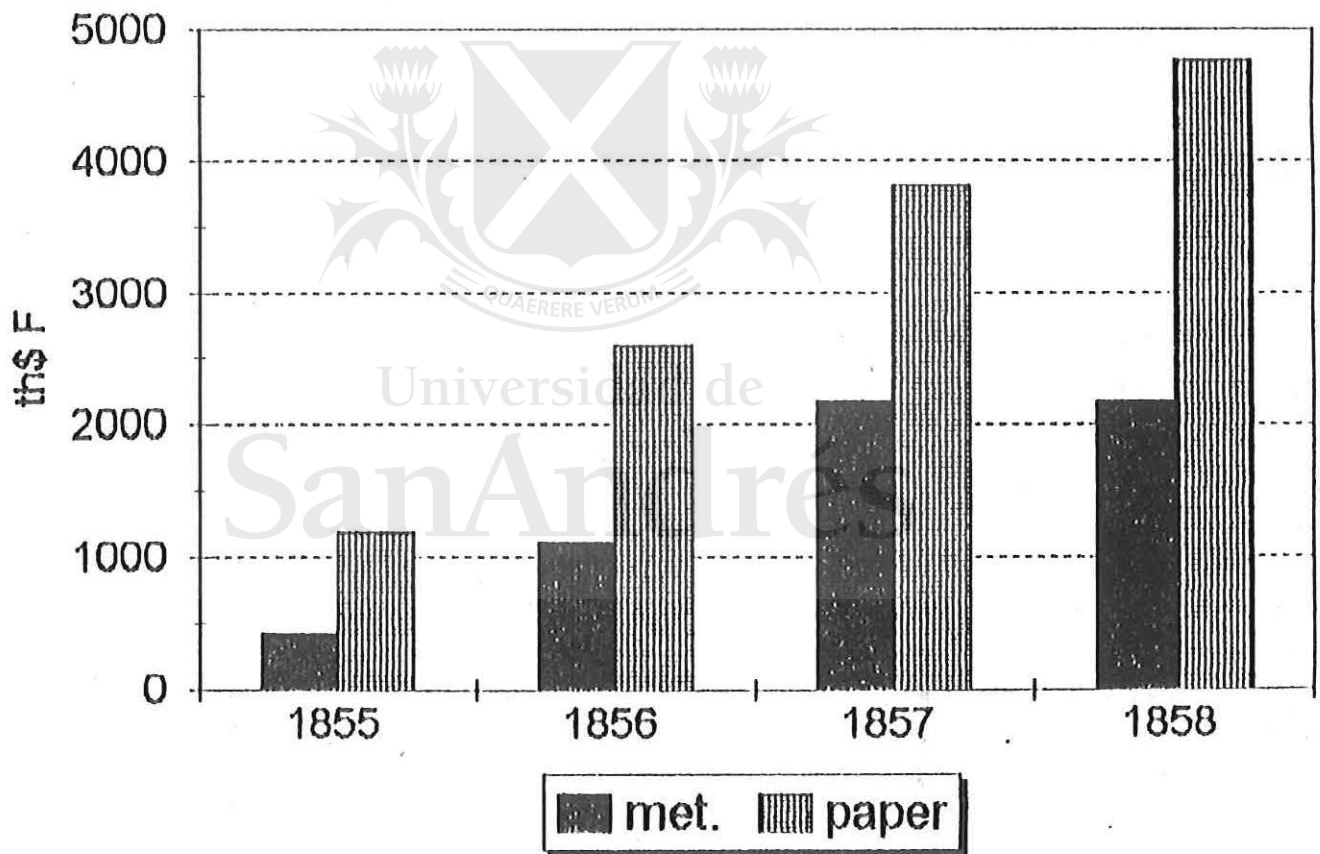
GRAPH 3

Money Supply and Gold Premium 1823-1852



GRAPH 4

Banco Provincia Deposits 1855-58



Source: Garrigós op. cit

Its impact on the depreciation of the peso notes is seen in the Graph 3, Gold Premium.

Comments:

An important institutional innovation, the creation of the first bank, was harmed by an institutional failure:

a) The granting of monopoly rights to the Bank did not impose constraints on the behavior of the bankers that lent money issuing notes beyond money demand and b) the government intervention in the Bank to obtain resources; both caused a fall of reserves and ended with the declaration of inconvertibility and the depreciation of the peso notes, concluding the experiment in 1836, and afterwards going to a system in which the government directly issued notes to cover its deficit.

That failure ended the first attempt to establish financial intermediaries and resulted in price instability a misuse of financial resources, a subsequent chronic shortage of credit, and the raise of the rate of interest which hampered the growth of the Argentine economy, that remained stagnant from the late 20's to the 50's.³

It also caused a considerable delay in the development of financial institutions, that more than 20 years had to go by to start a new experience.

II Banking in the early years of national organization 1854-1880.

1. The Casa de la Moneda and Banco Provincia, later on, Banco de la Provincia de Buenos Aires

As part of the financial reforms spurred by the Province (State) of Buenos Aires when it was separated from the Confederación Argentina, in 1854 as successor of the Casa de la Moneda, the Banco de la Provincia de Buenos Aires was founded.⁴ The purpose of the founders, in a phase of economic expansion, was to attract an unknown but important amount of savings hoarded by the public because of the lack of banks. In order to avoid the fall in a previous misconduct the charter did not give the Bank the right to issue. Its purpose was to establish an institution of deposit and discounts.

The existence of Bank with fractional reserves allowed to use the money deposited with a multiplier effect.

Deposits were received in paper notes or specie and kept in separated branches. They started at

³ See Carlos Newland, "Población y crecimiento económico: Argentina 1820-1870" in El Crecimiento Económico Argentino en Perspectiva Histórica, Universidad Carlos III de Madrid-Universidad de San Andrés, Argentina, Madrid, mayo 1994

⁴ In 1852 Rosas was ousted after two decades in power. A new national government was organized on the same year under the San Nicolas agreement and Urquiza was appointed Provisional President, mandate that was confirmed after a Constitution was sanctioned and elections held in 1853. From 1852 till 1862 Buenos Aires remained segregated from the rest of the Provinces that formed the Confederación Argentina. In 1860 Buenos Aires suggested some reforms to the Constitution that were approved by a special Convention on the same year. In 1862 Mitre was elected President and Buenos Aires returned to the Confederation, by then the Argentine Republic.

a very low level in 1858, reaching very high levels already by 1858.
See graph 4 at the following table

Banco Provincia

Banco Provincia de Buenos Aires								
	Deposits			Reserves				
	Met th	Met th	Met th	met	m.cte			
1855	418.3		1185.2	46	57.04	0.1099689	0.0481269	
1856	1108.8		2589.52	123	113.12	0.1109307	0.0436838	
1857	0		3802.96	340	238.8	0.1566099	0.0627932	
1858	0		4765.04	723	51.36	0.3325667	0.0107785	

Source: Garrigós op. cit

Two factors contributed to the acceptance of the Bank . One was a framework of major enforcement of property rights by the provincial government. The second was that the Bank, in order to attract customers, offered the payment of interest to demand deposits (depósitos con premio). The customer did not only have the possibility of liquidity but also to profit from a non negligible interest (6 to 7 %) on their demand deposits.

In the beginning the Bank followed the real bills doctrine. It discounted commercial (real) bills for a period not longer than 90 days subscribed by two commercial firms. This policy however did not last long.

2. The Bimonetarian standard

The most successful experience -at least for two decades- was the generalization of a bimonetarian standard through deposits.

We say generalization because metallic coins (specie) had been used before together with paper notes. (Some literature emphasized the existence of a bimetallic (gold and silver) standard which was not the problem in this period)⁵. But what was neglected by those who mentioned the use of coins (more spread in the interior, but not in Buenos Aires) for paper notes, was the existence of a bimonetarian system at the Bank, which allowed the mobilization of an huge mass of savings hoarded in metallic (gold or silver)

The Bank not only received and paid deposits and discount bills in paper but also in metallic (gold or silver) keeping records of both in different accounts. (metallic and paper peso). This use was confirmed in 1863 by a rule establishing that each person that deposited metallic or foreign coins would be paid in the same money, and each borrower that received loans in metallic was going to be paid in the same way.

This regulation laid down in a Bank a convertible (fix exchange) system for deposits in specie , and an inconvertible (floating) system for those in paper.

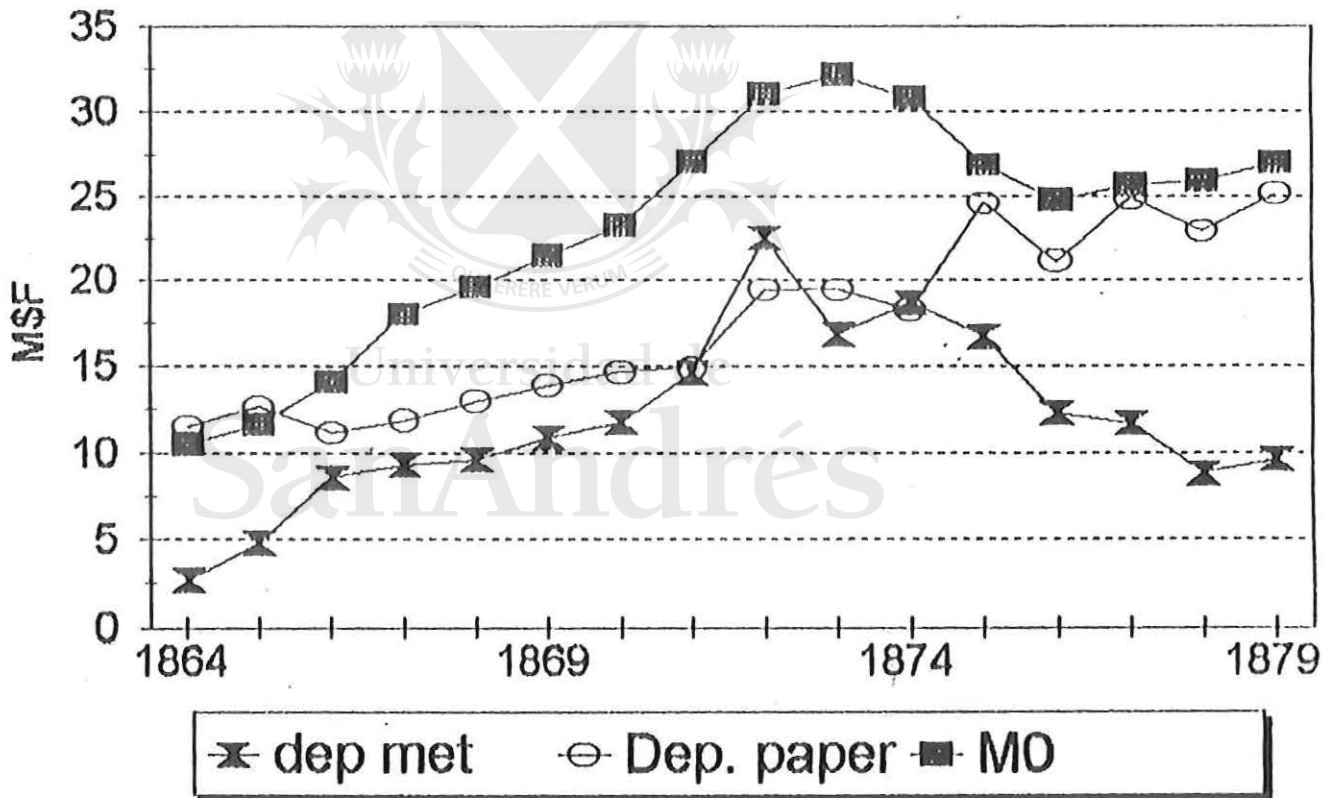
In order to do so the Bank used a money of account established by the government in 1857, as separated from the means of payment, the peso fuerte (\$F) at 17 pesos fuertes the ounce of gold. The peso fuerte was used for the metallic deposits and remained a fix parity until 1876.

⁵ A.G. Ford, The Gold Standard 1880-1914, Britain and Argentina, Oxford, Clarendon Press, 1962.

GRAPA 5

Deposits and Currency

1864-80



This was a very important institutional innovation because it allowed the use by the financial system of a large amounts of savings hoarded due to the volatility of the value domestic money (paper notes). Knowing that they were going to receive its deposits back in the same currency, deposits in metallic increased very rapidly. (From 1864 onwards, much more than deposits in paper).

See Graph 5

Unfortunately this commitment that lasted during two decades was no respected in the 80's.

3. The metallic notes. The Currency Board (Oficina de Cambio)The 1869-72 credit expansion.

3.1. Metallic notes

During the war with Paraguay the national government, that was already negotiating a loan with Baring Brothers for 2M pounds (10M\$F) , asked the Bank for 4M\$F to cover extraordinary war expenditures until the the receipts of the British loan arrived. The provincial government, owner of the Bank, authorised a loan under the condition that the national authorities accepted the provincial bank-notes in payment of fiscal obligations. It also allowed the Bank to issue notes up to the amount of 4 M\$F. Those notes were recorded as a liability in the metallic section of the Bank and had the same claims as the others on the total assets of the Bank . In fact it was similar to the Bank of England regime before the Peel's Act.

Banco de la Provincia
Metallic section

Assets	Liabilities
Reserves	Deposits
Credits	Notes

Those were convertible notes received as means of payment like the paper money already in circulation.

Although the government repaid the loan, the Bank did not withdraw those notes from circulation.

3.2. The creation of the Exchange Office (Oficina de Cambio). Argentina under the gold Standard

The provincial government took an additional measure. In 1867, an Exchange Office was established within the Bank and it was authorized to issue notes (in a different unit of account, the pesos corriente) to give to those who deposited metallic and to return the metallic to the holders of notes. The rate of exchange was fixed at 25 \$ moneda corriente for 1\$F peso fuerte using the national money of account . After many years of curso forzoso, convertibility was back in Buenos Aires.

The system of exchange office and the fix rate of exchange that was in force from 1867 to 1876 led some authors to think that Argentina was under the gold standard (as it was conceived

under the Peel's Act).⁶

In fact the paper money section of the Bank worked in a way similar to the Bank of England with the Exchange Office as the Issue department and the Commercial Branch discounting commercial bills

<u>Exchange Office(Issue Department)</u>	
Gold	Notes(in paper notes \$mc)

<u>Commercial Department (Paper pesos)</u>	
Notes	Deposits
Credits	

The difference with the Bank of England lies in the fact that in the Buenos Aires Bank there was another section: the metallic one, where notes (in this case metallic notes in \$F) were also issued.

<u>Commercial Department (Metallic Section, pesos Fuertes)</u>	
Reserves (gold silver)	Notes
Credits	Deposits

Although this was not completely clear by then, the mechanism made it possible -later on, when reserves fell- to avoid the constraints put on the issue of notes, that was the main requirement of the gold standard.

3.3. The increase of reserves and the expansion of deposits between 1869/72.

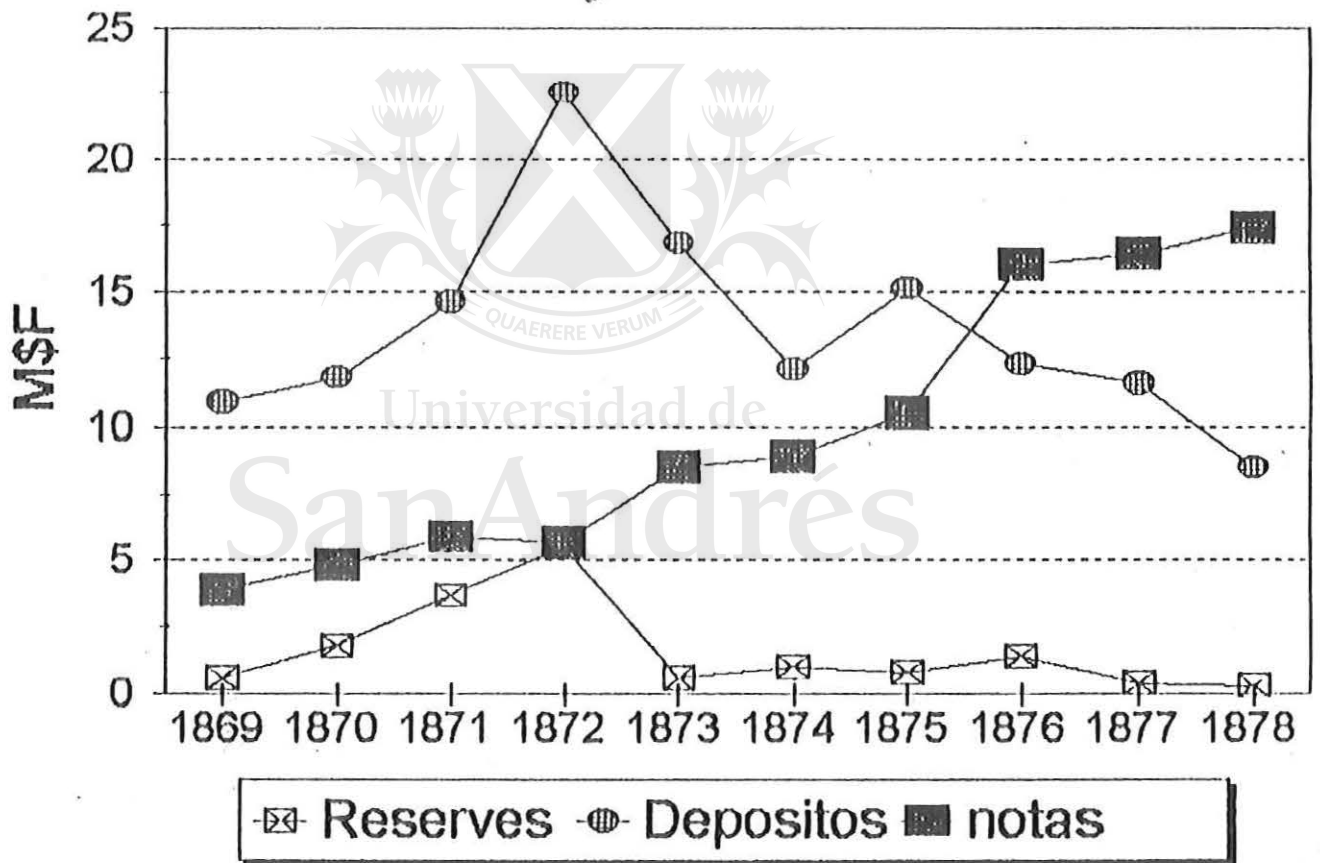
But gold did not enter solely into the Exchange Office, being it the unique source of creation of monetary base. As we mentioned, with reserves in gold and silver, the Bank also created notes (also used in some years as reserves). In addition it could create deposits for a multiple of the reserves held. In fact the Bank received a large amount of gold coming from the unused funds of the Public Works Loan of 1870 underwritten by Murietta in London. As a result of that, reserves increased as well as metallic deposits (notes less than the others). There was a multiplier effect. See the following table:

⁶John Williams, Argentine International Trade under Inconvertible Paper Money, 1880-1914, Greenwood Press, New York 1969.

A.G. Ford, The Gold Standard Britain and Argentina Oxford, Clarendon Press, 1962.

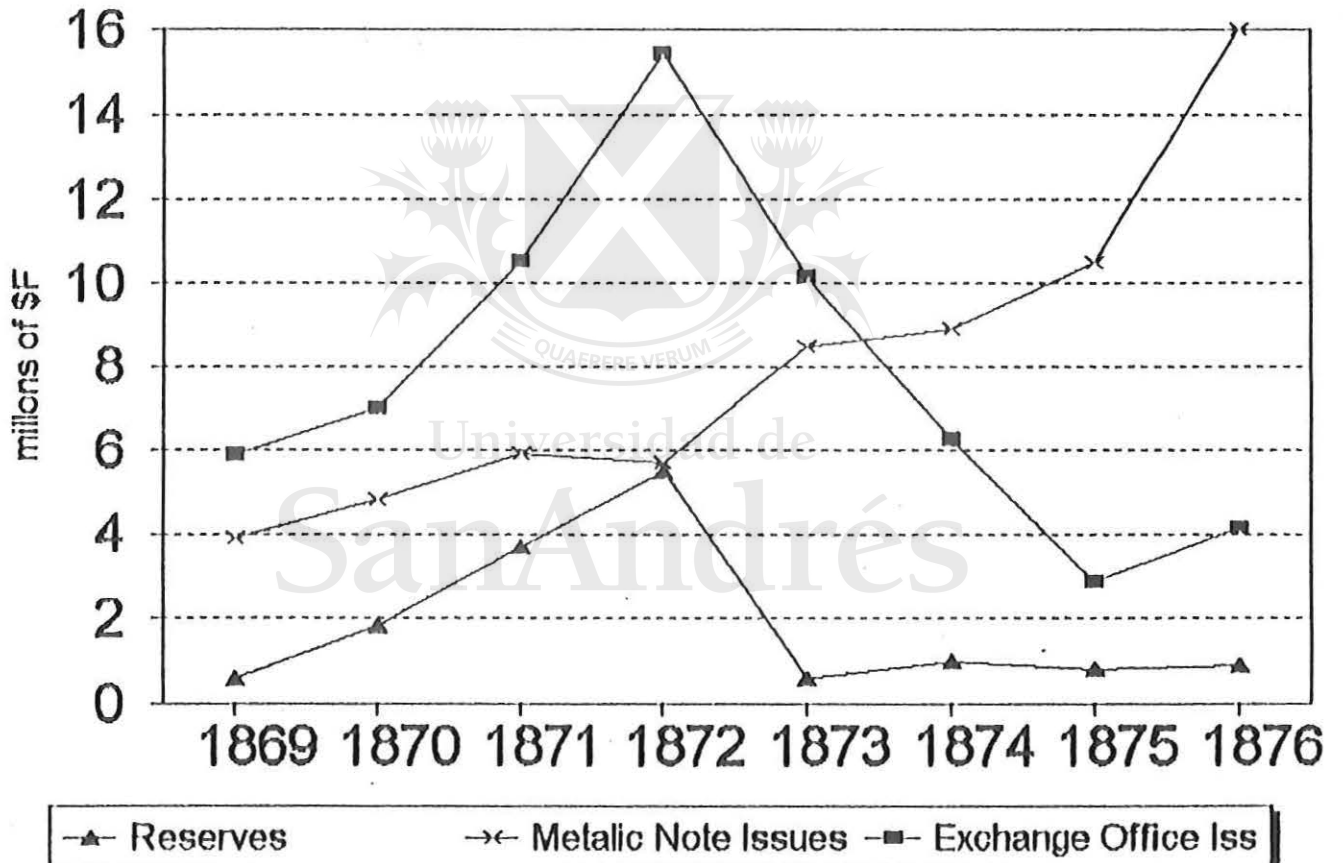
GRAPH 6

BProvincia 1869-78 Reserves, deposits, Notes



GRAPH 7

Exchange Office and Notes, Reserves 1869-1876



Banco Provincia de Buenos Aires			
	Res met.	Deposits	notes
	M \$ T	M \$ T	M \$ T
1869	0.6	10.9	3.9
1870	1.8	11.8	4.8
1871	3.7	14.6	5.9
1872	5.5	22.5	5.7
1873	0.6	16.8	8.5
1874	1	12.1	8.9
1875	0.8	15.1	10.5
1876	1.4	12.3	16
1877	0.4	11.6	16.4
1878	0.3	8.5	17.4

Source : R. Cortés Conde, *Dinero, Deuda y Crisis*, Buenos Aires, Sudamericana, 1989.

As it is seen in the table an increase of almost 5 M \$ in reserves produced an increase of 10 M \$ in deposits. On the other hand when the government withdrew deposits, first from the Provincial Bank (and later on from the National Bank) the same multiplier effect resulted in contraction. Between 1872 -74 reserves fell by 4.5 M\$ and deposits, by 12.4 M\$F.

See also the Graph 6

Therefore the monetary expansion in the early 70's was not mainly a consequence of the expansion of the monetary base (Exchange Office) but of the increase of reserves and its effects on deposits. The subsequent contraction (the so called crisis of credit of 1873) was due to the same cause.

III. The 1873-76 Crisis.

In 1872 a second Bank was founded with the national government as its main shareholder. In addition to the usual commercial operations it had the right to issue metallic notes . The bank received part of the funds of the Murietta Loan (30 M\$F) and suffered the same contraction when the government withdrew its deposits. (for payments abroad or other expenditures , the war in Entre Rios)

See Table B.Nacional 1872-76

But the fact that the amounts withdrawn by the government did not go bank to the Banks illustrates that the market was suspicious of the Banks commitment of maintaining convertibility ⁷, and reserves run off.

The loss of reserves was aggravated when the Provincial Bank, in order to offset the contractionary effect of the withdrawal of notes in the Exchange Office ,increased the issue of metallic notes.

See Graphs 7 at the following table

⁷On the importance of that commitment see Michael D. Bordo and Finn E Kidland, "The Gold Standard as a Rule" NBER Working Papper. May 1990

YEAR	1869	1870	1871	1872	1873	1874	1875	1876
Bs. As. Bank	M \$ T	M \$ T	M \$	M \$ T	M \$ T	M \$ T	M \$ T	M \$ T
Res.met.	0.6	1.8	3.7	5.5	0.6	1	0.8	0.9
	10.9	11.8	14.6	22.5	16.8	12.1	15.1	12.3
	3.9	4.8	5.9	5.7	8.5	8.9	10.5	16
Issues	5.88	7	10.53	15.41	10.16	6.24	2.84	4.15
Res.met.					1.9	3.4	2.6	
Dep.met.					0	6.6	1.6	
Notes					2.3	5.2	3.4	

Source: Cortes Conde op.cit.

It was the contrary to what was expected under the gold standard, which is that the paper note circulation must be reduced to the extent of the outflow of gold. When reserves at the Provincial Bank were depleted (May, 1876) the provincial government authorized the suspension of convertibility for all the notes: paper and metallic as well. The National Government did the same for the National Bank.

As an outcome of the crisis and the need to finance the national government, the Banco Provincia notes were granted legal tender and were the only ones allowed to circulate within the Province. The National Bank, near bankruptcy, entered a phase of reorganization that lasted until 1880.

Comments:

Again, two important institutional innovations that helped develop the financial system and the economy as a whole were misused. First, the creation of a bimetary banking system that gave confidence and attracted hoarded savings. Second, the attempt to establish a system similar to the Bank of England. Legal failures allowed the Banks and the government to deceive the public in order to obtain resources (from the depreciation of the peso, the inflationary tax). It was possible to profit from those failures because the financial system did not have clear rules or market constraints.

The consequence, again, was the outflow of gold, the depreciation of the peso, the shortage of credit and the raise of the rate of interest hampering the growth of the economy.

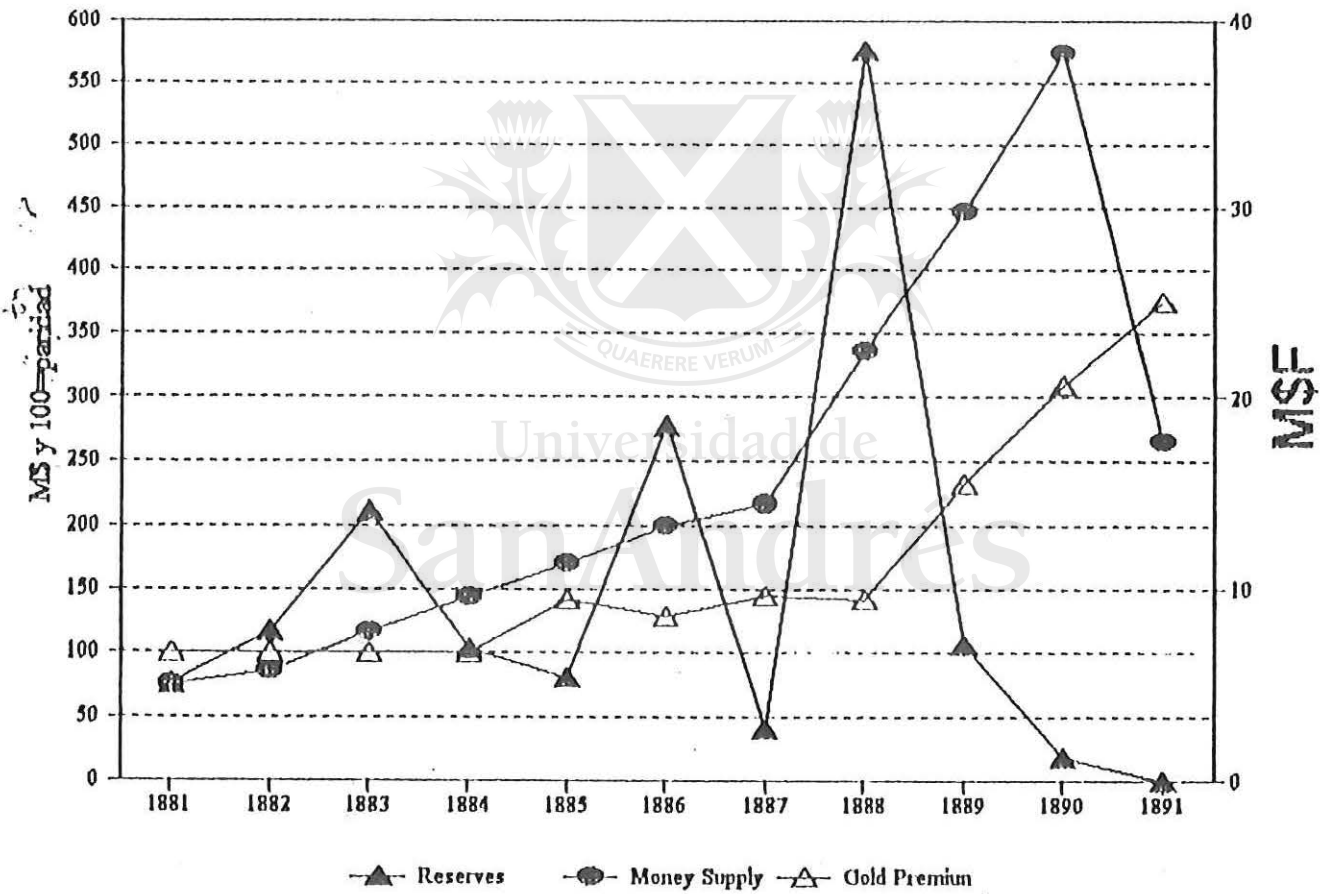
In addition, after deceiving the public it became more difficult, later on, to recreate confidence on financial institutions, something that had a very high economic cost.

IV. Banking in the 80's. The 1881 monetary reform. Convertibility. The gold standard. 1885 Suspension of convertibility.

The 1880 decade started with great optimism. After years of serious fiscal and monetary adjustments, in the newly reorganised Banco Nacional it was possible to go back to business, issuing new convertible notes that were exchanged for the former unconvertible ones. On the other hand the Banco Provincia reopened its office of exchange in 1881. In 1881 the national government sanctioned a law by which a new monetary unit, as unit of account, the peso oro (gold peso) with 25 grammes of silver instead of the 27 gr. peso fuerte was created. The government decided to mint gold coins, *argentinos*, for 5 pesos oro (almost a pound sterling)

GRAPH 8

Money Supply, Reserves, Premium
1880-91



and for 2.50 peso oro (*medio argentino*). There were already four Banks of issue in the country that were ordered to change the previous issues in different units of account peso moneda corriente, pesos fuertes to new issues in pesos gold. These changes had to be completed in 1883, when those new notes would become convertible.

Convertibility, that actually started before, was legally enforced in 1883 at the same parity than in 1867.⁸

Williams and Ford argued that this was a new (and failed) experience under the gold standard. But again the Banks had the obligation to convert their notes and there was no provision at all regarding the amount of reserves they had to hold in relation to the issues.

There also remained a system a oligopolistic banking (the other two banks were in Cordoba and Tucuman).

The National and Provincial Bank embarked in an expansionary policy of credit (in part due to some operation by which receipts in gold were obtained through the negotiations of Government Bonds abroad)

See Graph 8 at the following table.

	1	2	3	4	5	6	7	8	9	0	1
Res. met.											
B.Prov.	3.4	5.5	7.6	6.8	4.6	11.6	1.8	4.9	1.3	0.8	0.01
B.Nac.	1.7	2.3	6.5	0.08	0.8	6.9	0.9	33.5	5.8	0.45	0.01
Total	5.1	7.8	14.1	6.88	5.4	18.5	2.7	38.4	7.1	1.25	0.02
Of. Mon.	76	86	116	144	171	200	217	336	447	574	266
et/O mon	6.71	9.07	12.1	4.78	3.16	9.25	1.24	11.4	1.59	0.22	0.01
Res		2.7	6.3	-7.22	-1.48	13.1	-15.8	35.7	-31.3	-5.85	-1.23
io	0	0	0	0	142	129	145	142	233	309	375

Source: Cortés Conde

When reserves fell down in 1884 (Graph 8) and the Banks continued to issue notes, the public realized that under those conditions they would not be able to convert. Then there was a huge outflow of reserves, to the point that the banks facing serious difficulties asked the government to exempt them of the obligation to convert, which was done in January, 1885. Again it was not the case of the failure of the gold standard but of the lack of regulations what compelled the banks to withdraw notes when reserves were falling.

Given the fact that there was a new unit of account, the gold peso in which all the deposits (formerly metallic or paper) were held, the declaration of inconvertibility did not only reach notes but metallic deposits (gold and silver) as well.

It was a serious attack to property rights which had an enormous influence in the following capital flights that led to the 1890 crisis.

V. The Free Banks (Banco Garantidos) 1887-90

Actually the most important experiment and apparently a new one, was that of the Bancos Garantidos (Free Banks). Since the national organization (1853) there was a long debate on the

⁸ This was very important for getting confidence, specially in international markets.

See specially Michael Bordo op. cit.

most suitable system to adapt to Argentina . One of them was the monopolist bank of issue like the Bank of England after the Peel's Act; the other, the system of the National Banks of the United States. In 1862 the Executive Power sent Congress a project of Free Banks but it was rejected because of the strong opposition of Buenos Aires (and its Bank). In 1887 another administration, in this case stronger, moved to get the approval of a project of Bancos Garantidos. It asked all existing commercial banks to incorporate themselves to a system by which the business of banking and the right to issue would be free , without requiring an especial chart.

The aim of the Banks -it was said- was to have a uniform paper currency with circulation in the whole country. It was not the case to allow provinces to establish Banks of Issue, which some of them they already had -Cordoba, Tucumán-) and nothing prevented the establishment of new ones The Act was actually aimed at establishing a uniform currency because the issues from those banks were accepted with different discounts outside the boundaries of each province. In fact the winning political coalition formed by the governors of the interior provinces (Liga de Gobernadores) was looking for a mechanism by which the issues of the local official banks would obtain legal tender status for the whole country. Through this system the provincial issues got it. For the national government, whose external debt reached alarming proportions, the interest was to control the gold in the vault of the private Banks. The government, after the 1885 suspension of convertibility, was desperately trying to obtain gold to intervene in the market sustaining the peso parity (in order to avoid the erosion of its taxes due to the depreciation of the peso). They thought that all the gold held in the country was hoarded by the private banks. Then the government tried to force them to enter into the Bancos Garantidos regime in order to get the control of gold . As a result of that, the government obtained large amounts of gold (with relation to the inflow coming from other issues of external debt) but it was that of the provincial governments ,each of them founder of a new Banco Garantido get from the negotiation of their own external debt for more a 100 m\$ gold in international markets (mainly in London) using as collateral the National Government internal debt in gold, issue as a guarantee for the emissions of the Bancos Garantidos. Actually few private Banks entered the Bancos Garantidos regime but all the governments of the Argentine provinces founded their own official bank in order to have the possibility, enjoyed for years by the Buenos Aires Province, to monetize their deficits.

The provinces had issued external debt by which they obtained gold to buy the Bancos Garantidos Bonds. They received the interest of their bonds and had to pay the interest of their external debt, a little above those bonds (around 1 %). The difference was obtained by the interest paid by commercial loans or by the provincial government debt.

Following the idea of the National Banks , to open the business of banking without the need of a chart, any company could be established that had the right to issue bank notes if in compliance with the following conditions:

1. A capital of a quarter millon gold pesos.
2. Banknotes did not surpass 90 % of the capital;
3. They had to buy with gold an amount equal to the banknotes issued.
4. Those notes were provided by the Inspection of Bancos Garantidos, and would be uniform and guarantees by the government. The notes would be of legal tender in the territory of the nation and should be received at face value in payment of all obligations public and private. (art 31). As the previous issues those were also inconvertible

5. In case of Bank failure the Bancos Garantido Inspection would sell the bonds paying the holders of notes with its receipts.

The authorities at the time argued that with this regime Argentina did follow the National Banks system of the United States. The new one, they said, implied the abandonment of the monopolistic chartered regime to enter into a free banking one.

But the legal and regulatory framework of it was different as it was its practice . Actually there was no competitive business because there were many banks but just only one, and official, in each province.

The banknotes were not convertible in another currency used as legal tender as in the U.S. The requirements of guaranteeing bonds with gold were not completely fulfilled. The National Bank was exempted. The contribution of the Banco Provincia de Buenos Aires was compensated with the debt that the national government had with it since 1876. The Banco de Cordoba bought the bonds with promisory notes in gold .

Finally the National government issued an enormous internal debt in gold, that was bought by the Banks, debt larger than the already existing one. For this reason it never had a real possibility of being bought in the market, which made the guarantee illusory. Under the Bancos Garantidos regime, the money supply went from almost 200 M\$ gold to 500 M\$

This experiment, as many others that to some contemporaries seemed very ingenious, ended in an enormous failure raising the government debt by 158 M\$, coming for Public Bonds and producing a parallel increase in the currency in circulation.

The gold coming from those Bonds was sold in the market to support the parity of the depreciated peso in an effort condemned to fail. The government bought gold issuing debt (the Bancos Garantidos Bonds), with those bonds the Banks lent money, with which the public bought back gold that the government sold.

This was probably the main financial experiment in Argentina until 1890. It ended in a big failure and a new delay in the development of financial institutions.

VI. The use of gold of the Bancos Garantidos, Capital Flights and the 1890 crisis.

The depreciation of peso that occurred after 1885 inconvertibility did not hurt only the public. The government suffered the erosion of its revenues produced by the depreciation of the peso because by the 1885 Act it was compelled to receive notes in paper pesos oro moneda nacional in payment for taxes. This was the problem that most seriously incided on the deficit, because a large proportion of its expenditures had to be paid in gold (specially the external debt, later on also the internal one).

In order to overcome this problem it was embarked in a attempt to defend the peso parity trusting that in a country which experienced an extraordinary expansion; in the long run, a continuous inflow of foreign capital would provide an ample supply of gold. In 1886 the government sold gold using the procedures of the sale of the Andino Railway. (See Graph above) and it was successful in maintaining the parity between 1885 and 1887. In 1887 however Money Supply increased enormously due mainly to the new issues of Bancos Garantidos. After exhausting its reserves in 1887 the government had the chance to use the new funds of the Bancos Garantidos, which in fact it did it (see the same Graph) between 1887 and 1888. Until 1888, more or less the same parity was kept by selling gold. But noticing that the Banks continued expanding credit, the public with the notes lent by the banks bought gold. The gold reserves run off. The gold premium, almost stable during three years, jumped. Prices followed (see Graph). But the attempts by the bank to attract deposits failed because the public remember the 1885 experience, when metallic deposits were converted at paper pesos at nominal and not market rates. Moreover, the public was withdrawing deposits in paper, as it preferred to hold notes. After capital flights that left the Banks without metallic reserves, there came a run of deposits in paper. After a monetary crisis, a financial one. The Bancos Garantidos finally collapsed when they did not receive the interest of the Bonds. The official banks as well as the majority of private ones suspended their payments and a general moratorium was declared. With gold at 300% above parity the government was unable to fulfill its obligations of the internal and external debt. There came the crisis (1890), which caused a new institutional setback.

The whole currency in circulation was undertaken by the government, and until 1899 there were no new issues. Banks increased the ratio reserves/deposits. The rate of interest raised. Money supply fell dramatically between 1890 and 1893. There was a severe contraction. With serious fiscal and monetary adjustments, the end of the decade finally concluded with the stabilization of prices, converging to international levels(See Graph). As times went by the commercial private banks began to have a more important role in the financial system. In 1899 Argentina finally entered the gold standard to remain within it until 1929.

VI. General Conclusions

During almost all the XIX century, Argentina tried to adapt some financial institutions, already known in the world, to the local demand conditions.

The demand for financial institutions arose in the XIX century independent period from:

1. The shortage of means of payments, when silver inflows coming from Bolivia ended after the independence and war. The need of means of payment and the fiscal urgencies of the Buenos Aires government led to the creation of the first Bank of issue in Argentina, the Banco de Buenos Aires.

2. In 1863 after many years of price instability, depreciation and civil war, when national organization was finally reached, the growing economic activity required the mobilization of savings that were hoarded (in gold and silver) because the lack of financial intermediaries and the climate of lack of confidence coming from the past experience. Under those circumstances it led to the establishment of a bimonetary system by which the Bank could create deposits not only in paper money, the means of payment known, but in metallic (gold and silver) by a multiple of the reserves held in the Bank. For doing so the Bank used as a money of account the one that was established by the national government as separate from the means of payment: a peso fuerte (\$F) of 17 pesos the gold ounce.

3. In 1867 the creation, within the Banco de la Provincia, of a Currency Board (Exchange Office) similar to the Issue Department of the Bank of England, and from 1883-85 the enforcement of convertibility of notes of the Banks, were circumstances that made some people believe (Williams, Ford) that the country entered into the gold standard.

4. In 1887 the establishment of a system of plurality of banks of issue, the Bancos Garantidos, which was supposed similar to the National Banks (Free Banks) of United States in order to end the quasi monopolist system and open a free business of banking.

However the rules laid down for those institutions gave an ample ground for discretionality and in no way opened the business for competition. Under those circumstances the Banks and the government that ruled them used discretionary powers to extract savings, deceiving notesholder through the depreciation of the debt they issued (notes).

As we argued the defective institutional framework made that possible because:

- a) there was not a competitive banking business.
- b) there were no clear rules like those known under the currency principle.

The government used the Banks to force the transfer of savings either to the government or

to the debtors of the system (when they entered in a collusive practice with vested interests represented in the Board Banks).

Those practices that failed to establish sound financial intermediaries had negative consequences:

- 1) On the failure to mobilize savings ~~erived~~.
- 2) On the high rate of interest that prevailed for most of the century, that hampered investments and was not only a consequence of the shortage of capital but of the high risk premium resulting from those experiences.
- 3) On the instability of prices and the depreciation of the peso paper.
- 4) On the high cost of the deflationary adjustments after the 1890 crisis, that finally led to the convergence to international prices and in the country's entering the gold standard.

Note: Sources of the Graphs. If it is not indicated otherwise sources are:

Roberto Cortés Conde, "Dinero, Deuda y Crisis", Historical Statistic (unpublished).

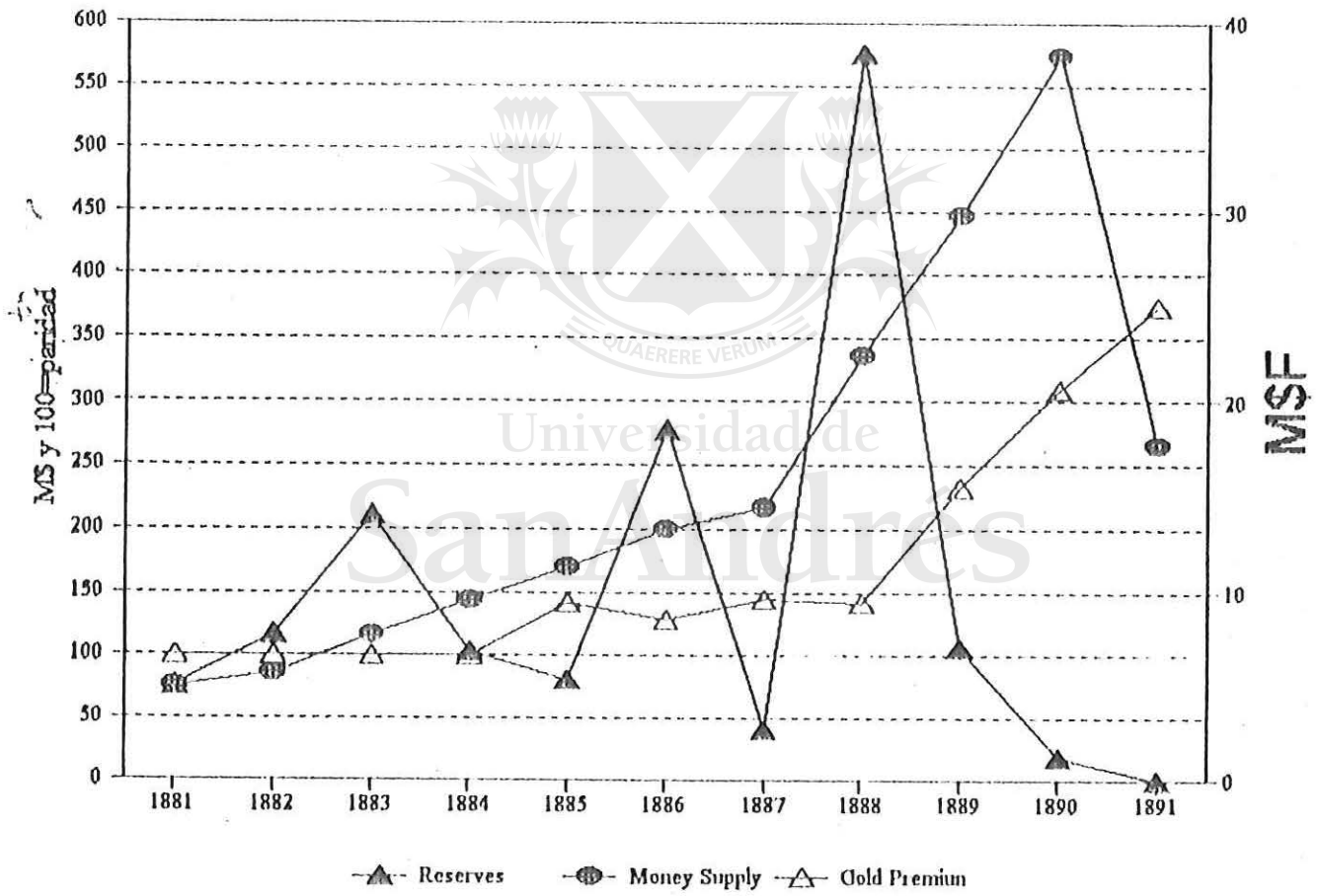
B. R. Mitchell, European Historical Statistics 1750-1970, Columbia University Press, New York, 1975.



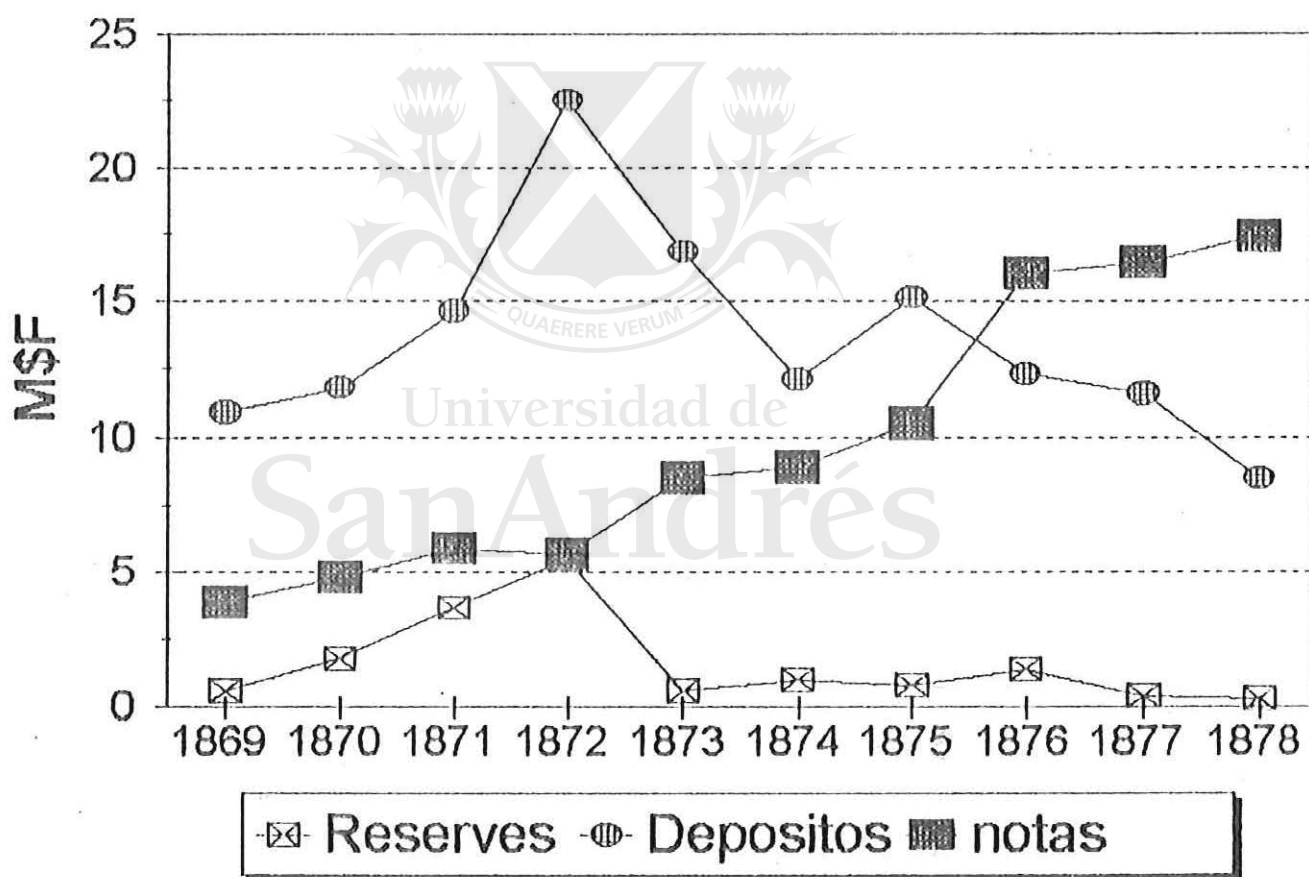
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Gráfico 8

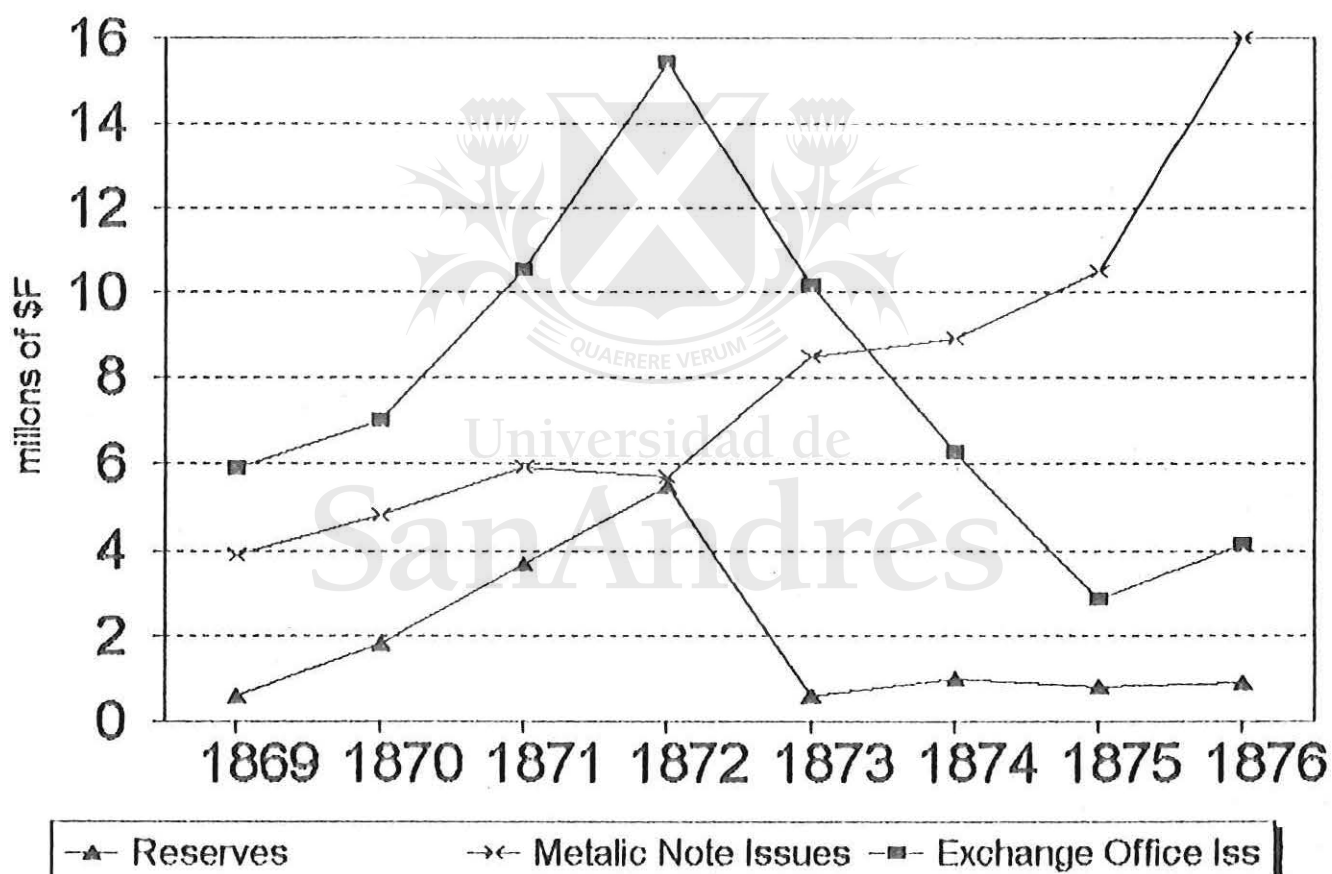
Money Supply, Reserves, Premium 1880-91



BProvincia 1869-78 Reserves, deposits, Notes



Exchange Office and Notes, Reserves 1869-1876



Deposits and Currency

1864-80

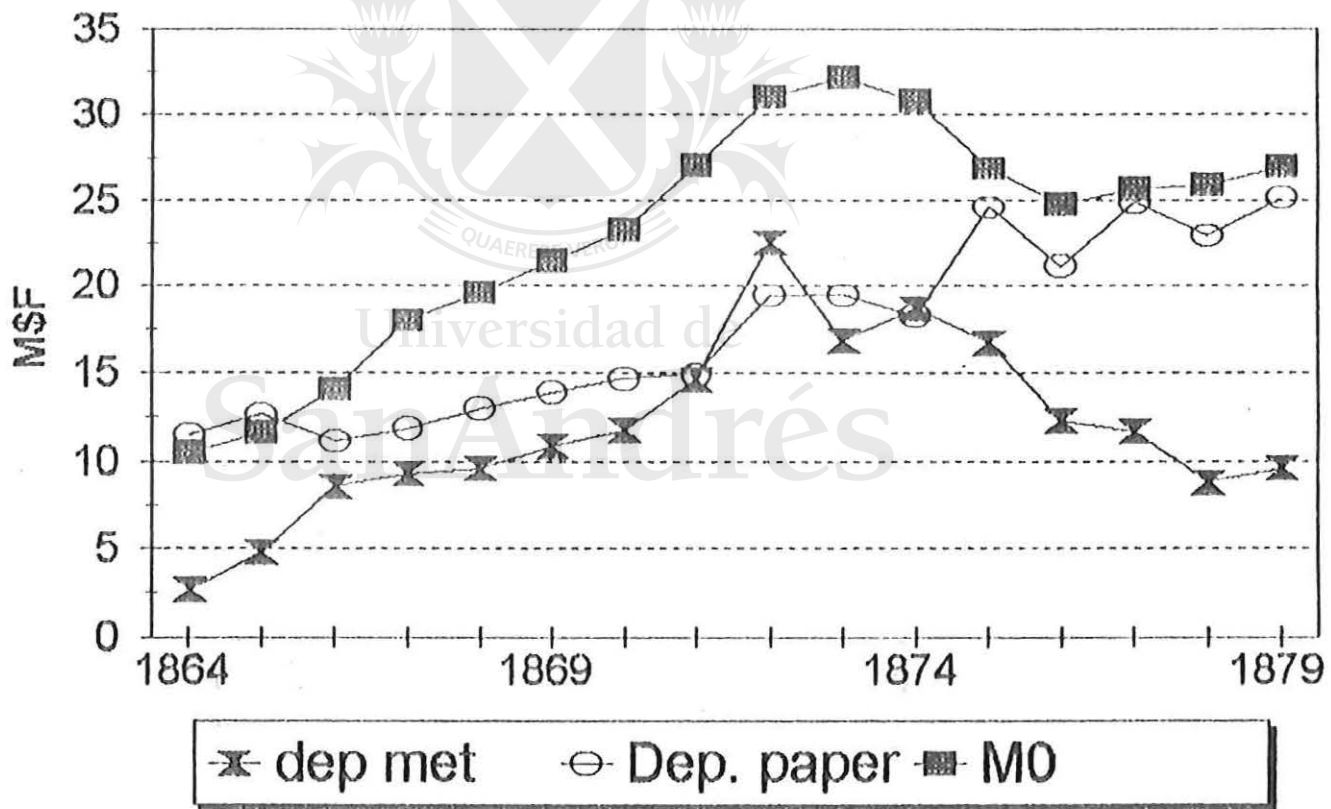
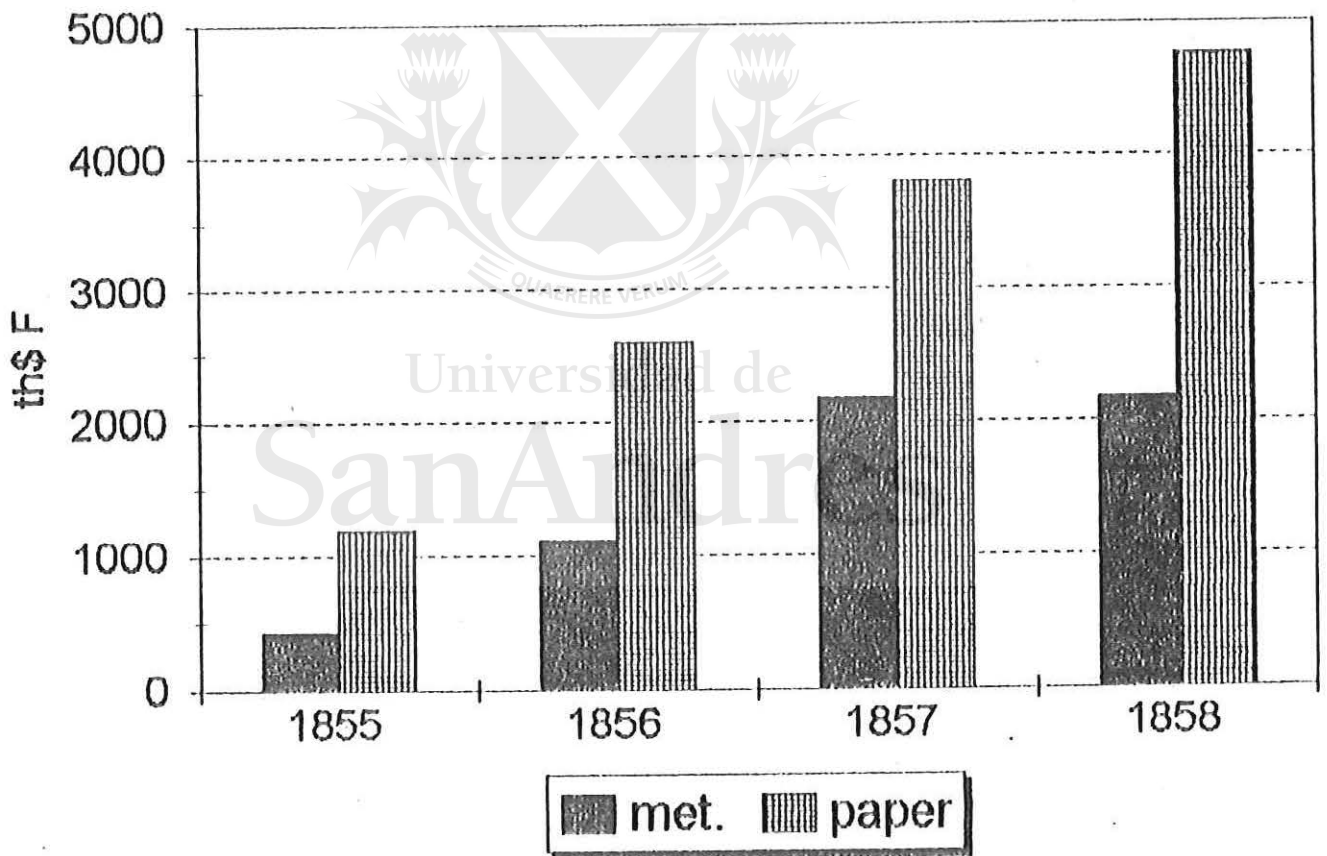


Gráfico 4

Banco Provincia Deposits 1855-58



Money Supply and Gold Premium 1823-1852

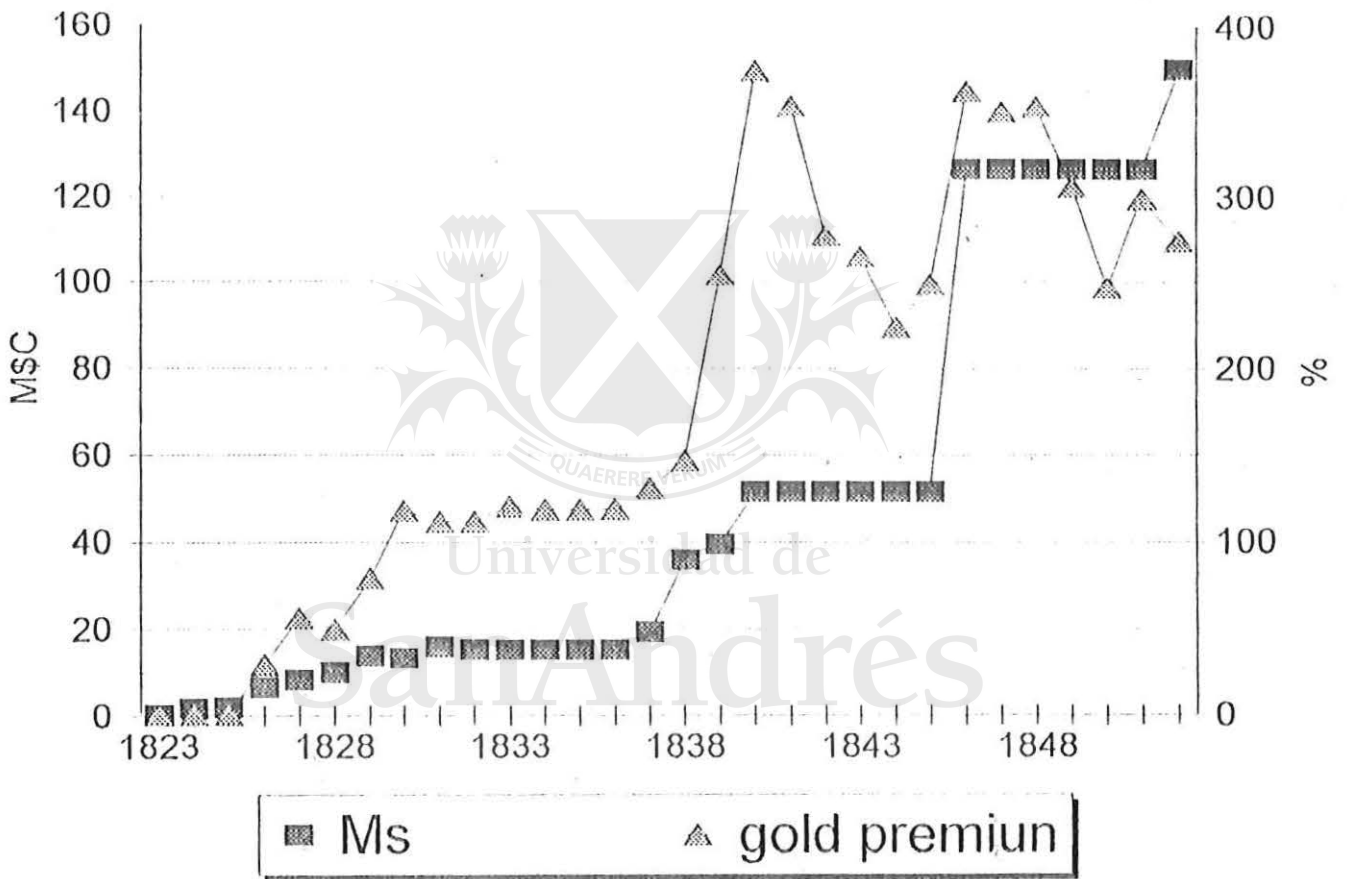
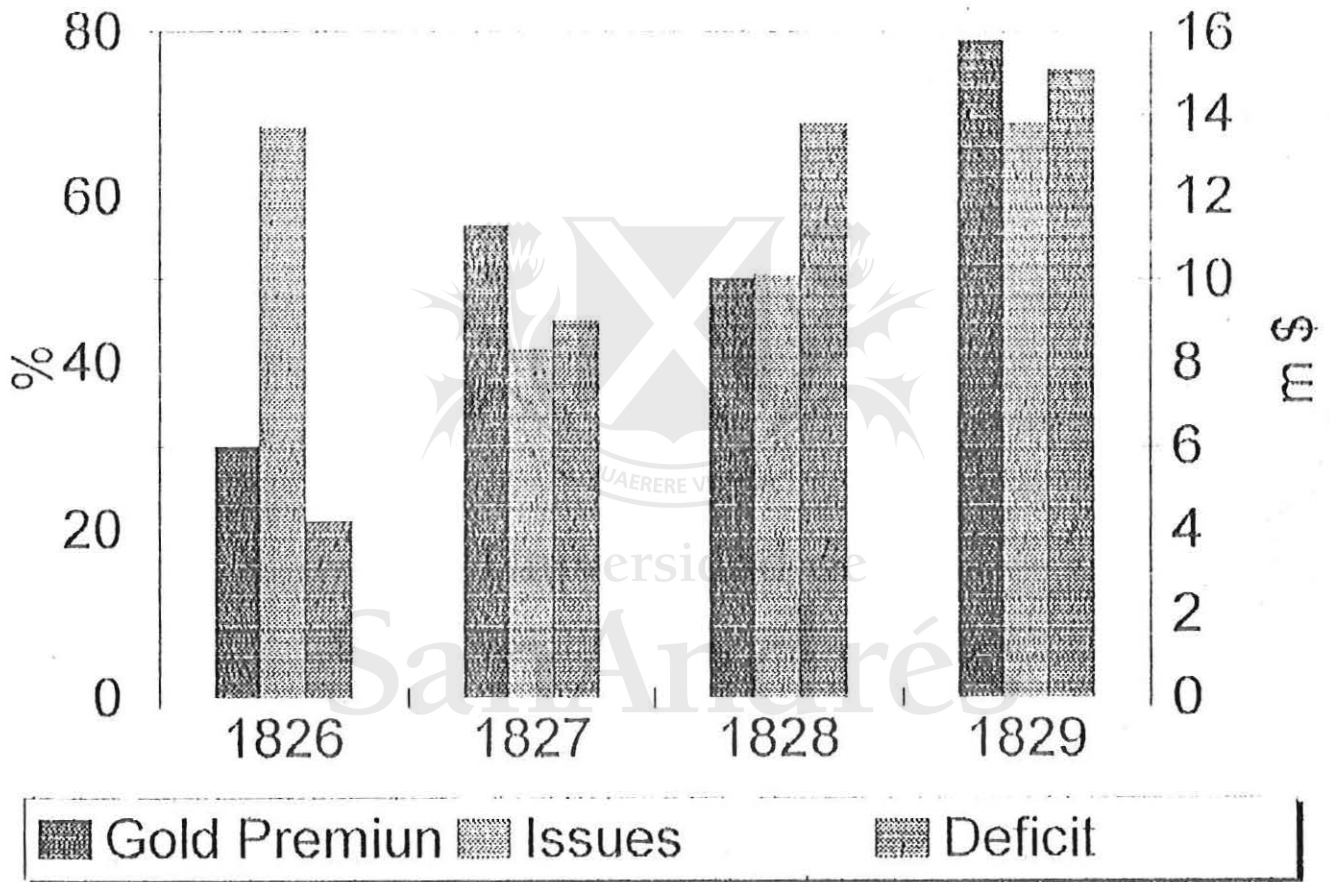


Gráfico 2

B. Nacional Issues, G. Premiun, Deficit 1826-1829



GRAPH 4

Banco de Buenos Aires 1823-1826

