

ARGENTINA EN LOS AÑOS 30

DE LA CAJA DE CONVERSIÓN AL BANCO CENTRAL DE 1935

ARGENTINA IN THE '30S. FROM CURRENCY BOARD TO A CENTRAL BANK IN 1935

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Palabras clave

Patrón oro,
Oferta monetaria,
Banco Central

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Resumen

Argentina abandonó el patrón oro en 1929 y el Banco Central fue constituido en 1935. En ese intervalo el sistema monetario continuó, en buena medida, respondiendo a las entradas y salidas del oro. Gracias al cierre de la Caja de Conversión en 1929, Argentina evitó una severa contracción monetaria y sufrió menos que otros países que continuaron más tiempo bajo el patrón oro (Gran Bretaña, Estados Unidos, Francia). De todos modos, no hubo, en esos tempranos años 30, una política monetaria de diseño keynesiano, sino que predominó el imperativo de preservar las reservas de oro para asegurar el pago de la deuda externa. La recuperación, en 1933, fue ayudada por la devaluación del dólar en los Estados Unidos y su impacto sobre los precios agrícolas mundiales y, al igual que en ese país, también fue favorecida por la afluencia de metálico desde Europa cuando Hitler asumió el poder.

Key words

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Abstract

Argentina abandoned the gold standard in 1929, which was replaced by a Central Bank regime in 1935. However, for some years, the monetary issues continued, largely in response to the gold inflows. Thanks to the Currency Board closure in 1929, Argentina avoided a severe contraction of money supply and suffered less than other countries (Britain, U.S.A., France). However, there was not, in the early 30s, an explicit monetary policy in the Keynesian lines, but the need to preserve gold reserves to be used for paying the external debt. In 1933, recuperation in Argentina was helped by the United States dollar devaluation and its impact in world agricultural prices and, as in the US, it was benefited by new gold inflows coming from Europe when Hitler assumed power.

In Argentina, the measures taken by the successive governments to deal with the '30s crisis were considered an early and successful implementation of John M. Keynes' expansionary monetary policies. Closing the Currency Board in September 1929 prevented the enormous monetary contraction that the outflows of gold would have

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created under the gold standard. The GDP fell less in Argentina as compared to other countries who kept the gold standard during the early 30s.

In this article, I will argue that abandoning the gold standard was not the result of a deliberate economic policy but responded to the need to preserved gold reserves held in the Currency Board in order to pay Argentina's outstanding foreign debt. There were no explicit expansionary monetary policies; the government saw the appropriation of gold in the vaults of the Conversions Board as a means to pay its external debt and avoid a default, something that was successfully done. In addition, I will highlight the positive effect the 1933 United States devaluation had in the recuperation of international agricultural dollar prices. To elaborate these arguments, I will present the events and the context that lead to these results.

During the first decades of the xx century the monetary regime in Argentina was quite different from that of other Latin American countries. In the '20s, Peru, Chile, Colombia (mainly in the Pacific) embarked in banking reforms, creating Central Banks with the monopoly of issue (of convertible) currency, a move that was part of the Kemmerer missions (for the Princeton Professor known as a *money doctor*). These reforms were to order the system of multiple banks by –among other activities– issuing bank notes. Before the monopoly of issued notes arise, an over issue (excess supply) was caused by that system of multiple banks which produced a generalize devaluation of local money.

Although the creation of the new *Kemmerer Central Banks* in the Pacific countries of South America implied the adoption of a gold standard (a convertibility of currency at a fix parity), those banks were organized following closely the rules of the Federal Reserve of the United States that had more flexibility than Argentina's Currency Board regime because it did not require 100 % reserves in gold (Ortiz Batalla 1998).

Argentina, in the first decade of the xx century, adopted a gold standard following even stricter rules than those of the Bank of England. The adoption of such a regime, after the 1890 crisis, can be related to the prominence of foreign investments in such sectors as Railways, Banks, Tramways, Packed Meat Industry, etc. Those investments had been placed in portfolio investments that were considered to be more secure than direct investments, because the former was not exposed to the country exchange risk (the eventual devaluation of the pesos) to the extent that it had been subscribed in gold or pound sterling. Such foreign investment, which Argentine received during the first decades of the xx century under the gold standard, was quite successful, and this explains the support it had in business and political circles.

The Currency Board, opening in the early 1900, was the only one that could issue notes at fix parity: 1 gold peso (almost equal to 1 dollar) per 2,2727 *pesos moneda nacional* (or paper pesos), the new issues was backed 100 % by gold. The Argentine regime was similar to that of some of the British colonies. But there, because the Banks were branches of London ones, in time of monetary stress they have the main headquarters performing as lenders of last resort. In Argentina, not being part of the empire, local banks lacked any mechanism as lender of last resort.

Brazil and Mexico, the other countries that received large flows of foreign investments at the beginning of the xx century, also adopted some variation of convertibility regime at fix parity (gold standard), but with more flexibility (they had fractional reserves, generally a minimum of 40% in gold). They adopted such a regime because the long history of monetary instability and bad management that cause recurrent devaluations. This was a risk that the direct foreign investors (those who received profits in local money) did not want to assume (after 1930 the British Railways suffered big losses in pounds because the peso devaluation and the implementation of exchange controls).

The point here is that the adherence to the gold standard that came at the end of the XIX and early xx century was a response to the globalization of capital markets with a stronger effect in countries that had more promising conditions for investments (exploitation of untapped of natural resources, widening markets, rule of law etc.) and –additionally– the guarantee of exchange stability (gold standard).

Needless to say, while the supply of official currency (coinage) was a government monopoly, the issue of notes, instead, was initially a banking business (as checks are today) although the right to establish banks was granted by the government. After the collapse of the *Bancos Garantidos* regime of the 1880's to the end of the century, the currency already in circulation was assumed as a liability of the national government.

Besides the Currency Board, the Banco de la Nación had the possibility to rediscount loans from other banks, but Banco de la Nación was not authorized to issue notes and was limited to using its own reserves (and additionally the amortization funds).

In many of other Latin American countries, the crises arrived when they had more flexible monetary and banking regimes (the *Kemmerer banks*). Argentine instead had a more rigid system: the gold standard

In 1929, the countries receiving large inflows of gold in 1928 had suffered a reversion of the trend when the Federal Reserve, to curb inflationary pressures, increased interest rates. Facing those outflows, the Argentine government rapidly decided to close the Currency Board. That is no to say there were not gold withdrawals because, besides those metallic reserves that already left the country in 1929, in the following years a new government extracted some gold from the Board at the official rate to pay the outstanding foreign liabilities, averting an external default.

The government's decision was not the generally accepted view that was the starting point of an expansionary monetary policy in the lines of Keynes, to avert the impact of a money contraction and deflation of the whole economy. After 1930 the government authorized only twice the Board to issue currency backed in credit, and maintained the new gold parity until 1933. In this year there was a new policy which implemented exchange control and proceeded to a new devaluation with two different rates (for sellers and buyers).

The reason for that –we think– is that the people in government knew that no long ago, in the 1890 crisis, in order to pay the foreign debt, they had to buy gold at a market

rate and under that turmoil the rate had rose more 200% in paper pesos (the currency in which the government collected its taxes). So, with their 1890 experience in mind, when the outflows began to increase, they responded without hesitation with a very pragmatic solution, closing the Board.

In fact, the early abandonment of the gold standard, in view to what happened in other countries still under that system, as Great Britain (1931), the United States (1933) and France (1936), was more advantageous to Argentine economy as a whole. However, the main recovery came from an improvement of international agricultural prices, to large extent resulted from the United States 1933 dollar devaluation, which helped the recuperation of agricultural prices.

THE CRISIS IN ARGENTINA

In Argentina, the 1930 crisis did not started in the stock market or in the financial system. The shock was on the real economy, caused by a 70% fall in the international prices of agricultural products (Kindleberger 1973, p.88). This negatively affected the farmers' networth and the government's income, and spreaded out almost without lags troughout the whole economy.

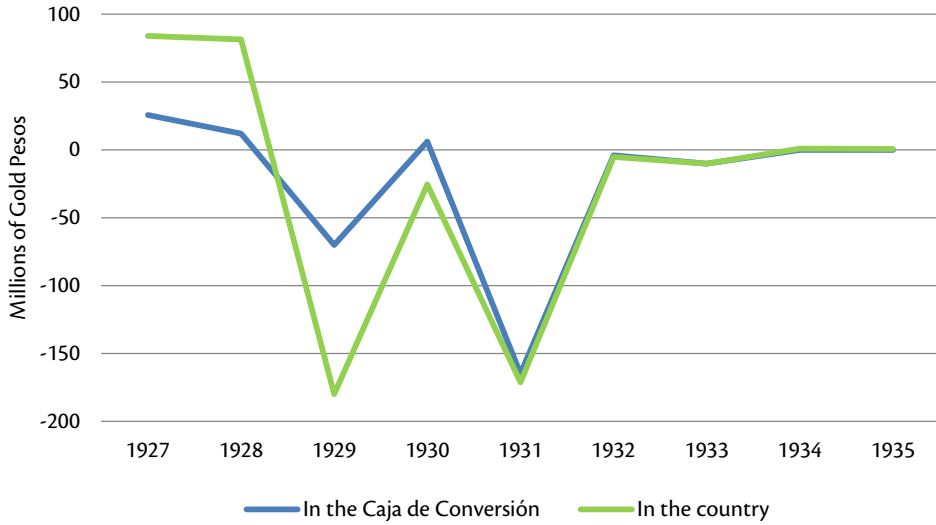
Trying to control the speculative bubble in Wall Street, the Fed increased interest rates. This caused in Argentina the outflow of gold, reversing the same amount of gold that had entered in 1928. In December 1929, the government of Yrigoyen closed the Currency Board, suspending the convertibility of its notes. From then on, noteholders who wanted foreign currency, had to buy it at the commercial banks with depreciated pesos. While the official rate was 2.2727 pesos for one gold peso –or 1 dollar– the market rate was 2,3912 and later reached 3,68 pesos (Comité Nacional de Geografía 1941). Noteholders had no chance to convert their notes at the Caja.

Abandoning the gold standard prevented the serious contraction of the money supply that had begun in 1929 with the outflow of gold. Later on, after the coup d'etat of September 1930 when the new "provisional" government seized gold from the Currency Board to pay the foreign debt, money supply declined a little.

As the new government thought that the run of gold was being caused by an external emergency and that normalcy, sooner or later, would be restored, it limited its intervention to freezing the gold holdings at the Caja, without taking any measure to expand the monetary supply in order to avoid an economic recession. Under the influence of former experiences (1885/90 crisis), its main concern was not deflation but the eventual inflationary effects of monetary expansion.

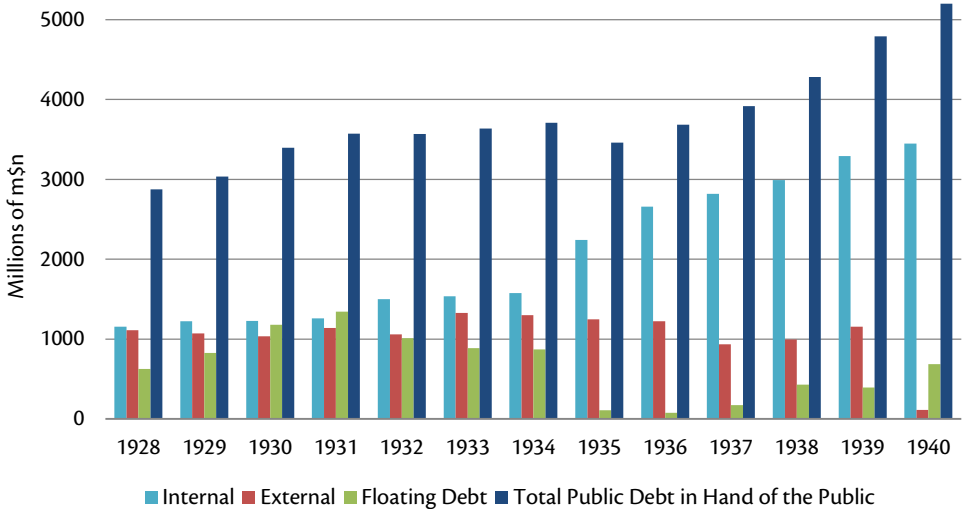
In addition, having in mind the fiscal problems produced during the 1890 crisis – when purchases of gold in the market had to be made with depreciated pesos–, the government's policy was to assure gold availability at an official undervalued former rate (because the devaluation of the peso) to pay for the foreign debt.

Graphic no. 1: Annual Balances Variation in the Caja de Conversión: 1927-1935
(in millions of gold pesos).



Source: Pedro Baiocco 1937.

Graphic no. 2: Public Debt, 1928-1940. Millions of pesos m.\$n.



Source: Comité Nacional de Geografía 1941.

In an attempt to offset the fall in fiscal revenues (import duties), an aftermath of the fall of foreign trade, the provisional government approved new taxes: sale and income tax (1931) and two years later (1933) a disguised export tax (*margen de cambios*). From then on, there was no significant expansion of expenditures nor of the deficit, and because of that, it is reasonable to assume there were no deliberate fiscal policies (Díaz Alejandro 1983, 22, y Della Paolera and Taylor 1999, 12).

In September 1931, when Great Britain left the gold standard, the Argentine government, in fear of a possible run on the banks, enforced a system of exchange control (similar to the one the Germans implemented in those same years). Under that system, an official rate was fixed at 3.68 pesos per dollar and maintained at that level (instead of 2,2727) for two years.

The Exchange Control Board was granted the power to provide foreign exchange according to priorities established by the law in the following order: payment of the public debt, crucial imports, enterprises' profits, and immigrants' remittances, etc. Because of that, the latter ones were not a priority and there was not enough foreign exchange for them. International companies (mainly British railways, banks, etc.) were forbidden to send remittances to their headquarters (the arrears accumulated along several years reached a huge amount that remained in frozen pesos).

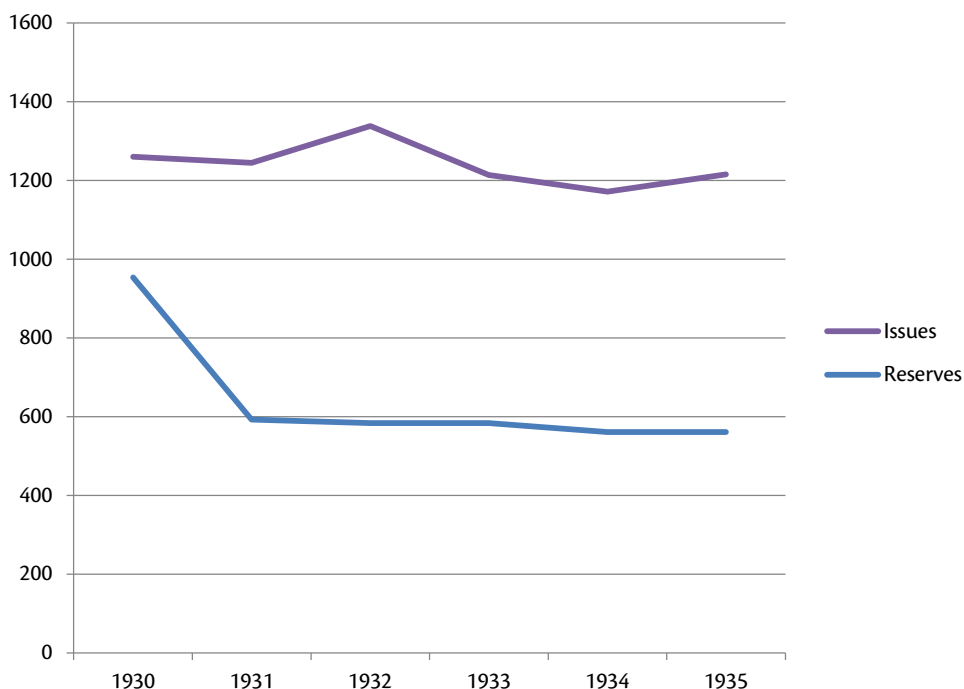
In spite of the British government's and private enterprises' complaints, the Argentine administration did not allow conversion of the frozen pesos into pounds until 1933. In that year, as part of the Roca-Runciman agreement, that debt was paid thanks to a loan given in pounds by a consortium of British banks (Cortés Conde 2009).

The fact that the government denied the British companies to provide exchange to remit profits had other macroeconomics effects. Had those remittances been sent abroad, the domestic saving would have declined, but instead, because pesos were frozen, they had no other alternative than to be invested in local banks or government bonds at a very low rate, contributing thus to a credit expansion.

A bill passed in 1913, at the time of World War I –that was enforced in 1931– granted the Currency Board the power to issue notes through rediscount of commercial papers already discounted by the *Banco de la Nación* (Cortés Conde 2009, 47). The following year, the Currency Board was again authorized to issue currency, this time by buying government bonds (the *Patriótico* Loan) which had previously failed to be placed in the market.

With the above mentioned currency issues, the government alleviated the commercial banks that were near insolvency due to the large number of non-performing loans in their assets, and their almost depleted reserves. In 1932, the new currency issues had solved, in part, the banks insolvency, the salaries of public employees', and the amounts due to suppliers of goods and services. Those arrears had produced a substantial contraction in demand. The partial normalization of government payments led to an alleviation of the contraction in consumers' demand.

Graphic no. 3: Gold Reserves and Monetary Issues at the Currency Board, 1930-1935
(millions of pesos).



Source: Arnaudo, 1987.

Needless to say, that until 1935 there was no additional creation of a monetary base, moreover it was more important the repletion of gold in the Conversion Board. Therefore, one cannot assume any clear intention on the part of the government to resort to instruments of policy in order to expand the monetary supply up to that year.

In 1933, the Justo administration devalued the pesos reforming the exchange control regime with a two-tier rate, one for selling and another one for buying foreign exchange. The revenues coming from the spread between the two rates (*margen de cambio*) went to the government and meant a substantial amount of money collected in foreign currency, which was mainly used to pay the foreign debt. The implementation of this reform reassured the British subscribers of the Roca bonds that the Argentine government had a source of substantial revenues enabling it to pay the foreign debt, which was the basis of the success of the loan (a by-product of the Roca-Runciman agreement). To obtain those funds, the local peso was devalued by 20%. A large share of the profits received by exporters due to the devaluation went to the government that fixed the buyer's rate below the market price.²

² "The Roca Runciman agreement [...] granted Argentina a quota of the British market based on 1932

1935. THE FOUNDATION OF THE CENTRAL BANK

Finally, in 1935, a change of regime came to the fore with the foundation of the Central Bank. The bill submitted to Congress had an antecedent in the memorandum written by a British expert, Sir Otto Niemeyer, who recommended the creation of a central bank of reserves having the monopoly of issue and the power to supervise the private banks. The law passed, added to the functions of the Bank the power to soften monetary fluctuations through open market operations, but did not specify the power to regulate the rate of reserve to deposits.

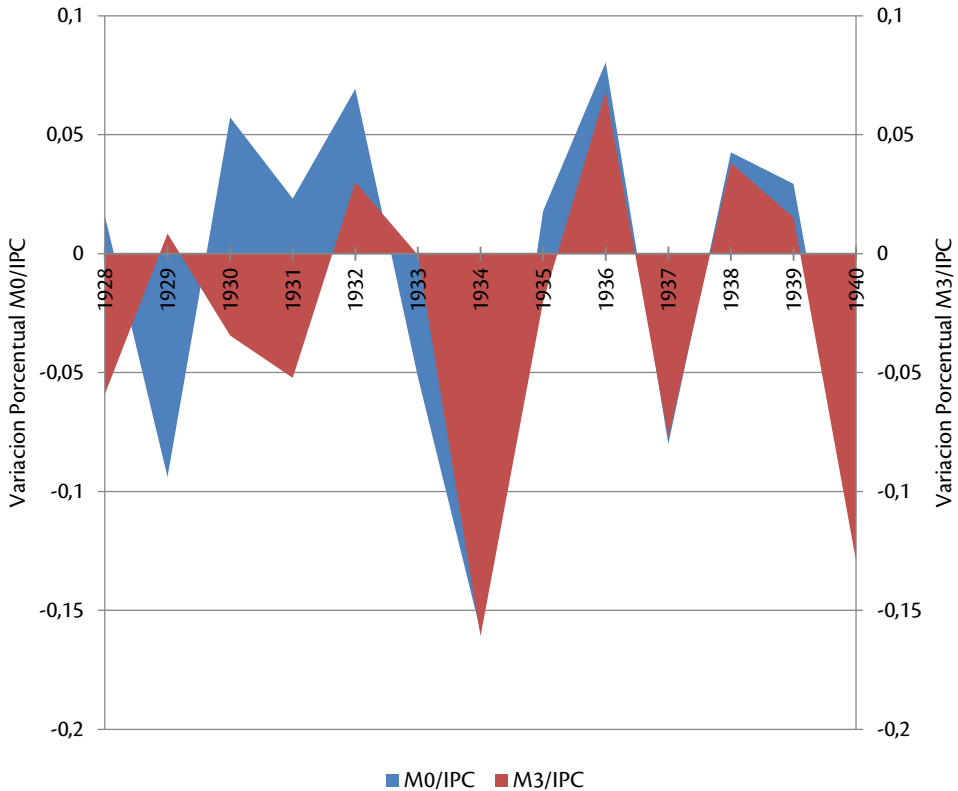
Moreover, the most important difference between the Niemeyer project and the law approved was that the latter included a bailout of the banks that were on the edge of bankruptcy, and a mechanism to help the treasury, in both cases with funds created through currency issues derived of a revaluation of the gold reserves.³ However, the huge increase in money supply did not have an inflationary effect (at that time, the most serious concern for the administration), because almost the whole amount went to increase the depleted reserves at various banks, taking on their losses by replacing non-performing loans (even those granted to the government) with new government ones. So, the increase in the money supply generated by the government was sterilized as reserves that the banks had in the Central Bank. To solve the problem of the banks' insolvency, an *Instituto Movilizador* was created –a kind of *bad bank*– that received 400 million pesos (from the revaluation of gold in the Central Bank) to buy non-performing loans.

The Central Bank incorporated to its assets 400 million of pesos of government bonds corresponding to the amount of its debts to the *Banco Nación* and other commercial banks. Those bonds were bought by the Central Bank with the revaluation of gold. In the following years, the Central Bank used those bonds to proceed with open-market operation, with the purpose of checking the monetary caused by the inflow of foreign reserves (due to the increase in exports), or promoting it in case it declined, as it happened during the crisis of 1937 (BCRA 1972). However, successful as it was, as a counter-cyclical policy, it was not applied during the WWII years; it would have been useful to sterilize a large amount of gold inflows from the commercial surplus.

exports[...]. But more importantly, there had been agreement on the issue of payments and a loan to unfreeze the pesos.[...] the equivalent of 12 million pounds sterling in paper pesos be taken from the exchange of pounds sterling that remains available "for remittances from Argentina to the United Kingdom during 1933 [...]". Cortés Conde 2009, 95.

3 The banks were in serious difficulties since the middle of the '20s. Additional to the disruption that came from the war and postwar, the banks, especially the local ones, were affected by the 1921 cattle crisis and the fall in agricultural prices since 1925. While the local banks were more involved in agricultural and cattle business, the international banks worked mainly in export-import operations. Lacking a Central Bank for rediscounts, the foreign banks had access to funds abroad, the local banks did not. On the other hand the Banco de la Nación had the guarantee of its deposits by law. That was the reason why in the '20s local banks suffered a fall in deposits while the Banco Nación and foreign banks did not (Della Paolera and Taylor 1997, 15).

Graphic no. 4. Real Monetary Aggregates. Percentual Variations , 1928-1940.

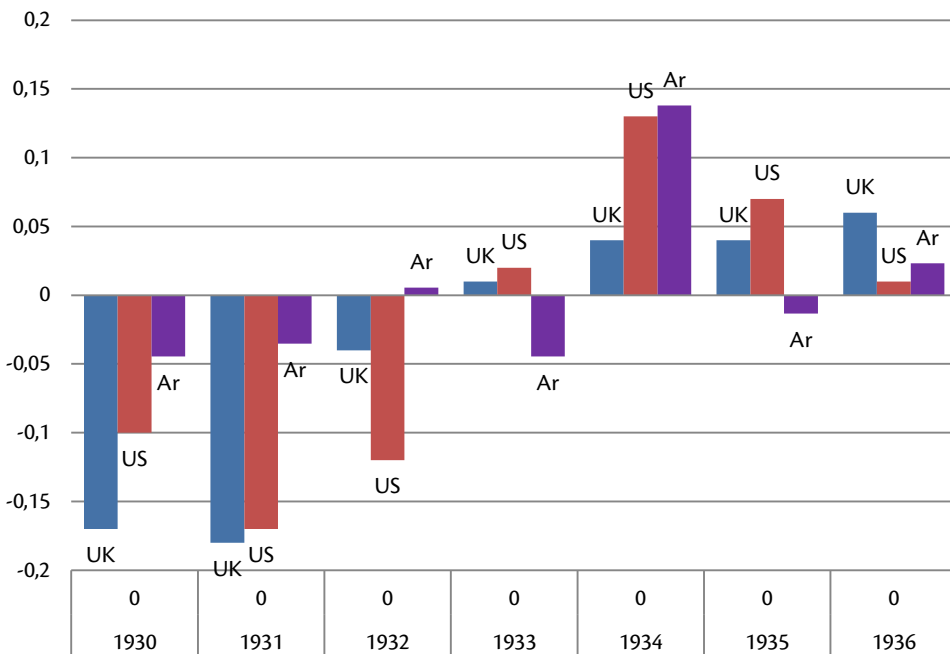


Source: own elaboration from Baiocco 1937 and Ferreres 2011.

The gold revaluation was the most important policy in 1935, with the creation of the Central Bank, because it prevented along agony of the banks –which would have otherwise gone bankrupt– and the elimination of deposit as money, that it would produce a severe monetary contraction. The other policies, such as the open-market operations, were successful in softening fluctuation, but they were enforced only two-years: in 1935, when the inflows of gold were sterilized by selling bonds, and in 1937, when the Central Bank bought bonds from the public expanding in that way the money supply to compensate the outflows of gold resulting from the fall in exports. However, overall, the Central Bank followed a quite orthodox policy because its emissions maintained a close relation with the gold inflows. Moreover, the Central Bank had no power to fix the rate of interest of the other banks, and –as its General Manager Prebisch reminds us– it could act only through “persuasion” (BCRA 1972, p. 59).

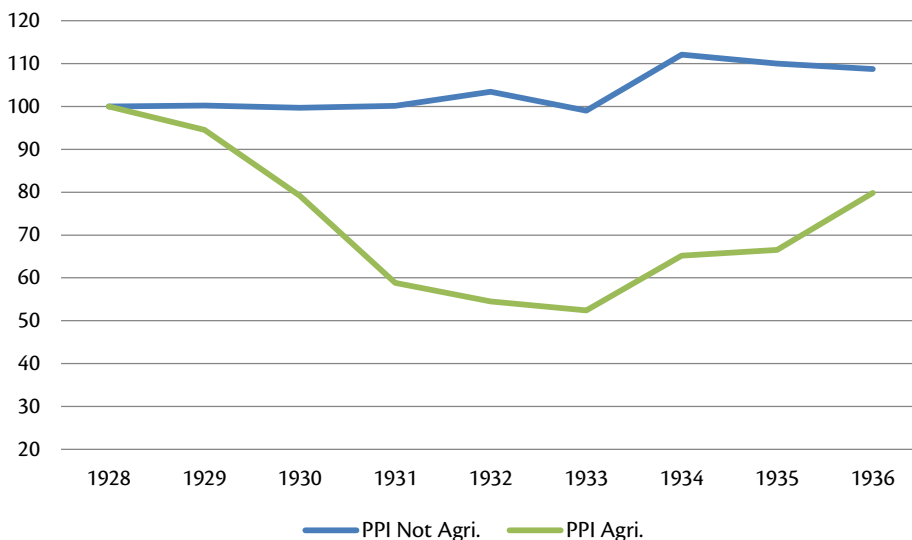
Whatever its reason, it’s clear –as seen in the graph below– that deflation in the United States and Great Britain (measured by the WPI) was deeper than in Argentina.

Graphic no. 5. Producer Price Index. Argentina, United Kingdom and USA, 1930-1936.



Source: own elaboration from US Department of Commerce (several years), Ferreres 2011 and Mitchell 1975.

Graphic no. 6. Producer Prices. Argentina 1928-1936 (1928=100).



Source: own elaboration from Ferreres 2011.

But, however, if we take into account agricultural prices, we see they fell much deeper than industrial prices. So, in order to compare with agricultural countries like Australia and New Zealand –as Bernanke and James (2000) have done– it is necessary to refer to the evolution of agricultural prices. As it is seen in the Argentine case, agricultural prices fell much deeper than non-agricultural prices (graph no. 6).

SUMMARY

The point of this paper is that the government had no explicit expansionary monetary policy to face the deflationary consequences of the 1930 crises. In fact, only when confronted with possible bankruptcy of banks in 1931, did they authorize the Board to issue currency based on rediscounts. In 1932, in the face of the fall of government income and the failure of the *Empréstito Patriótico*, the government authorized another issue of currency placing those bonds in the Currency Board. Except in these two cases the Board did not issue notes that were not backed in gold, so there was not an explicit reform of the monetary regime until 1935.

In 1935, with the creation of the Central Bank, the measure that had a powerful effect was the revaluation of the gold in its assets. The enormous new issues helped the Banco de la Nación that had a huge portion of its assets in nonperforming loans, those of the government and the agriculture sector, and some private banks to solve their solvency problems. The huge amount of money supply came from the gold revaluation but it was used not to expand credit but to replete the almost empty reserves in cash of the banks. On the other hand, because of that, it did not have a wide impact in money in circulation. Their debt was bought to a new institution, a 'bad bank', the IMIM.

But, although the authorities did not reject to adopt unconventional measures that they thought truly exceptional, when possible, they were willing to return to the rules of the gold standard, at least until 1935.

The other point of this paper is that economic recovery was not mainly a consequence of the policies followed by the government to isolate Argentina from the international markets but of the international recovery of agricultural prices after the US devaluation. It was helped, in 1933, by the reversal of the gold flows and its consequences, when gold from Europe arrived to the United States after Hitler assumed government in January of that year, as Milton Friedman noted (Friedman and Schwartz 1971, 474). Besides, the rising agricultural prices after 1933, what allowed the Argentine government to institute an export tax, disguise as exchange difference between the price paid for the importers and that paid to agricultural export to buy foreign exchange. That exchange difference (a tax on exports) provided exchange to pay the foreign liabilities. So external factors, more than isolationist domestic measures, were quite influential in the economic recovery.

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