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Nation-Building and National Banks in Latin America, 1850-1900

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This study posits that- in the modern era- changes in political regimes often lead to major changes in economic organization and, more specifically, in the financial and banking sector. Such a hypothesis- which lends special importance to the relation between politics and institutional change in the economic sphere- provides the framework to our object here, which is to explore some of the ways that politics and the evolution of state structures influenced the early development of banking in Latin America.

To affirm that politics and finances have been (and are) closely intertwined in modern Latin American history is certainly no novelty. But it is worth noting that relatively

few studies have made an explicit attempt to link political modernization with the creation and/or development of banks in Latin America.

At the same time- and *reciprocally*-, it is proposed that institutional policies and/or innovations in the financial sector can affect the efficiency or lack of economic efficiency of state administrations. In this sense, it can be argued that in the process of capitalist development, the establishment of banks represent one of the key institutional "innovations" that can contribute not only to financial development but also to political/administrative modernization. It is our argument that, in the Latin American case, the forging of a "modern" banking system in the late 19th century accompanied and reinforced the process of consolidation of national state structures. In fact, the modernization and increasing financial strength of government depended to a considerable degree upon the creation of powerful banks which served as key auxiliaries in the task of creating a more efficient and broad-ranging fiscal and financial administration.

A different and much more debatable question is whether the type of heavily "political" banking structures which emerged in many Latin American countries at the time proved to be economically beneficial in the long-run. For this reason, care must be taken to evaluate just what one means by "modernization". For, indeed, in the principal Latin American nations, the rapid advances in the banking sector attained by the beginning of the 20th century were not accompanied by a process of balanced economic development

nor rapid industrial transformation. Furthermore, the extremely close ties between certain large banks and the respective governments could have perverse effects, as can be observed in the widespread financial crises in Latin America in the early 1890s.

Indeed, a review of the evolution of the overall structure of banking systems in the larger Latin American nations indicates that contrary to common belief, the most important banks were by far those most closely linked to national governments. Several of these big, domestic banks began operations in the 1850s although it was after the 1880s that their dominance became truly evident. It is well-known that a few British banks were established in various cities of the region from the 1860s but it should be underlined that they were neither the first banks nor, by any means, the largest financial institutions.¹ On the contrary, domestic institutions (with close links to government) such as the Banco do Brasil, the Banco de la Nación (Argentina) and the Banco Nacional de México became the dominant institutions in the respective Latin American financial markets by the turn of the century, and these same domestic entities continue to be the largest banks in Latin America today.

Given this continuity, it seems of interest here to explore the historical period when such structural trends originated, which we locate in the last quarter of the 19th century.

¹ On British banks in Latin America the best studies are still Joslin (1966) and Jones (1977). The first of these were the Bank of London and the River Plate (1863), the Bank of London and Brazil (1863) and the Bank of London, Mexico and Peru (1864). They were relatively small firms but catered to a wealthy elite including some of the more prosperous local landowners and merchants as well the leading British import/export firms in the capital cities- Buenos Aires, Lima, Rio de Janeiro and Mexico City- but as yet (1860s) had no offices in secondary cities.

But in order to place these problems in context we will begin with a few comments on the current historiography of Latin American banking and then proceed to a brief overview of the birth of banking in Latin America in the mid-19th century. The heart of the essay, however, centers on the analysis of developments during the decade of the 1880s - when banking systems and modern financial markets began to develop- as well during the equally critical decade of the 1890s- when major political and financial crises led to a profound and long-lasting restructuring of national banking structures, establishing trends that would hold at least until 1930 and which, in some ways, still can be perceived in contemporary Latin American banking structures.

Recent trends in Latin American banking history

The banking and monetary history of Latin America has advanced at a fast pace over the last fifteen years. A testimony to this fact is the multiplication of monographs and essays in the field. To cite only a few of the most significant contributions to this literature it may be useful to draw attention, for example, to the recent works of Alfonso Quiroz on the development of Peruvian banking and finance between 1850 and 1950; to the also recent studies of Roberto Cortes Conde on banking and monetary policies in Argentina between 1862 and 1890; to the diverse publications of María Barbara Levy on the banking history of Brazil and formation of the Rio de Janeiro stock exchange; to the already classic studies of Carlos Peláez and Wilson Suzigan on Brazilian monetary policies in the 19th and 20th centuries; the recent doctoral thesis of Gail Triner on the

Brazilian banking system, or the monographs of Flavio Saes on the origins of banking in Sao Paulo in the late 19th century.² In the case of Mexico, a number of monographs and collections of essays have opened the field of banking history in recent years³ and- as in the rest of the subcontinent- it may be expected that this trend will intensify in the near future, particularly as the financial sector comes to occupy a more important place in economic history than in the past.

Within this terrain, studies on the relation between banks and economic and monetary policies have gained a certain preeminence, as the studies on Peru, Argentina and Brazil testify. On the other hand, it is clear that much more work is required on the history of individual firms and on financial markets in order to flesh out the still stark and bony anatomy of Latin American banking history.

At the same time, it should be noted that economic historians- who are working on the reconstruction of the banking history of Latin America- face a number of problems which differentiates the field somewhat from current trends in research in Europe or the United States. In the first place there is much less interest and preoccupation in Latin America with the analysis of the relationship between early banking structures and industrialization, since the latter process began quite late in Latin America. The first banks throughout the subcontinent emerged largely as a result the expansion of

² Quiroz (1989 and 1993), Cortes Conde (1989), Levy (1977 and 1985), Peláez and Suzigan (1976), Triner (1994), Saes (1986).

³ The pioneer was Potash (1960), but more recent contributions include Marichal and Ludlow (1986), Turrent (1988), Oñate (1991), Ludlow (1993) and Cerda (forthcoming).

agro/export and mineral/export economies. A second key feature of the early Latin American banking systems- which is perhaps not singular but must be borne in mind- was the intense concentration of banking resources in the hands of a very few banks, a fact perhaps linked to the marked concentration of income in the hands of landed, mining and mercantile elites as well as the relatively small size of the "middle classes." A third and related question is the dominant role of powerful government banks -in most of the larger Latin American countries. Such "government" or "national" banks were not necessarily state-owned; indeed, most were not, but they maintained extremely close links to the state and effectively used that privileged relationship to increase their (generally) dominant role in financial markets.

In the present essay we wish to emphasize the long-range development of banking structures and, in particular, the key role of the largest banking firms which were closely linked to national governments from the last decades of the 19th century. This preoccupation is, in good measure, the result of consideration of the ideas advanced by two distinguished bank historians who have reflected on comparative problems in banking history, namely Charles Goodhart and Rondo Cameron.⁴ One key question emphasized by Goodhart is to what extent government banks in the 19th century actually exercised the functions of central banks. A comprehensive response based on the Latin American experience is not yet available due to the lack of institutional and company histories, although it is sufficiently clear that by the end of the century a few of these banks were fulfilling some of those functions, hence suggesting the importance of further study of the

historical antecedents of central banking.⁵ In this respect, it should be kept in mind that while 19th century Latin American financial ministers did not have a very broad grasp of the principles of central banking, they found it necessary to impell a given bank(s) to assume responsibility for the implementation of monetary and debt policies which were essential to the efficient fiscal and financial administration of the state. The increasing complexity of the institutionalization of such policies was thus a major factor in promoting privileged relations between the increasingly strong national governments and a given bank.

A second key question is that posed by Rondo Cameron and the coauthors of several comparative studies on banking history and economic development in the 19th century. Of particular interest here is Cameron's suggestion with respect to the possibly negative effects for an economy in which the commercial banking structure is dominated by one great government bank (with some tendencies toward monopoly) as was the case in France or in Spain during various phases of the 19th century; to wit, the preeminent role of the Banque de France or the Banco de España at different moments.

In the diverse Latin American nations, the dominance of one or two large banks (with close links to the respective government) from the end of the 19th century could be observed in the cases of Brazil, Argentina and Mexico- among others- . Naturally, we

⁴ Cameron (1967 and 1972) and Goodhart (1988).

⁵ A good model of the usefulness of such analyses are the studies of Rafael Anes, "El Banco de España, 1874-1914: un Banco Nacional," and Gabriel Tortella "Las magnitudes monetarias y sus determinantes," in Tortella (1974).

must ask why this was a common tendency among the principal economies of Latin America? We venture to suggest that it may be attributed to the advantages acquired by those banks which had a monopoly of note issue and dominant control of government financial accounts. Moreover, such advantages were particularly important in monetary and credit markets which were still relatively underdeveloped.

Alliances with the state were therefore fundamental. A privileged relation with the government (precisely at the time that such governments were consolidating a national administration) would appear to have provided comparative advantages of considerable importance in the banking sector. In this regard, moreover, it seems appropriate to recall the commentary of the late, great banking historian, Jean Bouvier, who insisted on paying special attention to the role of the state in the economy, for as he noted "What has the state been in the 19th and 20th centuries but the largest enterprise in the economy? By reason of the mass of its employees, the enormous nature of its business and the great movement of funds... the state has always been the most influential of economic agents."⁶

On the other hand, such alliances could also prove to be the cause of bankruptcy and the origin of political/financial crises of severe impact. The early 1890s were witness to such crises and major political revolutions in Argentina, Brazil and Chile, in various cases linked to extreme mismanagement of state banks. As a result of the different crises, the relationships between state and banks were restructured, but paradoxically

they were not delinked but rather strengthened. Thus the symbiotic evolution of national governments and state banks continued into the 20th century.

Origins of government banks in Latin America, 1850-1880

The first half of the 19th century was witness in Latin America to a series of relatively short-lived banking experiments which we will only briefly mention as antecedents. Among these experiments stand out the first Banco do Brasil (1808-1829), the Banco de Buenos Aires (1822-26) and its successor the Banco Nacional (1826-1835), although a number of additional financial institutions were also established in other countries of the region such as the Banco de Avío (1830-1840) in Mexico.⁷

It was not, however, until the 1850s and 1860s that banking truly took root in Latin America and it was during these decades that a considerable number of firms were established in the leading ports and capitals of the vast subcontinent. It was in this period that small financial markets in Rio de Janeiro, Santiago, Valparaíso, Buenos Aires and Lima began to acquire certain dynamism, manifest in the diversification and initial institutionalization of financial activities. In these years, primitive but operative stock exchanges were set up in the cities mentioned, the first private commercial banks began to proliferate as well as a series of insurance and complementary financial-service firms.

⁶ Bouvier (1978).

⁷ All of these were government-owned banks except for the Banco de Buenos Aires. On the Banco do Brasil see Peláez (1975) and Levy (1980); on the Banco de Buenos Aires and Banco Nacional see Amaral (1979 and 1982) and Garrigós (1873); on the Banco de Avío see Potash

In each of these as yet relatively small urban centers, a number of commercial banks began operations, of which there were a dozen each in Rio de Janeiro and Buenos Aires by the early 1870s (see Charts 1 and 2) and half a dozen or more in Santiago and Lima.

Already from this era, those banking institutions mostly closely linked to national governments began to stand out. The Banco do Brasil- refounded in 1850- was to dominate Brazilian domestic banking until the end of the 19th century.⁸ The Banco de la Provincia de Buenos Aires, created in 1854, soon controlled much of local credit for commerce in the Argentine capital and for agriculture and ranching in the rich hinterland of Buenos Aires. Similarly, although perhaps a less dominant force, there was the Banco Nacional de Chile, established in 1865, which soon became a key auxiliary of government finance as well as a dynamic commercial bank.⁹

It was also from this period that debates began on the institutional and legal models believed most adequate for the development of local banking systems. In most Latin American countries there were already two different schools of thought, which corresponded broadly to the those in favor of "free-banking" and limited regulation and those who were advocates of more strict regulation and of a great state bank in the style of the Banque de France. "Free-bankers", such as Ferreira Soares, finance minister of

(1965).

⁸ A discussion of the banking developments in Brazil in the 1860s can be found in Andrade (1987). In the late 1880s and early 1890s the Banco do Brasil went through a series of fusions with two other banks, which together dominated the Rio de Janeiro financial market. Later in 1905 the Banco do Brasil was reorganized and restructured into the banking firm which still today is the largest in Brazil. See Barroso (1983) and Topik (1981).

Brazil in 1857, argued that this system allowed for more rapid growth and diversification of the banking sector. Similar arguments were advanced by Juan Bautista Alberdi in Argentina and- as of the 1860s- by the disciples of the influential French economist, Courcelle Seneuil, in Chile.¹⁰

While the ideologues of free banking tended to win much space in the financial press, in practice the incipient banking structures in Argentina, Brazil and Chile were soon dominated by one or two large government banks, as we have already had occasion to indicate. These banks were not usually owned by the government, although in some cases there was state participation. In the 1870s, for example, the largest Argentine bank was the Banco de la Provincia de Buenos Aires, the capital of which was largely controlled by the provincial government, but the directors were selected from the merchant community of Buenos Aires on the basis of their commercial and financial experience. Its new rival, the Banco Nacional (1872), on the other hand, was privately owned but initially tended simply to operate as an auxiliary to the national treasury. Thus, there were many different, possible ways of operating these banks, and success depended on a combination of personality, good management and limited government intervention in the daily affairs of such firms.¹¹

⁹ For additional information on these early banks see Marichal (1986).

¹⁰ For the Brazilian debate see Ferreira Soares (1865). For the Argentine debates see Cortes Conde (1989) who reviews the parliamentary discussions of banking in 1863; on the influence of Courcelle Seneuil in Chile from 1860 see Subercasseaux (1922). For an overview see C. Marichal, "Modelos y sistemas bancarios en América Latina en el siglo XIX, 1850-1880", in Marichal and Tedde (1994), pp. 131-158

¹¹ Behind most of the major new banks in Latin America it can be frequently found that there was some outstanding personality who was an innovative entrepreneur with a penetrating grasp

The growth of Latin American banking was fairly rapid between 1865 and 1873, but in the latter year an international economic crisis stopped short most commercial activity and in soon drove a number of private banks in various cities into bankruptcy.¹² In Lima and Callao the crisis of the 1870s hit hardest, wiping out virtually all the existing banks except the Banco de Londres y Peru and the Banco de Callao. In the cities of Santiago, Rio de Janeiro and Montevideo and Buenos Aires a few private banks went under but the major banks linked to government finance were able to weather the storm, albeit with some difficulties.¹³ Evidently, the mismanagement of the resources of government banks was not yet a common practice.

National banks and national governments: the 1880s

In the 1880s there was a renewed boom in banking in the larger Latin American nations, which began first in the capital cities and then by the end of the decade began to spread to the more commercially dynamic provincial centers in Argentina, Brazil, Chile and Mexico.¹⁴ From the point of view of the traditional historiography of Latin America,

of financial affairs. The names of the Baron de Mauá (founder of the second Banco do Brasil and of the privately-owned Banco Mauá), of Eduardo Tornquist (founder in 1872 of the Tornquist Bank of Buenos Aires and influential adviser to the government and state banks on international finance), or of Edouard Noetzlin (one of the guiding spirits of the Banco Nacional de México, from 1881) are indicative, but only Mauá has found a biographer. See Marchant (1966).

¹² For some comparative data see Marichal (1982) and (1989), chap. 4.

¹³ Among the most notorious bankruptcies was that of the famous Mauá Bank which operated in Rio de Janeiro, Montevideo and Buenos Aires. Owned by the foremost Brazilian capitalist of the age, the Barón de Mauá, its fall marked the demise of his multinational business empire.

¹⁴ By the end of the 1880s there were at least 15 important commercial banks in Rio de Janeiro

the 1880s are seen both as the age of consolidation of national government under oligarchic structures, as well as a golden age of the export economies. It is often argued that it was the new political stability which allowed for the expansion of the economies, but it is more rarely observed that it was precisely the turnaround in the economy that allowed for a more stable and stronger national administration. In the pages following we advance the argument that the expansion of national banks proved to be a key element in facilitating "national" government, so lacking in previous decades.

In essence, we argue that institutional innovation in the banking sector initially induced improvements in the efficiency of management of the state fiscal and financial administration. But the structure of banking varied from country to country, and not all "national" banks were similar.

Thus, a few preliminary descriptive comments are in order to provide an idea of the relative importance of these banks. In Argentina, for example, banking was heavily concentrated in the city of Buenos Aires, and, furthermore, dominated by two "government" banks, namely the Banco de la Provincia de Buenos Aires and the Banco Nacional: in 1885 these two banks controlled 67% of the capital, 41% of the metallic

and 16 in Buenos Aires and lesser numbers in other Latin American cities. In Argentina there were also some 10 official provincial banks and another dozen private banking institutions in various provincial cities. In Brazil provincial banking in the late 1880s was concentrated in the Northeast and in Sao Paulo, although a few small banking firms could be found in other regions. Among the few studies on regional banking in this period see Saes (1986).

reserves, 64% of the loans and 89% of the note issue of all banks in the capital.¹⁵

In Brazil, the predominance of the Banco do Brasil was manifest until the end of the 1880s, as it held sway in the realm of capital, deposits and note issue. It should be noted that the relation between reserves and total note issue was apparently similar to that of the Argentine banks, but actually the Brazilian banks (initially) proved to be more conservative in this regard since most of the notes were issued by the national treasury rather than by the banks. Nonetheless, the stability of the Brazilian banking system was undermined in the late 1880s when two other banks (with special issuing privileges) were established. According to Stephen Topik: "By September, 1890, the three banks, the Banco do Brasil, the Banco dos Estados Unidos do Brasil and the Banco Nacional controlled by means of their privileges- and through other banks which they owned- 95% of all bank notes in circulation."¹⁶

The banking system of Chile in the mid-1880s was freer and more competitive from every point of view than its South American neighbors. It is true that in the 1860s the Banco Nacional de Chile had exercised a clear predominance within the local banking structure, but after the financial crisis of 1873 and the suspension of convertibility of the notes of the Banco Nacional in 1876, the latter institution lost weight and influence. By 1885, for example, the Banco de Valparaíso had attained a similar size and surpassed the Banco Nacional in deposits.

¹⁵ The best statistics on Argentine banking in the 1880s are to be found in the official reports of Agote (1887).

Altogether different was the situation in Mexico, the Latin American nation where banking took longest to develop and where- from the start- the banking structure proved most concentrated. It was only in the mid 1880s that a banking infrastructure was established in Mexico City being initially dominated by one great institution, the Banco Nacional de México which in 1885 held close to 80% of total capital, deposits and loans of the capital's banking firms. The Banco Nacional de México was a privately-owned and managed bank, but at the same time it was put in charge of a great number of government financial affairs: it handled a large current account for the finance ministry, it provided the service on the internal and external debts of the republic and it made regular medium-term advances to the government when in urgent need of funds.¹⁷

Similar functions- as government banker- had been carried out by the already mentioned, Banco de la Provincia de Buenos Aires, the Banco Nacional (Argentina), the Banco do Brasil and the Banco Nacional de Chile from the 1860s, but it was in the 1880s that the importance of their activities - as government bankers- intensified, a fact not unrelated to the steep rise in income as well as expenditures of national governments.

That the governments of the larger Latin American nations were able to systematically increase income and at the same time consolidate political, military and administrative

¹⁶ Topik (1987), p.31.

¹⁷ See essays by Bátiz, Ludlow and Marichal in Marichal and Ludlow (1986). Also see Ludlow

control over their relatively vast territories in the 1880s, has been considered by many historians as the result of new intra-oligarchic political pacts and, also, as the consequence of capable military/political authoritarianism as represented by such dominant figures as Porfirio Diaz in Mexico or general Roca in Argentina. But, clearly, the impact of institutional and economic innovations must also be taken into account.

It is a well-known but little studied fact that the combination of railroads and telegraphs contributed notably to the establishment not only of incipient domestic markets but also to a more efficient state and military administration. Much more infrequent, however, are references to the role of "national" banks, which also played a not insignificant role in this dramatic process of "modernization." It is our opinion that, in numerous ways, the national banks (and we recall that they tended to be privately-owned) contributed to the improvement of the fiscal and financial administration by the government in good measure because they were the first banks to establish large networks of offices and agencies throughout the respective nation in which they operated. But it should be understood that the observations in pages following need to be verified (or dismissed) by future research- using a complex quantitative analysis- on the relationship between bank administration and public fiscal administration.

Previous to the 1880s, national administrations in most Latin American countries had been relatively weak due to a great variety of factors: lack of modern transport and

communications, federalist political trends (and, as a result, frequent local rebellions), inadequate fiscal machinery, chronic deficits and, therefore, wavering military loyalties by officers and soldiers who were often underpaid or paid with great delay. All of these traditional obstacles to political modernization and centralization of national state power began to be eliminated in the 1880s in the larger Latin American nations.

The improvement of government finances and administration went hand in hand with military modernization. Railroads, telegraphs and banks reduced military costs substantially and increased efficiency. This was due in good measure to the fact that, now, the same or a lesser number of soldiers could be moved more rapidly, and- being well paid and armed- their loyalty and efficiency increased. Not surprisingly, after 1880 there was a sharp drop in provincial revolutions by military discontents (a key feature of early 19th century political instability). And proportionally, military expenditures declined in terms of total public expenses.¹⁸

If we look more specifically at fiscal administration, it is clear that the creation of national banks- with numerous agencies- implied "institutional innovations" with important and positive effects upon state finance. For example, the collection and movement of taxes (and government funds in general) proved much swifter and surer in the 1880s as a result of the establishment of bank agencies in many secondary cities and ports. The collection of funds continued to be handled by fiscal agents but they now had more

¹⁸ This, in turn, helped free public funds for investment in public works (investment in communications infrastructure, etc.) in public education and other activities which were essential

secure places to safeguard such funds. Moreover, finance ministers now counted on more complete and quicker information on how much money was available throughout the nation and could therefore dispose of it more effectively. In combination with telegraphs and railroads, this substantially improved the efficiency of the state fiscal and financial administration.¹⁹

The improved collection and transfer of funds, the more rapid concentration of funds in key points, the reduced risks and greater punctuality in government payments all substantially reduced the financial costs of government. Indeed, these factors can be defined as "transaction costs" which had seriously limited the efficiency of previous governments and, therefore, had negative effects upon the private sector. But the establishment of banks with national networks of offices also had other, additional benefits. For example, public accounting methods improved substantially as both private and public managers became more familiar with modern financial administration, allowing for great precision, punctuality and centralization of movement and register of funds. In addition, finance ministers had greater possibilities of predicting future trends of public finance and of its general relationship with the economy as banks now published regular information on interest rates, a key variable for the diagnosis of economic cycles. In this respect, it can be argued that information costs (for government finance ministries) related to "the price of money" (present and future) tended to drop. In the first half of the

to modernization and the forging of a strong state administration.

¹⁹ For the consolidation of national administration both telegraphs and railroads were essential. Telegraphs provided the means for swift communication of instructions to local agents for payment or transfer of funds, and railroads allowed for rapid transfer either of government metallic

19th century such costs were quite substantial and had diminished efficiency of the respective state administrations.²⁰

But not only information costs declined. The broadening of money markets and the creation of banks brought down the price of money (interest rates) generally speaking and, specifically, reduced the costs of money required by the government for short term overdrafts or medium term loans.²¹ With the creation of national banks, governments opened large accounts in them which allowed for substantial overdrafts at small cost, facilitating the payment of expenses by all public agencies in any part of the country. This increased flexibility was accompanied by the improved handling of internal debt, with lower interest rates and less dependency on moneylenders. The national banks took charge of service of internal debts and, in addition, provided increased access to foreign funds- external loans- at more reasonable costs, and with regular service in gold.²²

Hence, both information costs and costs of money for the respective governments tended to fall as a result of the establishment of institutions such as Banco do Brasil,

funds or of the government agents themselves, in the persons of fiscal or military personnel.

²⁰ A particularly notorious example of the negative effects of the lack of adequate information on supply and costs of money can be found in the review of Mexican state finances before 1860. See Tenenbaum (1987).

²¹ In the case of Mexico City, for example, interest rates in the 1870s fluctuated between 10 and 14%, but from the early 1880s with establishment of several large banks dropped to levels of 6-10%. Obviously, this benefitted both the private and the public sectors. For analysis of trends in the 1880s see Marichal (1995).

²² The Banco Nacional in Argentina, for example, negotiated various foreign loans in the 1880s for the national government as did the Banco Nacional de México. For details see Marichal (1989), chap.5.

Banco Nacional de Argentina and the Banco Nacional de México. Nation-building and administrative modernization thus went hand in hand with the broadening commercial networks of these new banking institutions. Nonetheless, the creation of such large banking companies with links so close to governments also posed a series of formidable dangers. For, indeed, the financial boom of the 1880s and the consequent phase of prosperity led political and economic elites to fancy that they could do no wrong and impelled them into a whirlwind of speculative ventures that were pregnant with catastrophe.

The political and financial crises of the 1890s

While the "national" banks (we have reviewed) provided Latin American governments with important instruments for more efficient administration, they also lent themselves to all kinds of speculation, both with public and private funds. Thus- paradoxically- the creation of the state banks strengthened the state's fiscal and financial machinery and, at the same time, encouraged politicians, bureaucrats and well-connected speculators to engage in risky financial deals on a large scale.

There was at this time little grasp by finance ministers of the complexities of managing monetary policy in a time of unbridled bank competition which led to massive issues of paper money by many rival financial institutions. And neither did finance ministers understand the dangers of overheating the economy by establishing policies

which tended to systematically lower interest rates. For instance, as a result of massive inflows of foreign capital and as a result of the establishment of a great number of financial firms (banks, insurance firms, real estate financial agencies, firms specializing in stock exchange speculation, etc.) interest rates in the leading Latin American cities tended to decline somewhat in the early and mid-1880s. These lower rates and the abundant supply of capital stimulated two related speculative booms in burgeoning stock exchange markets and in the growing urban real estate markets.

The allure of fast fortunes drew all kinds of speculators- including many politicians- into the financial frenzy. And in numerous cases the larger banks were also drawn into the game, advancing credit to clients who wanted the money basically for speculation. The Argentine state banks were among the most notorious instruments of the financial boom of the late 1880s as they also would soon be victims of the subsequent financial panic.

Nonetheless, most Latin American finance ministers of the late 1880s believed that the financial boom was simply a sign of the entrance of their respective economies into a stage of modern capitalism. Wasn't it true that- as had occurred in all the great industrial nations, France, Great Britain, Germany and the United States- stock exchange booms and speculation were formidable engines of growth? Indeed, the late 1880s were generally everywhere a time of unbridled optimism in the magic of money markets.

But the crash came soon enough, and in the case of Latin America financial collapse was accompanied by major social convulsion and political crises. In the Argentine case the banking crisis of 1890/91 (which coincided with a foreign debt crisis) lasted a year and a half and was extremely violent. The two largest state banks, the Banco Nacional and the Banco de la Provincia de Buenos Aires collapsed, as did ten regional banks sponsored by provincial governments.²³ In other words, all the banks closely linked to government went under, an indication of the perils potentially implicit in such relationships. On the other hand, relatively few private banks went bankrupt, although the number of mercantile firms that did so was quite large.²⁴

It would not be until the end of 1891-with the creation of the Banco de la Nación-that the financial situation began to ameliorate. In practice, the success of the new national bank in establishing itself at the heart of the Argentine financial system was quite surprising- given the breadth of the collapse of the previous state banks. For in a short time, the Banco de la Nación not only had become the largest bank in the capital but also proceeded to establish branches in virtually all important provincial cities and large towns. This was undoubtedly due in large measure to the export boom of the years 1890-1914, but it also reflected the success of the extremely cautious policies of the new bank's managers who maintained extremely high metallic reserves to make sure that a financial

²³ For details see Marichal (1989) chap.6.

²⁴ The most important private bank to collapse was the Banco Carabassa, subsequently absorbed by the Bank of London and River Plate. The other merchant and financial firms that went under suffered as a result of both the decline in trade, the fall in real estate prices and the fall of the state banks which with they had conducted business. For details see Marichal (1989) chap.6.

crisis like that of 1890-91 would not be repeated.

In Brazil, the late 1880s also witnessed an extraordinary stock exchange boom that culminated in the financial frenzy of 1889-91 known as the "Encilhamento". The position of the Banco do Brasil was weakened by increasing competition with two large banks that obtained note-issue privileges from the government: the rivalry intensified as of December, 1890 when the two rival banks- the Banco dos Estados Unidos do Brasil and the Banco Nacional- proceeded to fuse into one giant financial enterprise called the Banco da República. Nonetheless, the fusion also reflected the increasingly unstable economic situation and the need to pool resources in order to avoid a panic. In 1891 bankruptcies began to multiply in Ríó de Janeiro in the midst of an orgy of speculation. A generalized financial collapse came in 1892 as dozens of old and new companies toppled. In order to shore up public and private credit a new restructuring plan was put in force, leading to the fusion of the old Banco do Brasil and the new Banco da República.²⁵

In this instance- as in the Argentine case- the Brazilian state assumed rectorship of the banking system, forcing bankrupt firms to close down and thereby accentuating the concentration of bank capital. The objective of such policies was essentially designed to defend and stabilize public finance but, in practice, it also deeply affected private finances. Eventually, the reforms gave place to the configuration of the Banco do Brasil in 1905, the institution which was destined to dominate Brazilian banking during most of

²⁵ For antecedents y details see Barroso (1983) and Topik (1987).

the 20th century.

In Chile the banking crisis followed on the civil war of 1890-91 and the downfall of the Balmaceda administration. In this case also- and in a surprisingly similar fashion- the government intervened to force the fusion of the three largest banks into one, dominant institution, the Banco de Chile, which inevitably was to assume many of the functions of a government bank, even while continuing as a privately-owned firm.

Finally, in the Mexican case it may be observed that while the financial crisis of the early 1890s was less severe, it also reflected the dangers implicit in the close links established between a great bank and the government. In 1893- as a major economic crisis broke in the international arena- Mexican finances began to break down. The Banco Nacional de México had made large advances over various years to the government in order to cover its deficits and was by now over its head in public debts which (however lucrative) threatened the lifeblood of the bank. Finance minister José Yves Limantour was able to save the situation by negotiating a large foreign loan with the Bleichroder banking firm of Berlin, a loan that was nominally to be used for public works but in practice went to pay the backlog of loans due to the Banco Nacional de México. A few years later, in 1897, Limantour ratified the first comprehensive Mexican banking law which promised to allow for a more federalist financial structure, but in practice the Banco Nacional continued to be the most important bank and the one most engaged in the administration of government finance.

Given the parallels between the financial and banking crises in various Latin American nations in the early 1890s, it seems worthwhile to attempt to summarize both the causes of these as well as its effects on banking policies in the immediate decades following. For, indeed, the banking reforms that followed these crises were to shape the basic banking structures and policies of most Latin American nations until the outbreak of the Great Depression in 1929, when a whole slew of new and very different financial reforms began to be formulated.

Among the causes of the financial crises of the early 1890s, it is possible to point out a large number of strictly bank-related factors, which point to bad management and overly political use of banks, elements which go beyond the collective, psychological behavior characteristic of financial frenzies and booms.²⁶

One dangerous bank policy which tended to be adopted by the managers of Latin American government banks in the late 1880s was excess bank note issue in relation to metallic reserves.²⁷ This was indicative of the lack of banking experience locally, and proved to be in notable contrast with the few operating British banks in the region, all of which came out with flying colors from the crises of the early 1890s.²⁸

²⁶ On the collective financial mentalities and behaviors see Charles Kindleberger, (1978).

²⁷ In the case of the Banco Nacional of Argentina these tendencies can be observed in the bank balances: it had among the most expansionist loan policies [the ratio of loans to total resources being close to 90/100] while its metallic reserves were extraordinarily scarce [the ratio of reserves to note issue was extremely low, 12/100]. Data can be found in Agote (1887).

²⁸ It was precisely the success of these few British banks in crisis situations that won them their

A second bad management policy was the acquisition of risky bonds and stock- much in speculative bonds and real estate paper- which were often registered as part of bank reserves. This was common practice among the Argentine and Brazilian banks in the late 1880s and exposed them to the perils of bankruptcy when stock exchange and the real estate markets declined. A related weakness of these banks was the adoption of indiscriminate policies of issuing loans to clients with inadequate guarantees: particularly notorious were large loans to capitalists and speculators who offered real estate as guarantees precisely when property values were going through the roof. When prices dropped, however, such guarantees turned out to be virtually worthless.

Another characteristic of much banking conducted by banks closely linked to national or provincial governments in the 1880s was favoritism: policies of lending money to cronies of bank directors and more particularly to politicians and their friends and relatives were quite common. This practice was particularly notorious in the case of the Argentine state banks.

Finally, bank management problems arose from misunderstanding of monetary and public debt problems. On the one hand, bank directors had an inadequate understanding of monetary inflation with inconvertible currency (as was the Argentine case after 1885) or with monetary systems with inadequate metallic reserves, common in

fame within Latin America in the late 19th century and, subsequently, in economic history texts. See the classic text by Joslin (1966).

Brazil and Chile, as well. In Mexico, on the other hand, this pitfall was avoided because of large silver monetary reserves, but major problems did arise as a result of the falling value of silver in relation to gold.

Finally, the accumulation of foreign debts by state banks, which were only payable in gold- a common feature of Argentine finance in the late 1880s- led to perilous situations the balance of payments situation worsened. As the metallic reserves of banks evaporated and, generally, as foreign currency and gold disappeared from local money markets, there was no way of continuing the service on foreign debts. As a result, a number of banks found their international sources of credit and capital frozen, and they were soon subject to severe international pressures to renew payments despite all the difficulties. In summary, inadequate care in management of bank balances (overlending, insufficient reserves, low metallic reserves) plus corruption, plus a hugely speculative market created all the adequate conditions for major financial crashes.

Epilogue

This brief review of the birth of banking in Latin America in the second half of the 19th century and of the growing importance of national banks- closely linked to governments- may be of some interest to economic historians insofar as it indicates the existence of certain structural trends which appear to have been common throughout a vast geographical zone. On the one hand, it should be underlined that the "banking revolution" took place before the "industrial revolution" in Latin America. On the other hand, the fact that many of the largest banks were so closely linked to state administrations implied certain advantages, insofar as the rapid growth of government also helped impel the growth of national banks with a network of offices and agencies in each of the larger Latin American countries. Nonetheless, the links with government led to some singular tendencies and certain dangers in the financial sphere, as witnessed with the generalized financial crashes in Argentina, Brazil and Chile in the early 1890s.

In summary, we hold that the relationship between the institutional development of banks and political evolution in Latin America was quite close during the second half of the 19th century. In the 1850s the consolidation of parliamentary government- accompanied by an export boom- led to the establishment of economic conditions and legislation favorable to the establishment of early banks. In the 1880s the process of consolidation of national government administrations went hand-in-hand with the creation of networks of the offices and agencies of the largest national banks in each of the countries here reviewed. Finally, in the 1890s the downfall of many government banks led to a massive process of restructuring and, to the creation of even more powerful state

banks.

The restructured state banks- the Banco de la Nación de Argentina (1891), the Banco do Brasil (1905), the Banco de Chile (1892) and the Banco Nacional de México (1884)- dominated both commercial and public finance for many years. They also fulfilled -during several decades- several of the functions of central banks. Indeed, their preeminent role might help explain why central banking did take as long as it did to become formally established in these countries: the first central bank (as such) was established in Chile in 1923, in Mexico in 1926, in Argentina in 1935 and in Brazil only in 1965! Clearly, the historical exploration of the of banking structures in Latin America can provide some useful insights to the long-term trends of the respective financial sectors in these diverse nations well into the 20th century.

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