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**The role of the Bank of England in creating central banks during the
1930s: an examination of the central Bank of the Argentine Republic***

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Introduction

The purpose of this presentation is to reassess the role of the Bank of England in creating central banks during the 1930s. The Bank of England dispatched advisors who were familiar with central banking such as Sir Otto Niemeyer and Sir Ernest Harvey not only to the members of the 'formal empire' such as India and the Dominions, but also to those of the 'informal empire', including China, Egypt, and countries in Latin America. These advisors' missions were to encourage governments to create central banks. In effect, by these advisors' recommendations, many governments decided to found central banks, so it is no wonder that the foundations of central banks owed much to the comments of advisor¹.

Table 1. Actions of the Bank of England in creating central banks during the 1930s

Countries	Year	Advisors	Results
Formal Empire			
Australia	1930	O.Niemeyer, N.Kershaw	Commonwealth Bank became a full-fledged central bank.
New Zealand	1930	O.Niemeyer, N.Kershaw	Reserve Bank of New Zealand was established.
Canada	1933	H.Macmillan, C.Addis	Bank of Canada(central bank) was established.
India	1936	O.Niemeyer, E.Harvey	Reserve Bank of India became a full-fledge central bank.
Informal Empire			
Brazil	1931	O.Niemeyer	Bank of Brazil became a full-fledged central bank.
Argentina	1932/1935	O.Niemeyer, F.F.J.Powell	Central Bank of Argentina was established.
El Salvador	1934	F.F.J.Powell	Central Bank of El Salvador was established.
Egypt	1936/39	O.Niemeyer	The National Bank of Egypt became a full-fledged central bank.
China	1935/41	F.Leith-Ross	Monetary Reform was implemented.

¹ The outline of these activities of the Bank of England are described in Sayers(1976).

However, in these traditional interpretations concerning the role of the advisors, it is difficult to say that the actual process of foundation in each case has been fully argued². Two points need to be clarified to reveal the process: the content of the advice of the Bank of England which was given to a local government and its consequence--whether it was actually accepted or not. Most studies up to now, having focused only on the intentions of the Bank of England, have paid few attentions to these two points. The investigation into these points will provide us with a new interpretation about the actual process.

The aim of this paper is to examine, as a typical case, the role of the Bank of England in creating the Central Bank of the Argentine Republic (hereafter CBAR) in 1935. At the end of the year 1932, Niemeyer³ visited Argentina and submitted the report which was composed of two parts, namely, the analysis of the present financial situation of the Argentine Republic at that time and the draft of the Laws pertaining to the creation of the CBAR. Then, the CBAR was created in May 1935. As these situations are taken into consideration, it has been generally interpreted that the establishment of the CBAR was mainly based on Niemeyer's instructions.

The point that requires more clarification is that whether Niemeyer's advice was practically accepted or not. In order to reveal this point it is useful to compare the Niemeyer's draft of the Law with the Laws concerning to the establishment of the CBAR, which were actually enacted and enforced. Firstly, we will outline the financial institutions and the system before 1935 in Chapter 1. Secondly, we will examine the Niemeyer's above mentioned Report in Chapter 2. And finally, we will consider the Laws comparing it with the content of the Niemeyer's draft in Chapter 3.

² The case study of the role of the Bank of England in creating the Canadian central bank (Bank of Canada) was done by Cain (1996).

³ The biography of Niemeyer is noted in the Blake and Nicholls(eds) (1986),pp.631-633.

1. Factors leading to the founding of the CBAR

In this chapter we consider the financial and economic contexts of Argentina at that time which resulted in creating the CBAR. We start with the outline of the system of Argentina before 1935 and then proceed to the impact of the Great Depression on it.

1.1. Financial institutions and the system of Argentine Republic before 1935

In Argentina gold standard was formed by the Law 3871 which provided the 1 gold peso=2.27 paper pesos⁴. The financial regime on the gold standard was constituted by the Conversion Office and the private banks. The Conversion Office is an only institution which had the right of note issuing in Argentina. It issued paper money according to the stock of gold which varied by trade balances, so money supply was regulated by the inflow and outflow of gold automatically. In this sense, the financial system of Argentina was very simple.

However the financial system of Argentina was, in other respect, much complicated because of the existence of the Banco de la Nación, established in 1872 by the Law 2841⁵. It granted loans to the Government to the extent of 20 per cent of its capital, and used up to 20 per cent of its resources to buy public debt securities on the market. Although it functioned as an ordinary commercial bank receiving deposits from, and granting discounts and advances to the general public, it was an official bank acting as financial agent of the Government.

On the other hand, the Banco de la Nación behaved as a bankers' bank in one aspect. Since World War I, it was empowered to rediscount the negotiable paper of other private banks and to have this paper again rediscounted at the Conversion Office. It had rediscounted considerable sums of paper for the other banks, but it did not make use of its privilege of rediscount with the Conversion Office. It was required to keep a reserve of 25 per cent against total deposits, but other banks were under no such statutory obligations.

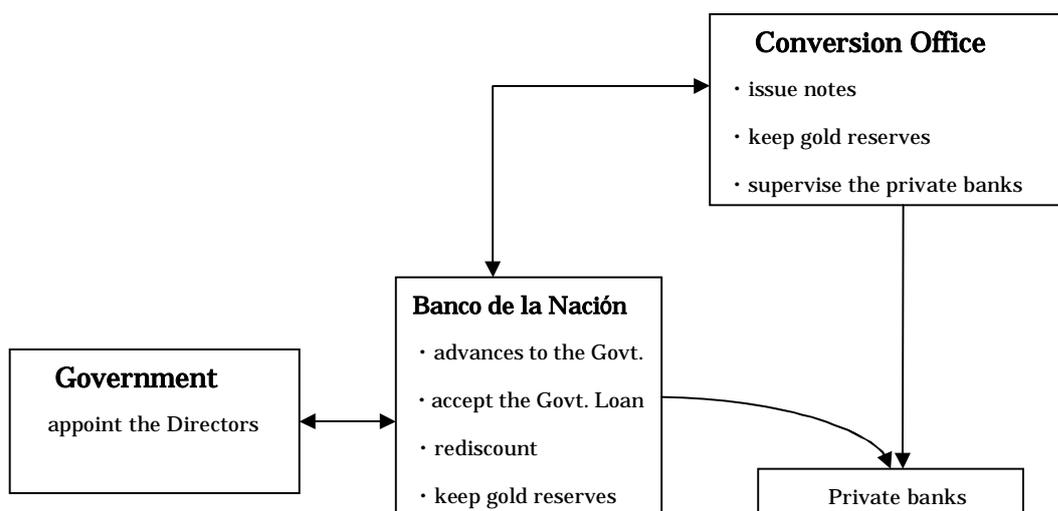
In concluding the financial system of Argentina before the establishment of the BCRA, I would like to emphasize the following three points (See Figure 1).

⁴ Ministerio de Hacienda(1926),p.297.

⁵ Ministerio de Hacienda(1926),pp.187-196.

First, the Government was able to have an influence on the financial system through the intermediary of the Banco de la Nación. Second, the private banks were not only influenced by the Conversion Office but also by the Banco de la Nación. Third, the money supply of Argentina was governed by the volume of the gold stocked in Conversion Office theoretically, but it could be fluctuated by the volume of the rediscount by the Banco de la Nación in virtual.

Figure 1. Financial system of Argentina under the Gold Standard Regime



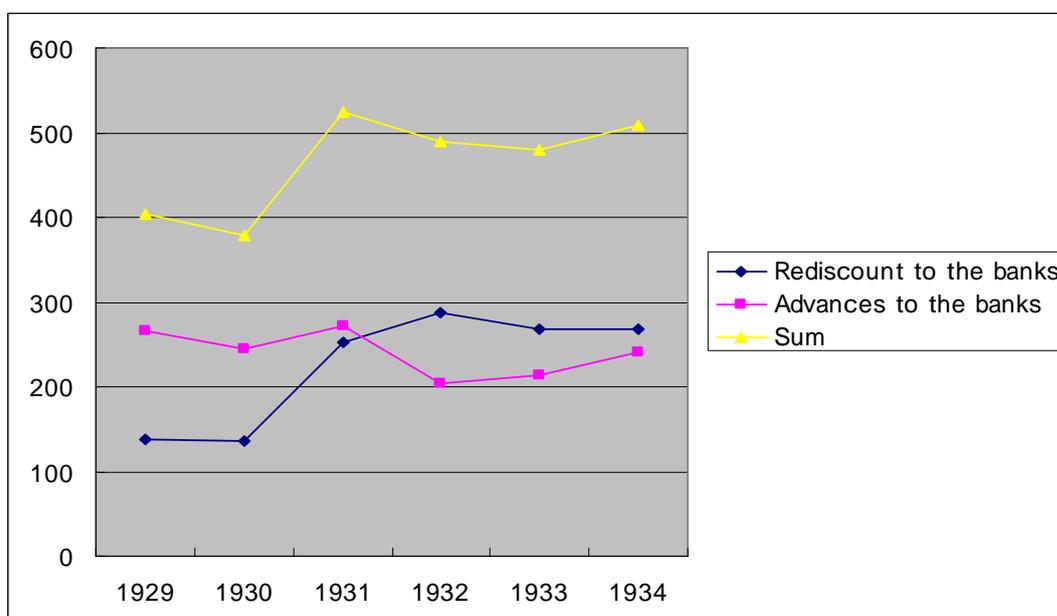
1.2 Impact of the Great Depression on the financial system

It is the well-known fact that economic growth of Argentina were based on a few primary products such as meat and wheat, and like other agricultural States, Argentina has borrowed heavily abroad since the end of the 19th century. Argentina was forced to export gold in order to balance her international accounts when capital imports ceased and the prices of her raw products fell at the outbreak of the Great Depression.

Between the end of 1928 and the end of 1931, the gold stocks in Argentina were reduced to over 850 million pesos, or almost 60 per cent. The Conversion Office was closed in 1929, and the Exchange Control Commission was set up to maintain the level equivalent to a depreciation of about 40 per cent in relation to its gold parity at the end of 1931.

In order to prevent the loss of gold, which might have result in a contradiction of the volume of circulating media, the Banco de la Nación started in April 1931 to rediscount commercial paper with the Conversion Office and secure notes in exchange. At the end of 1931, the Banco de la Nación's rediscounts at the conversion Office reached a total of 359 million pesos. The Banco de la Nación used the funds acquired partly (145 million pesos) to increase its rediscount and other credits to the ordinary banks, which rose from a total of 410 million pesos in April 1931 to 555 million pesos at the end of 1931, partly (160 million pesos) to meet withdrawals of deposits, and partly (65 million pesos) to increase its cash holdings.

Figure 2. Rediscount and advances to the banks, 1929-1934



Note: Units are millions of paper pesos.

Source: The League of Nations(1987),p.13.

The Banco de la Nación also started to approach to the Government directly in exchange for the Patriotic Loan in May 1932. Series 1 to 4 issued between May and October 1932 which amounted to 350 million pesos in all. It was used mainly for Government debts in suspense.

As we have seen above, a few novel policies and operations which had never been deployed in the gold standard regime were introduced during the Great Depression. The main opinion in the economic circle in Argentina at that

time was so conservative that they saw these as unorthodox and even dangerous, and a central bank came to be highlighted as an instrument that would manage to preserve and maintain the gold standard, in other words, as an organ to modify the gold standard to survive the difficult situation.

Then Finance Minister Uriburu made a draft for a central bank at the end of 1931 for the first time in Argentine history. In Uriburu's draft the gold standard remained as a central system. It is clearly shown in the following articles of this draft⁶: Article 4 stipulates that the principle object of the CBAR is to sustain the convertibility of the peso with gold at the fixed parity; article 27 obliges the CBAR for its note issue to secure minimum reserve of 40% in gold.

Uriburu's draft was not actually enacted because the world economic conditions changed, particularly, British departed from the gold standard. That is why the Argentine Government started to make a new plan for establishing a central bank and sought technical advice pertaining to central banking from Sir Otto Niemeyer, a world-famous financial expert of the Bank of England at the time.

⁶ Banco Central de la República Argentina(1972), pp.661-668.

2. Niemeyer's visit to Argentina

In this chapter we will examine the Niemeyer's Report⁷. As has been noted in the Introduction, Niemeyer visited Argentina in December 1932 at the invitation of the Argentine Government and submitted the report which consisted of two parts: first, an analysis of the financial system at that time of Argentina; second, the draft of the new laws concerning the central bank and the private banks. Let us examine these points in the following respectively.

2.1. Niemeyer's Analysis

According to Niemeyer's analysis the major problems of the financial system of Argentina can be summarized into the following three points.

First, there exists no special system of banking control in Argentina at the time. The banks, subject to the ordinary law of commercial companies, only submit monthly statements of the main items of their balance-sheets to the Research Bureau of the Banco de la Nación. Niemeyer warned that central control was more needed to avoid the oscillations tended to be further intensified by violent inflation and contraction of bank credit because the agricultural country like Argentina was much more affected by seasonal variations in the weather than industrial nations.

Second, the mechanism of the gold standard had not actually functioned since WW 1. In theory the volume of currency was to be regulated not by the deliberate policy by some institutions but automatically by the influx and the efflux of gold at the Conversion Office. The object of the system is to adjust automatically the volume of cash to changes in the balance of payments so as to ensure that cash only expands when exports expand and contracts when exports fall off.

However, in practice the system did not operate as 40 years ago. For the means of payment at the disposal of industry depended not only merely upon the quantity of notes supplied by the Conversion Office but, more substantially, upon the loans and advances given by the banks on the basis of their own cash reserves. These had not been regulated in proportion to gold reserves of the country. Particularly from the end of the 1920s when the system had difficulty

⁷ This Report was published by the Ministry of Finance of Argentina. See Ministerio de Hacienda(1933).

in having its full effect, the absence of elasticity in the monetary system was made up by the actions of the Banco de la Nación.

The observation so far shows that the gold standard had not been functioning virtually. Recognizing this fact, Niemeyer in his draft discusses that the gold standard, which became shackle for the monetary policy of Argentina, should be abandoned and a new central bank which is to be created in line with the orthodox policy of the Bank of England should take all responsibility for the discretionary monetary policy.

The third point is about the crisis of the financial system. The unhealthy financial and fiscal system had been created by import of the large amount of foreign capital in the 1920s: because the foreign loans which had the similar effect of real increase in exports stimulated the economic activity, the banks came to be expanding credit excessively. And also, the foreign loans were used to meet current administrative expenses abundantly, therefore the Government became to have chronic budget deficit. In order to remedy the severe situations which brought about by these problems, Niemeyer recommends that immediate steps should be taken to co-ordinate banking organization by establishing a central bank, and he presents the draft of the Central Bank Law and the Banking Law. Let us consider the important points of these laws.

2.2 The Niemeyer's Draft

Let us start with the examination of the draft of the Central Banking Law. The article 3 stipulates that the general object of the CBAR shall be the following three points: (a)to coordinate the expansion or contraction of the volume of credit and to secure the liquidity of the separate banks by establishing a central banking reserve; (b)to regulate the volume of credit to keep the external value of the Argentine peso fixed by law; (c)to maintain the influence on credit and trade activity of public borrowing by advising the Government on all loans and by issuing and managing Government loans. Whereas the Uriburu's draft indicates that he clings to the gold standard, these three objects make it evident that Niemeyer's designs are based on the idea of the managed currency system.

The article 5 and 6 are about the capital of the CBAR. The former stipulates that the both national and foreign banks in Argentina with a paid-up capital of not less than 1 million dollars m/n shall subscribe for the original capital of the

CBAR at par in proportion to their paid-up capital at the time of its establishment. Furthermore, the latter stipulates that the Government shall not hold shares of the CBAR. These articles show the Niemeyer's intention to prevent the Government from exerting some influence over the policies of the CBAR.

The article 32 stipulates the various operations of the CBAR; (a) Issue notes in accordance with the provision of the article 35 to 41; (b) Buy and sell gold and foreign currencies; (c) Rediscount for the banks; (d) Undertake the issue and management of Government loans; (e) Administer the Clearing system in Buenos Aires and in other stock exchange markets.

The article 35 and the 39 are about the note issue. The former stipulates that the CBAR has the sole right of issuing notes in Argentina. The latter stipulates that the CBAR shall at all times hold a minimum cover in gold and foreign currencies equivalent to at least 25 per cent of its notes in circulation and with sight liabilities. It should be noted that this reserve ratio is very low, compared with the minimum reserve ratio of 40 per cent which is required in Uriburu's draft, and while only gold is permitted as the reserve assets in Uriburu's draft, the hard foreign currency such as pound and dollar could be the reserve assets in Niemeyer's draft.

Now we shall proceed to the explanation of the Banking Law. In Article 2, national banks or branches of foreign banks established in the Argentina shall at all times maintain a cash balance of at least 20 per cent of their sight deposits and 10 per cent of their time deposits, at least one half both of which shall be in the form of balances on sight deposit with the CBAR.

In the stipulation of article 10, every bank in Argentina must render confidential monthly statements to the CBAR and must furnish any further information for explaining or amplifying the statements which the CBAR may request in its discretion, and the CBAR shall publish monthly a summary of the bank's statements showing the totals of the various heads in aggregate figures.

3. The Formation of the Central Bank of Argentina

In this chapter, first, we will examine the Banking and Currency Reform Laws, considering the differences between them and the Niemeyer's draft which has been already scrutinized in the former chapter, and then, we will examine why these differences emerged.

3.1. The Banking and Currency Reform Laws

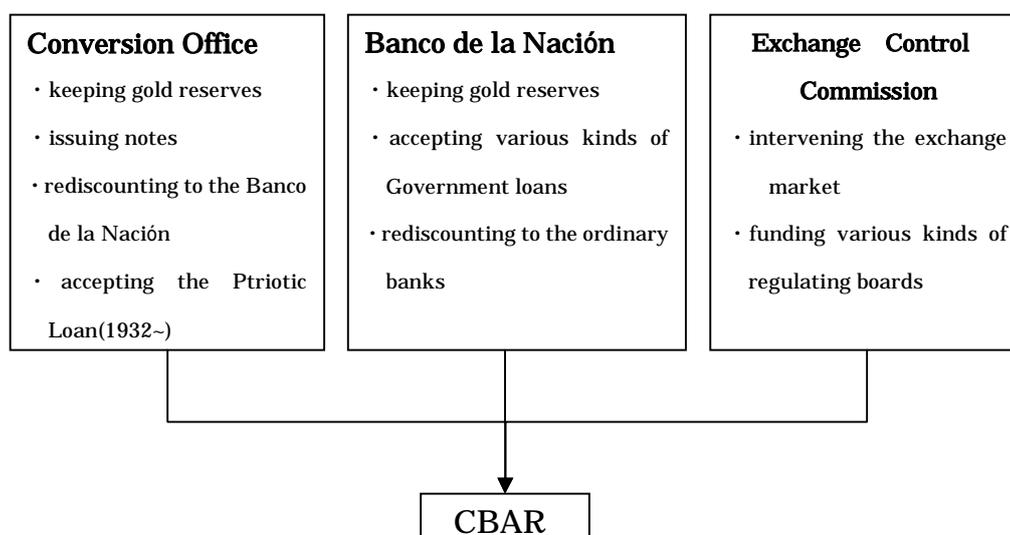
The former banking system was completely altered by the five laws which were issued on March 28th, 1935⁸. According to the description of the Economic Statistical Series of the League of Nations, the banking reform was based on Niemeyer's recommendations and framed by the then Finance Minister Pinedo (Federico Pinedo). Pinedo played a key role in establishing the CBAR, as will be explained in later.

The enactments embodying the reform comprised five closely connected measures: (1) The Central Bank of the Argentine Republic Law (Law 12,155); (2) The Banking Law (Law 12,156); (3) The Instituto Movilizador Inversiones Bancarias Law (Law 12,157); (4) The Modifications of the Laws of the Official Banks Law (Law 12,158/12,159); (5) The Organization Law (Law 12,160). By these laws, central banking system was firmly established in Argentina. We cannot investigate into each law in detail, but it is useful to outline its general features of the Laws except the Law 12,158 and 12,159, which are unimportant now.

First, let us consider the Law 12,155 which stipulates the organization and operation of the CBAR. In the articles 4 to 8, the capital of the CBAR and subscription for its shares is mentioned. According to these articles, the CBAR is a joint-stock company with a capital of 30 million pesos, divided into three blocks, the first 10 million pesos block of which will be subscribed by the Government. It is important to note the difference between this stipulation and the article 5 of the Niemeyer's draft.

⁸ Academia Nacional de la Historia (1966), pp.596-610.

Figure 3 Formation of the CBAR



The articles 32 to 41 refer to the various operations of the banks. The CBAR assumed certain functions hitherto exercised by a number of different bodies. In particular, it is responsible for the gold reserves and the note circulation, and for rediscounting operations and the control of the exchanges and of the value of the national currency. In addition, it acts as financial agent and advisor to the Government, administers the reserves of the member banks and conducts clearing operations.

What needs to be emphasized here is that the open-market operations were implemented for the first time in Argentina. The CBAR's operations were restricted by the Consolidated Treasury Bills created by the transformation of the Patriotic Loan of the Conversion Office and of the Treasury bonds in circulation. It should never be overlooked that Niemeyer opposed to introducing the open-market operations to the country for the reason of the immature financial market of Argentina, so the open-market operations were not even mentioned in the Niemeyer's draft.

The Law 12,156 includes the regulations of the national and foreign banks in Argentina. This Law was as almost same as the Niemeyer's draft except for the following point. Namely, as we have seen, while the banks are required to deposit a proportion of their liquid assets equivalent to 20 per cent of their sight deposits and 10 per cent of their time deposits with the CBAR in the Niemeyer's draft, they are required 16 per cent and 8 per cent respectively.

Since there was no draft for the Law 12,157 in the Niemeyer's Report, this Law was made by the policy-makers of Argentina at the time. This Law defines the foundation of the Instituto Movilizador Inversiones Bancarias(hereafter IMIB). The purpose of this institution is to liquidate the frozen assets of the banks. To put it differently, it is to bail out the private banking sector which was in the precarious position by the accumulation of enormous amount of bad assets resulting from the generous finance of the big banks to the companies in strong connection with the big-name politicians.

According to a recent survey by A. M. Taylor and G. della Paolera⁹, the main source of funds for the operation were seigniorage profits of the CBAR arising from the decision to devalue the peso parity from 2.27 paper pesos per gold peso to 4.96 in 1935. This operation provided the government with a huge accounting profit of 701 million paper pesos. This was allocated to various uses as indicated in the Figure 2, and IMIB was supplied with funds as much as 390 million paper pesos for bailout operations.

Table 2. Distribution of the profit brought about by the revaluation of gold

Banco de la Nación	173,440,344.76
Redemption of short-term Government loans	137,620,421.66
IMIB	390,000,000.00
Total	701,060,766.00

Note: Units are millions of paper pesos.

Source: Banco Central de la Republica Argentina(1935),p.9.

IMIB set about rescuing the big commercial banks having recourse to such an affluent fund. In 1935, the IMIB took over from the Banco de la Nación some 315 millions of frozen credits, handing to the latter more than half of that amount(178.4 millions) in cash. Later, at the end of the year, the IMIB established the Banco Español del Rio de la Plata to take over the frozen assets and deposits of the four big banking institutions which were notorious for their bad management: Banco Español del Rio de la Plata; Banco el Hogar Argentino; Ernesto Tornquist y Cia; Banco Argentino Uruguayo.

⁹ Paolera and Taylor(2001),p.253.

Table 3. Distribution of the resources of the IMIB

Paid to the Banco de la Nacion	178,408,974.13
Paid to the Banco Español del Rio de la Plata	170,000,000.00
Miscellaneous	11,499,086.27
Balance in hand	30,091,086.27
Total resources of the IMIB	390,000,000.00

Note: Units are paper pesos.

Sources: Banco Central de la Republica Argentina(1935), p.9.

F.F.J Powell, as a technical advisor of the Bank of England to the CBAR in Argentina from August 1935 to August 1936, expressed his disgust towards these operations in his letter to Niemeyer in the following:

Of the increase in cash of 400 millions from April to December 1935, 298 million is accounted for by the Banco de la Nación and the new Banco Español, 141 million being represented by the former and 157 million by the latter. It follows that if special measures can be taken so as to reduce the excess cash reserves of these two banks there will be far less danger of credit inflation in Argentina¹⁰.

The Law 12,160 is about the committee of experts to assist the Government in implementing the various policies which were stipulated by the above-mentioned Laws. Notably, the Minister of the Finance became the chairman of this committee. This meant that the all policies concerning to the financial matters including the CBAR' various operations were designed and introduced by the Minister of Finance exclusively. It is natural that Niemeyer, who asserted the independence of the central bank from its government, opposed setting up such a committee.

¹⁰ The Bank of England Archives, OV9, Sir Otto Niemeyer's Papers, Powell to Niemeyer, April 27, 1936.

3.2. The Cause of the difference between the Laws and Niemeyer's draft

Now we will consider why these differences between the Laws and Niemeyer's draft emerged. To answer this question, it is necessary to look into the circumstances in which the five Laws were declared.

The bills of the five Laws were drawn up by Pinedo¹¹ and sent to Congress on 17th January. Although it has been argued that the Laws concerning the CBAR were framed based on the Niemeyer's draft up to now, such a view must be modified with the fact that these Laws were made by Pinedo actually. Let us examine his political background and his goal as the Finance Minister briefly.

He had been a member of the Socialist Party of Argentina for many years but he left the party and became the Finance Minister of the Conservative Government in August 1933. This was a coalition government which represented the interests of the traditional export sector (namely meat and wheat). However, he tried to not only protect the primary industry threatened by the Great Depression but also, by setting up various Regulatory Boards, boost the infant import-substitution industry such as cotton manufacture.

In any case, it is clear that Pinedo regarded the CBAR as useful means to regulate the economy and an institution which was able to wield a strong power to accomplish the above-mentioned objectives. Therefore the CBAR should have been under the full control of the Finance Minister, unlike the model presented by Niemeyer on the Bank of England's principle that a central bank must be independent from its government. This fact sufficiently implies that Niemeyer's role in creating the CBAR was a more limited one than have been considered.

¹¹ See Azarett(1998).

Then what role did Niemeyer play in establishing the CBAR? The answer may be found in the Pinedo's following recollections.

There was rather excessive partiality in favor of the British proposal from which we drew not only many ideas but also the phraseology... We did this because we did not want to create serious obstacles to the approval of the bills and we knew that, by a curious characteristic of the collective mentality, at that moment adoption of the government's proposals would be facilitated if we could make them appear to coincide to a great extent with what the foreign expert had advised¹².

¹² Ciria(1974),pp.24-25.

Conclusion

Up to now, It has been considered whether the Niemeyer's advice was accepted or not. By way of conclusion, I must reiterate my point that it was not Niemeyer but Pinedo, the Minister of Finance of Argentina, who had the initiative in creating CBAR.

According to Plumpter' survey of the development of the central banking in the British Dominions in the inter-war period, the world-wide demand for central banking arose from the atmosphere which was the mixture of the two elements; nationalism and imperialism¹³.

For the Dominions, a central bank meant an institution which gave the financial means to promote big development projects such as the one for import-substitution industries in embryo at the time, which stimulated people to having the prospect of future independence. On the other hand, for the Bank of England, it was regarded as an agent to oppress such a big scheme of development and to implement various policies directed from the Bank of England to sustain the financial hierarchy of the British Empire.

From this study, confined to the Argentine case, it is possible to conclude the former element must have been stronger as long as the CBAR is concerned. The study from this view would require collecting more case studies and doing a comparative analysis of each case in the future.

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¹³ Plumpter(1940),p.201.

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