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**DID ARGENTINA HAVE
A CURRENCY BOARD IN
THE MID 1880S?**

Currency Board Working Paper

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Did Argentina Have a Currency Board in the Mid 1880s?

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About the series

The *Studies in Applied Economics* series is under the general direction of Prof. Steve H. Hanke, Co-Director of the Institute for Applied Economics, Global Health and the Study of Business Enterprise (Hanke@jhu.edu).

This working paper is one in a series on currency boards. The currency board working papers will fill gaps in the history, statistics, and scholarship of the subject. The authors are mainly students at The Johns Hopkins University in Baltimore. Some performed their work as research assistants at the Institute.

About the authors

Adria Haimann (ahaiman1@jhu.edu) is a senior at The Johns Hopkins University in Baltimore, majoring in economics and biology. This paper was written as a partial fulfillment for the course "Problems in Applied Economics," which was directed by Prof. Steve H. Hanke. I thank Kurt Schuler and Nicholas Krus for advice.

Description of research task

My research was part of a larger project to determine how currency board monetary systems have performed. The goal was to find information about the note issue of Argentina's Banco de la Provincia in the mid 1800s in order to determine if Argentina had a currency board system. I also tried to find answers to the questions of why the note issue arrangement was established, how it worked organizationally and why it was replaced.

The majority of the information I found came from the book *El Banco de la Provincia* by Osvaldo Garrigos. Other accounts of this period include *Straining at the Anchor: The Argentine Currency Board and the Search for Macroeconomic Stability* by Gerardo della Paolera and Alan Taylor and *La economía argentina en el largo plazo* by Roberto Cortés Conde, but they are less detailed in their descriptions of the history of the Banco de la Provincia.

Description of findings

Why was the note issue arrangement established?

The Banco de Buenos Aires was created in 1822 in an effort to stabilize the local economy wrecked by the Argentine War of Independence against Spain. The newly founded institution became known as the Banco de Descuentos (Discount Bank) because of its role as a source of credit to the local banks in the mainly rural province of Buenos Aires. Shareholders in the bank included local landowners, professionals, military, government officials and Spanish, German, French and British nationals. In 1826, the bank was reorganized and became known as the Bank of the United Provinces of the Rio de la Plata. This newly defined institution had a role as a national bank because the federal government acquired a stake. The first national mint was later opened at the bank as an annex. In 1854, after some political conflict regarding the role of the bank, the bank was transformed into the Banco de la Provincia (Bank of the Province of Buenos Aires), which retained its function as a national and provincial mint. From the mid 1860s to the 1870s the Banco de la Provincia held a monopoly in note issuing; however, citizens were able to make deposits at smaller local banks. The Banco de la Provincia was located in La Plata, the capital city of the Province of Buenos Aires.

In the late 1850s, Argentina had great financial needs due to the aftermath of the Platine War. Also known as the War against Oribe and Rosas, the Platine War lasted from August 1851 to February 1852 and was fought between the Argentine Confederacy and an alliance consisting of the Empire of Brazil, Uruguay and the Argentine provinces of Entre Ríos and Corrientes. The war was between Argentina and Brazil for influence over Uruguay and Paraguay, and hegemony over the regions bordering the Río de la Plata (River Plate). The Platine War increased the economy's financial needs because it damaged sources of income of trade, industry and development of credit. In response to the economic problems, the national Argentinan government ordered that the public treasury print 200 million pesos in paper money. On December 31, 1854 the amount of money the treasury had issued was 210,247,636 pesos. Six years later on December 31, 1861, it was 378,717,656 pesos (Garrigos, 124).

The most crucial laws regarding the issuance of paper currency were those in 1859 and 1861, which ordered for 160 million pesos to be printed. The intention of these laws was to finance government budget deficits. Furthermore, these laws created additional *derechos de importación y exportación*, literally “rights of importation and exportation,” but more accurately rendered as customs duties required to be paid in specific kinds of currency. A considerable mass of paper money was emitted by the state and for the state, creating an oversupply of currency that led to a depreciation of the currency against gold and silver. Before this law inflation was relatively stable however after the law was passed inflation levels rose.

Before these issues occurred, paper money was accounted for separately from gold and silver in business dealings. The government was not positive how to defend the price of pesos for gold and eventually agreed upon 361 pesos per ounce of gold (125). By 1863, one ounce of gold was worth 450 paper pesos (Olarra Jiménez 1968: 27, 30). Olarra Jimenez (1968: 181-2) shows average annual exchange rates for this period and beyond.

During the period of 1854 through 1861, financial disorder occurred, leading to widespread bankruptcy. Argentines were worried about paper money being detrimental and paralyzing business and progress of the country and the Banco de la Provincia. There was a huge interest burden that led to a massive economic weakening. Public dissatisfaction led to an eventual overthrow of the government by a rival democratic faction that came into power on March 5, 1854.

The overthrow of the government produced panic. As a result, gold-denominated deposits increased relative to paper-denominated deposits. The Banco de la Provincia needed money to be able to pay withdrawals from gold deposits and was therefore obligated to buy metal at unfavorably high prices, suffering a loss of reserves. Furthermore, this action was harmful to the paper currency. In order to address this problem the Banco de la Provincia wanted to determine how deposits of metal affected the value of paper. More specifically, the bank was looking to find out if deposits of metal were good or bad for the value of paper money and if it was convenient to limit the quantity of paper money (Garrigos, 127).

The director of the bank claimed that deposits of metal were helpful to paper money. He explained that expansion of paper money produced benefits that increase employment and activate capital instead of just sitting in the bank, something common for the time because citizens possessed a saver’s mentality. He proposed to expand the use of paper money in order to allow the state a means of earning its income. (Garrigos, 128-129).

His proposal led to the Decree of March 10, 1862 (Garrigos, 129), which stated that purchases carried out by public offices must be in paper money. In cases where it was necessary, public offices could fix the price of paper money in metal, but upon expiry they must have an equivalent quantity in paper money. Written contracts that covered foreign commerce and spending must be converted to paper money when possible. The Treasury, and an association of leading merchants, created demand for paper money by using it in their transactions, giving the paper currency some credibility and stability.

Until this point, the custom of businesses was payment in gold or silver coins. With the new decree, businesses bought raw materials in paper money and paid wages in paper money; however, they still sold their products in exchange for metal. This led to the disadvantage of double monetary exchange. The association of merchants wished to conduct exchange solely in paper money, but a compromise was necessary between sellers and buyers in order for this to be possible. In order to achieve this goal, on March 29, 1862 an initiative was created stating that beginning on April 1, 1862 the branch of commerce (Bolsa de Comercio) of the Stock Exchange would only buy using paper money (130). During this time, the Buenos Aires stock exchange handled stocks and additional commodities, including mortgages.

Due to the religious nature of the populace, great care was placed on satisfying laws of repayment. This led to a popular desire to see excess currency disappear. People did not want the use of metal to be the only way to stop fluctuations in the exchange rate and credit markets. Instead, they wished to improve the quality of the paper currency and to re-establish equilibrium between paper money and gold or silver coins (131). This was a radical idea for the time, because it emphasized the power of the state in stabilizing the value of the currency as opposed to the conventional idea that equated stability with gold or silver coinage. Thus, there was a need to inspire confidence in loans from the state and the state's credit. Furthermore, the government needed to dissipate the fear that new issues of currency were bad for the economy. Many believed there was a need for a change in the political institutions of the country, which they considered to have limited growth of the population, commerce and industry and to have been harmful to public and private wealth (Garrigos, 133).

How did the note issue arrangement work organizationally?

The Public Treasury needed the Banco de la Provincia as a powerful instrument to reconstruct the economy. Commercial relations with the national government considerably widened the Bank's operations and multiplied its utility. This gave credit to paper money and was the cause and occasion for the Nation's loans (Garrigos, 137). Also, the Banco de la Provincia had the authority to issue bank notes. These notes were from Buenos Aires and were acceptable in the entire republic. The re-establishment of peace throughout the country in the early 1860s allowed the bank to extend its lending and deposit-taking business, and gain public confidence. This showed that there was an overall benefit of the Bank having more freedom to perform services to improve the well-being of the country.

The primary concern of the Banco de la Provincia was to improve the condition of the circulating medium (Garrigos, 138). The Bank wanted to avoid sharp oscillations of the supply of paper money, which had occurred in the past, and thus needed to back the paper money with metal to have a guarantee of its value. To achieve metal backing, the plan was to hire an outside agency to re-establish the balance paper money and coins. In 1863 credit was opened to the bank with the government's guarantee. Interest rates and repayments were recovered regardless of the effect on the national income affected by the repayment of emissions (Garrigos, 139).

In 1863, the Bank's directors decided to establish what was in effect a dual currency system. This system stated that if a person deposited gold they would be repaid in gold. If the deposit was in paper money, they would be repaid in paper money. If gold was borrowed from the bank then the repayment had to be in gold, not paper money. If the deposit was made using foreign currency, meaning currency convertible into gold at a pegged rate, then the bank would keep the amount in pesos fuertes, a gold-denominated currency.

The Law of November 3, 1863 guaranteed the value of paper money. One peso fuerte ("strong peso") was equivalent to twenty-five paper pesos (142). There was a need for a fixed financial instrument and therefore the benefit to trade and security that this law brought outweighed the harm of potential instability. The Banco de la Provincia was the only bank in Argentina allowed to issue these bank notes. This was because the government thought it was dangerous to let other banks issue notes that could add to the supply of those issued by the Banco de la Provincia.

Other banks wished to operate in a monetary system where the currency had a rigid exchange rate. Thus, the Banco de la Provincia wanted to remove inconvertible paper money from the economy and replace it with the new paper money. The directors of the bank wanted to reassure the public by guaranteeing constant convertibility (Garrigos, 145). Laws of May 5, 1865 and Oct 10, 1865 helped with the fixation, stability and establishment of the value of paper money.

The Law of January 3, 1867 stated that the Banco de La Provincia was authorized to return 25 paper pesos for one peso fuerte or one peso fuerte for 25 paper pesos to whoever asked. The Bank would give paper money to the customer in exchange for gold received (Garrigos, 147).

The Office of Exchange was established, as a separate part of the Banco de la Provincia, to indicate that currency exchange was separate from other transactions performed by the bank. The Office of Exchange kept a separate balance sheet from the Banco de la Provincia. Gold was still accepted in the economy; however, people liked to exchange it for paper money because of the convenience of paper money. It is important to note that the Office of Exchange was not creating paper money; it was only exchanging paper money with the equivalent gold value. In 1872, 15,413,202.1 ounces of gold was stored in the Office of Exchange, indicating a prosperous seven years and an increase in reserves (Garrigos, 150). This economic prosperity was due to better commercial customs, improvement of credit and expansive economic development. The capital of the bank, which included gold and paper components, rose to a sum of 6,778,622.1 pesos fuertes and 39,374,110 paper pesos. One of the main reasons for the increase in the capital of the bank was due to the sales of land. Under the law of December 1864 the sales of land were used to increase the capital of the Banco de la Provincia (Garrigos, 150).

A crucial aspect of the law regarding the bank note issue arrangement was that the bills created by the Banco de la Provincia must be accepted in all regions of Argentina. From 1866 to 1869, the amount of bills issued by the Banco de la Provincia was limited to the amount of 4,000 pesos fuertes per year because of the Law of Oct 22, 1866 (Garrigos, 151). In 1870, the

limit was widened to 6,000 pesos per year and thus 5,900.58 and 5,712.42 notes were issues in the years 1871 and 1872 respectively (Garrigos, 152).

During the early 1870s the public was generally at ease with the actions of the Banco de la Provincia. Bills emitted by the Office of Exchange had a constant base and were guaranteed conversion into gold. Furthermore, the public was content with the fact that the Banco de la Provincia had a yearly limit on the emission of bills. Paper money was slowly introduced into everyday business transactions. Although some people feared depreciation of the money, it did not occur early on and people actually preferred the paper money to coins. Thus, during this period of time the bank had considerable power to help commerce and industry. It was a time of prosperity and with the resources of the bank, train tracks, factories, theaters and public works offices were built. As this was occurring commerce was still widening. Aside from building up the economy, the bank continued to focus on maintaining low interest rates to avoid political or commercial crisis.

Why was the note issue system replaced?

In 1873, economic troubles arose that exhausted the resources of the Banco de la Provincia. Some of Argentina's economic problems were attributable to the worldwide trend of economic problems of 1873, including a panic in Austria, tight financial market conditions leading to high interest rates in London, the leading center for "emerging market" finance at the time, and a financial panic in the United States in October. One important problem in Argentina was the loss of value of mortgage securities. This was because of disorderly speculation in land, which led to under-the-table cash transaction that, contemporary observers thought, led to cash shortages and a consequent elevation of interest rates (Garrigos, 158). Furthermore, unfavorable prices for Argentinean products in consumer markets led to stagnation in the market, forcing the Banco de la Provincia to pay off a major part of imports with their gold resources. Also, there was a sudden commercial disruption in Uruguay that also caused an outflow of gold. The quantity of gold in the Office of Exchange dropped by more than 4,000 pesos (158).

It was becoming clear that the resources of the Banco de la Provincia were far from inexhaustible and that the Bank was limited by its credit. Furthermore, the Bank could not passively escape the course of the financial events that occurred and needed to moderate its actions in precaution of contingencies that could seriously compromise its status. Thus began a debate over the operation of the Banco de la Provincia. A new charter provision of organization was created to eliminate the aspects of the current regime that disrupted credit. An attempt was made to create laws that prevented reckless discretionary acts by the Bank.

The primary goal was to answer the altered credit problem. In the early to mid 1870s it was known that there was a defect in the execution of the law of 1864 (regarding the conversion of money), which the directorate of the bank did not recognize at the time. The defect was related to the conversion to paper money and since it was improperly carried out for several years, problems with the Banco de la Provincia arose. A lot of debt accumulated due

to the new western railroad as well as from provincial governments. Ultimately, there was a fundamental problem with the inability to convert the paper money and immobilization of deposits and repayments, which did not work as smoothly as anticipated. The Bank had 3,529,411 pesos fuertes and owed roughly 7,000,000 pesos fuertes (160). To make matters worse, a significant quantity of the Bank's assets was in mortgages, which were illiquid. The quantity of money that the Bank needed to move was significantly less than the amount of money to which they had access.

In order to prevent a bank failure and public outcry, the Banco de la Provincia was well aware that they needed to honor their debts. The administration of the Banco de la Provincia worked hard to maintain public calm by limiting the means of taking out a principal part of the Bank's resources meaning that they restricted the ability of depositors to withdraw deposits. A transformation to the system of the Banco de la Provincia was necessary but they did not want to hike interest rates, curtail loans nor damage the state of credit.

Unfortunately, legislators could not resolve the Bank's problems without abandoning the existing constitution of the Bank. In 1876 the Office of Exchange was closed because people were exchanging paper pesos for gold in quantities too large for the Bank to sustain itself. A new bank system was established that eliminated the bank note system that existed from 1867 – 1876.

Was the note issue arrangement a currency board?

The aspect of the note-issue arrangement which shows evidence that this system was not a currency board is the fact that a currency board cannot make independent monetary policy nor can the government print unbacked money. During the period 1867-1872 the Banco de la Provincia was printing paper money equal to 4,000 to 6,000 gold pesos per year without acquiring 4,000 to 6,000 gold pesos for the reserves. This quantity was a very small proportion of the bank's overall assets and liabilities yet it was still an action that an orthodox currency board would not carry out. For the most part, the Banco de la Provincia and the Office of Exchange only exchanged coins and gold for paper money; however, small amounts of unbacked paper money were created over that five-year period. Many books have been written about Argentina's financial history and the existence of currency boards, yet many sources have failed to address the details of the operations of an orthodox currency board. An analysis of this shortcoming is explained in Professor Hanke's (2003) book review of *Straining at the Anchor: The Argentine Currency Board and the Search for Macroeconomic Stability* by della Paolera and Taylor. Hanke explains that the book lacks a thorough explanation of how orthodox currency boards operate and therefore readers are left unclear as to how deviations from orthodox currency boards can cause currency boards to malfunction (Hanke, 888). This idea can be applied to the note issue of the Banco de la Provincia, which certainly did not act as an orthodox currency board, and thus, malfunctioned in 1872.

Note about statistical information

The sources used for this working paper had little statistical information, but an appendix with a balance sheet of the Banco de la Provincia in 1872 is included.

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