The great depression in Argentina, Brazil and Uruguay: revisiting vulnerabilities and policies

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Title: The great depression in Argentina, Brazil and Uruguay : revisiting vulnerabilities and policies
Issue Date: 2015-10-01

X. Building a casket for the gold standard

At least fifty countries joined the gold standard during the twenties. Among them, the US returned to this regime in 1919, Germany in 1924, the UK in 1925 and France in 1928. In relation to South American countries, Colombia returned in 1923, Chile in 1926 and Argentina and Brazil in 1927[423].

This general trend had an explanation on a state of mind or mainstream thinking among decision makes worldwide. Clavin (2000, pp. 98-99) explains that in spite of the falling crisis, during 1929-1930 politicians across the political spectrum in Europe continued to argue that the membership of the gold standard guaranteed stability and prosperity because it constrained governments not to pursue unsound spending policies to encourage employment and consumption that would jeopardize the credibility of the exchange rate. Moreover, James (1992, p. 596) suggests that budget deficits threatened a likely departure from gold, not just because there may have been a fear of the repetition of inflation and hyper-inflation that had ravaged Europe in the immediate post-war period, but because of the increased public deficits that could not be accommodated easily by financial markets, resulting in an increased market volatility. And in addition to orthodox governments, central banks' unwillingness to lower discount rates to prevent gold from flowing away to the US or France and banks' reluctance to reduce interest rates to encourage domestic investment aggravated the downturn further.

But this outcome was probably justified by the state of knowledge at the time and the historic context. As Temin (1989, p. 86) remarks, the Keynesian analysis was in the early stages of development. It took Keynes half a decade to complete it and more time for people to understand it[424]. Thus, that type of model was not available during the late twenties to face any strong downturn. Furthermore, he concludes that the gold standard was a 'Midas touch' that

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[423] See Wolf & Yousef (2006, pp. 34-36) and Kemmerer, D. (1954). Also the League of Nations yearbooks provide information, see Table 64.

[424] See also Skidelsky (2010). In this regard, John Maynard Keynes, published in 'The Times' on March 1933, a few months before the key London World Economic Conference, an article in which he presented the bases for a broad expansive policy, based on financing of internal deficits and on international economic cooperation. He affirmed that the only possible and effective way of achieving the recovery of the world economy, the increase of commodity prices and the relief of the highly indebted countries, was the expansion of world demand by a coordinated action. That would be achieved by means of a substantial and simultaneous relief of taxes and increase of the expenses financed by credits. His views were mostly disregarded by delegates at that Conference, and even by British officials such as Neville Chamberlain.

paralyzed the world economy, and the single best predictor of how severe the depression was in different countries according to how long they stayed on gold. The relatively short-lived experiment of the restoration of the gold standard by the mid-twenties is an indicator of that assertion. In Table 64, reproduced from the League of Nation's Yearbook (1933-1934, p. 219) we show the domino effect on the suspension of the gold standard system, which lost most of its adherents between 1929 and 1932, including all Latin American countries.

Table 64 Dates of principal measures affecting exchange rates

Country	Official suspension of gold standard	Official foreign exchange control	Depreciation in relation to gold	Country	Official suspension of gold standard	Official foreign exchange control	Depreciation in relation to gold
Argentina	16/XII/29	13/X/31	XI/29	**India**	21/IX/31	—	IX/31
Australia	17/XII/29	—	III/30	**Irish State**	26/IX/31	—	IX/31
Austria	5/IV/33	9/X/31	IX/31	**Italy**	—	26/V/34	III/34
Belgium	30/III/35	18/III/35	III/35	**Japan**	13/XII/31	l/VII/32	XII/31
Bolivia	25/IX/31	3/X/31	III/30	**Mexico**	25/VII/31	—	VIII/31
Brazil	22/XI/30	18/V/31	XII/29	**Norway**	28/IX/31	—	IX/31
Canada	19/X/31	—	IX/31	**Netherlands**	26/IX/36	—	IX/36
Chile	20/IV/32	30/VII/31	IV/32	**New Zealand**	21/IX/31	—	IV/30
China	—	9/IX/34	—	**Paraguay**	—	VIII/32	XI/29
Colombia	25/IX/31	25/IX/31	I/32	**Peru**	14/V/32	—	V/32
Costa Rica	—	16/I/1932	I/32	**Philippines**	—	—	IV/33
Cuba	21/XI/33	2/VI/34	IV/33	**Portugal**	31/XII/31	21/X/22	X/31
Czechoslovakia	—	II/X/31	II/34	**Romania**	—	18/V/32	VII/35
Denmark	29/IX/31	18/XI/31	IX/31	**Salvador**	9/X/31	VIII/33	X/31
Ecuador	8/II/32	2/V/32	VI/32	**Spain**	—	18/V/31	1920
Egypt	21/IX/31	—	IX/31	**Sweden**	29/IX/31	—	IX/31
Finland	12/X/31	—	X/31	**Turkey**	—	26/II/30	1915
France	—	—	IX/36	**South Africa**	28/XII/32	—	I/33
Germany	—	13/VII/31	—	**UK**	21/IX/31	—	21/IX/31
Greece	26/IV/32	28/IX/31	IV/32	**US**	20/IV/33	6/III/33	19/IV/33
Guatemala	—	—	IV/33	**Uruguay**	XII/29	7/IX/31	IV/29
Honduras	—	27/III/34	IV/33	**Venezuela**	—	12/XII/36	IX/30
Hungary	—	17/VII/31	—	**Yugoslavia**	—	7/X/31	VII/32

Source: League of Nations (1937, p. 218). Argentina, Brazil and Uruguay corrected according to respective chapters in this thesis.

Although Bernanke & Carey (2000, p. 276) states that there is an 'emerging view' among scholars that the proximate cause of the Great Depression was the shortcomings of the interwar gold standard that explains the deflationary process of 1929-32, that consensus fades when the responsible countries, institutions and policies are considered. Some examples are given. The classic debate regarding its origin was that the Great Depression started exclusively in the US, as Friedman & Schwartz (2008) assert, or that it was the consequence of European mistakes, as President Hoover of the US insisted[425]. Friedman and Schwartz (2008) largely dismiss factors

[425] See Hoover (1952, pp. 2-5).

external to the United States and argue that no international deflation would have occurred if exchange rates had been allowed to float. Few found causes of the depression outside the US and Europe, apart from Latham (1981, p. 185), who ascribes a portion of its origin to Asian overproduction of rice (along with world surpluses of wheat). Smiley (2002, p. 57) states that the Great Depression did not start in the US, because by 1927 there were signs of economic contraction in Southeast Asia and Germany. Other authors, as Fremling (1985) conclude that it was not only the US that played an important role in the international transmission to other countries, but also the other developed countries. Eichengreen (2004, pp. 4-5), while stressing the role of US monetary policy in the depression, also is aware that at least France and Germany were independent sources of monetary deflation in the second half of the twenties. Indeed, the Poincaré stabilization raised French real interest rates in the second half of 1926, and in Germany, the President of the Reichsbank, Hjalmar Schacht, became convinced of the dangers of a speculative bubble in the spring of 1927, leading the German Central Bank to tighten credit.

Eichengreen (1990, p. 108) blames the interwar gold standard's unsatisfactory performance on the conduct of the authorities in France and other surplus countries who sterilized inflows of gold. Eichengreen (1992) also emphasises the role of international cooperation (or its absence) among central bankers. And Irwin (2010) concludes that France was somewhat more to blame than the United States for the worldwide deflation of 1929-33, because it increased its share of total world gold reserves from 7% to 27% between 1927 and 1932 and effectively sterilized most of this accumulation. Temin (1989) highlights the role of the United States and Germany in inducing deflation, but overlooks the role of the Bank of France. Temin (1976, p. 173; 1989) points out that the origin of the European crisis was the result of prior reductions in lending that weakened the European economies, and the weak position of Germany due to domestic rather than foreign influences. Temin & Eichengreen (1992) link the gold standard to deflationary policies adopted by various central banks, while either neglecting or denying any general reserve constraint. In any case, the commitment to the gold standard was so strong that it endured evident signs of economic distress in key countries, each of whom contributed in their own right to the full extent of the worldwide contraction and eventual recovery.

The literature identifies other possible structural sources of distress during the twenties than the gold standard. Temin (1976, p. 173; 1989) mentions various problems left by the First World War, including new political borders disrupting economic integration, war reparations and overcapacity in some sectors such as agriculture and heavy industry. Eichengreen (1992b, pp. 214-221) identifies three sources of instability arising from the changes in the economic structure during the First World War and the twenties. Firstly, one issue was the change in the composition of production. For example, the decline of the staple trades (iron and steel, coal, textiles and shipbuilding) and the rise of new industries in the UK (chemicals, electrical engineering, motor vehicles), increased the vulnerability to cyclical instability. Also the growing importance of credit instalments of the consumer durables debt in households' expenses can be linked to a heightened cyclical sensitivity. When income turned down, as in 1929, a small increase in the risk of job loss could act as a deterrent to households entering into new instalment contracts or an incentive to reduce other forms of spending so as not to miss a payment and risk repossession. Secondly, the labour market was affected by collective bargaining that restricted the downward flexibility of wages, while the generous unemployment benefits raised the natural rate of unemployment. Finally, the pattern of international settlements was affected by the deterioration in the competitive position of European exports, the payment of principal and interest on Germany's war debts that passed on from Western Europe to the US, the transformation of the US from a net foreign debtor to a net foreign creditor and the corresponding fact that New York surpassed London as the leading international financial centre. And linked to this last argument, Kindleberger (1973) adds the inexperience and insularity of the new potential hegemon, the US, and the ineffective cooperation among central banks that left no one able to take responsibility for the system as a whole. These trends increased the dependence of the global commercial and financial system on continued lending by the US, so that any interruption of lending would force severe dislocations to the borrowers.

In this chapter we address the fall of the gold standard ideology during the twenties and its rapid collapse during 1929-1933. In doing this, we discuss briefly the role of the US, the UK, France and Germany and contrast the evolution of the system in those countries with the fast departure from ABU. The underlying idea is to verify how vulnerable ABU were to the inaction that many governments suffered from in spite of the evident deflationary forces. We also focus on the kind of monetary and exchange rate policies that replaced the gold standard orthodoxy.

i. The role of the core countries

The US monetary policy has been blamed for the severity of the Great Depression. As explained by Clavin (2000, pp. 96-97), the Federal Reserve disregarded international considerations, the rules of the gold standard and the principles underpinning central banking cooperation. Ahamed (2009) remembers that the Central Bank cooperation until 1928 rested on the precarious footing of the personal sympathies and similar views among the Governor of the Bank of England, Montagu Norman, the President of the Reichsbank of Germany, Hjalmar Schacht and Benjamin Strong, Governor of the Federal Reserve Bank of New York, who shared the same fear of inflation and the same common vision that the solution was to return to the gold standard. James (2001, p. 35-37) adds that when Strong passed away in October 1928, his successor, George Harrison, could not gather the same loyalty from his European colleagues. In this regard, the classic book written by Friedman & Schwartz (2008, p. 232) gives a major causal role to the US monetary policy for the Great Depression worldwide and argues that one contributing factor to this outcome was Strong's death, a man who left a power vacuum at the Federal Reserve and was replaced by a team less open to intervention[426]. The Federal Reserve contributed to the contraction because it wanted to increase its gold reserves[427]. For that purpose it increased the discount rate to 5% in July 1928, and to 6% in September and October 1929, the highest since 1921. After the crash the discount rate was reduced to 4.5% and then, in a series of steps, to

[426] However, Temin (1989, p. 35) completely disregards this argument on the grounds that Strong was a believer in the gold standard, and nothing would have changed if he was alive.
[427] Ibid., p. 289.

1.5% by April 1931, but it was too late[428]. Although the New York Federal Reserve Bank purchased securities to provide cash, this was quickly withdrawn and no further open market operations were conducted[429]. When the depression deepened, the Federal Reserve Board failed to pump money into the banking system after October 1930 to offset 'hoarding' by the banks and the public[430]. When Britain was forced off the gold standard and investors feared that the US would devalue as well, the Federal Reserve again deliberately contracted the money supply and raised interest rates in September 1931[431].

The monetary view of Friedman & Schwartz is contended in literature by many authors, with the classic debate being with Temin (1976, p. 169), who stresses an autonomous decline in expenditure and observes money supply adjusting passively to the falling demand. Furthermore, Temin holds that there is no evidence of any effective deflationary pressure between the stock-market crash in October 1929 and the British abandonment of the gold standard in September 1931. If that were the case, the deflationary monetary pressure should have been visible in the financial markets, but actually short-term interest rates declined steadily during September 1929-October 1931. Following Skidelsky (2009, p. 68), the Keynesian version is that private investment and consumption fell because of the collapse of the construction industry and the Wall Street crash. While construction declined because the supply of housing exceeded demand after 1925, consumption fell in response to the stock market crash. The depression was severe because the fall in private spending was not offset by an increase in public spending. And Fremling (1985) rules out the possibility that the US could have prevented or mitigated the worldwide depression through appropriate monetary policies. In spite of this debate, the fact is that as a consequence of the high interest rates, capital exports began to fall steeply from the US, reducing in this way a key source of growth for the rest of the world during the twenties. As capital was mobile and exchange rates were fixed, higher interest rates in the US meant higher interest rates in the rest of the world as a result of interest arbitrage. Consequently, the restrictive turn in monetary policy in the US during 1928-1929 provoked an even more restrictive turn in monetary policy elsewhere, especially in Latin America and Europe. As a consequence, Canada, Germany, Argentina, Australia, Brazil and Poland contracted before the US. The one factor that insulated US economic activity from the effects of higher Federal Reserve discount rates, namely the reversal of US capital exports, further explains why other countries began to contract before the US. In addition, the contraction of the American demand, the release of the accumulated stocks and the fall of the American price levels, especially in agricultural products, led the way to the decline of world prices. The fall in US trade during the Great Depression had a big impact because of its significant share in worldwide trade and capital flows. The withdrawal of American capital and the effect on international trade of the diminished purchasing power of the US and the primary producing countries (as the case of

[428] US Discount Rates, Federal Reserve Bank of New York from www.nber.org, page visited in October 2012. Other authors such as Almunia et al. (2009, pp. 12-13) point out that during the Great Depression a liquidity trap emerged, so that diminishing interest rates did not stimulate the economy any more.
[429] See Smiley (2002, p. 64).
[430] See Skidelsky (2010, p. 68).
[431] See Romer (2003).

Latin American countries), combined with the fall in world prices, in turn, contributed to a path of depressions of the European industrial countries which further decreased the demand for goods produced elsewhere and depressed wholesale prices and world trade. Many countries resorted to isolationist policies, which added to the initial cumulative depressions and contractive monetary policies, resulting in an unprecedented decline in world economic activity[432]. A view from the South is given by Raúl Prebisch, who points out that the depression was aggravated because there was a basic blockade in the global economic system: the US had replaced the UK as the main creditor, but its high tariffs did not allow debtor countries to pay their debts to that country with exports. As a consequence, the rest of the world sent to the US gold that was not recycled in the international financial system[433].

Turning to France, this country is remembered for two outstanding facts. On the one hand, the depression was delayed in France. The franc was undervalued as it had returned to the gold standard on a very low parity in 1928 and held large gold reserves that provided a comfortable position. Thus, its industrial production did not recede until 1931, when the contraction of world trade, a rigid deflationary internal policy and the successive depreciations of the pound and the dollar combined to depress the French economy. In 1931 agricultural producer prices were falling rapidly, hurting the key agricultural sector and turning the farmers into the main victims of the crisis. The devaluation of the pound sterling in September 1931 had economic repercussions throughout the world as the gold prices of raw materials began to drop once again, after a significant lull. Then, in 1933, the devaluation of the dollar and other currencies also placed the franc and other currencies in an exposed position. For the first time since the war, French prices were higher by about 20% than English prices and those of other countries, so that foreign trade was damaged[434]. Eventually those forces finally affected France, which was among the last of the more developed countries in feeling the effects of the world slump. On the other hand, the French monetary policy has been pointed to as a reinforcing factor in the deflationary forces. Indeed, France became a destination for the world's gold, along with the US. Clavin (2000, p. 97) affirms that the monetary policy did matter, because it enabled a rapid accumulation of gold without a compensating loosening monetary policy. Eichengreen (1990, pp. 108-109) adds that among the various channels through which France influenced gold inflows, the absence of open market operations was the key, and this occurred because the Bank of France was precluded from conducting open market purchases by its statutes. According to Johnson (1997, p. 186), these legal constraints reflected memories of the inflation associated with the 1924-26 collapse of the franc as well as the political clout of rentiers, small farmers, and even industrial workers. However, there are other views. For example, Johnson (1997, p. 178) considers that whereas the post-stabilization capital inflows to Germany and Britain were induced by high interest rates, the subsequent flow to France was spontaneous, a result of an

[432] Many researchers have analysed the sequence of events that led to the transmission of the crisis from the US to the world. For example, Arndt (1944), Bernanke & James (2000), Eichengreen (1992), Eichengreen & Portes (1987), Eichengreen & Temin (2000), Eichengreen (1992b), Eichengreen (2004), Kindleberger (1973), Smiley (2002) and Rothermund (1996).
[433] See González & Pollock (1991, p. 462).
[434] See Sauvy (1969, pp. 22-24) and Rothermund (1996, p. 70).

attractive investment climate consequent upon low taxes and an undervalued currency. And Rothermund (1996, p. 70) affirms that the inflow of gold into France was paralleled by a 40% increase in the circulation of banknotes between 1928 and 1931. While the United States, Great Britain and Germany were in the grip of deflation, France enjoyed a stimulating inflationary trend.

In any case, the US and France had a key role in the gold standard's asymmetry between surplus and deficit countries because they were prone to accumulate gold indefinitely without the incentive to expand domestic supplies and inflate[435]. Thus, both countries received a massive influx of gold and accumulated around 60% of the available gold worldwide[436]. And this trend entailed a high risk, not only because the sterilized gold inflows in the US and France meant a deflationary shock for the rest of the world, but also because other countries were forced to use the available foreign exchange as reserve. Whenever the commitment of the reserve core countries (the US, the UK and France) to convert their currency into a fixed parity of gold was put to the question, the rest of the world would be negatively affected by a vicious circle of deflationary policies as many countries would sell their foreign exchange into gold to protect themselves from a the massive outflow of gold and to remain in the gold standard[437].

Germany's slide into depression began as early as 1928, and many historians believe that the causes of the decline were mostly domestic. A key weakness was the dependence of Chancellor Hermann Müller's government on foreign loans to finance its expenditures. The decline in foreign investment meant that state, regional and municipal budget deficits began to grow at an alarming rate. By 1929 key local governments, including Berlin and Cologne, were facing bankruptcy. In this context, a run on the Deutsche mark and a drain on gold in June and July of 1931 unfolded[438]. The run on deposits took the form of withdrawals across exchanges and the rapid depletion of the Central Bank's international reserves[439]. The reserve ratio of German banks fell sharply as depositors withdrew money from banks. The reduction was concentrated almost entirely in the six great Berlin banks, who sold short-term bills to the Reichsbank to replenish their reserves[440].

The origin of this crisis is a matter of debate. On May 11th 1931 it became public that the Bank Vienna Credit Anstalt failed to publish its annual accounts, and that the Austrian government was forced to guarantee the deposits of the ailing bank, placing the convertibility promise in doubt[441]. This failure initiated a banking panic that spread to the neighbouring German financial

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[435] Bernanke (2008) and Temin (1993), among others, agree on the significance of this characteristic of the gold standard in the downturn.
[436] See Temin (1989, p. 20).
[437] See Irwin (2012, pp. 7-8).
[438] Many authors have addressed the experience of Germany during the Great Depression and its role in European depression. Among them Ferguson & Temin (2001), Temin (2008, 1989), Clavin (2000), Kindleberger (1973), James (1992) and Hardach (1976).
[439] See James (1992, p. 601).
[440] See Temin (1989, p. 94).
[441] See Wolf & Yousef (2006, p. 10). International politics also played a role. It is widely maintained that the Austrian Credit Anstalt closed its doors as a consequence of French withdrawals of credits as a punishment for

system, as well as to Hungary, Czechoslovakia, Romania and Poland[442]. However, James (1992, p. 595) argues that the extent of German financial involvement in Austria was very limited, and it would be impossible to argue that the Austrian developments directly weakened German institutions. He asserts that the German weaknesses and difficulties in the sphere of public finance and the structural weakness and unsoundness of the local banks played a significant role in the crisis because it led to a general loss of confidence in financial markets[443]. Following Ferguson & Temin (2001), in the first half of 1931 the expectations were that Germany's chronic budget deficits would be monetized. These expectations led to a currency crisis and deposit withdrawals on May and June of that year. Another contributing factor pointed out by James (1984, p. 71) is the enactment by the government on June 5th of an Emergency Decree which imposed new privations, including higher consumption taxes and civil service wages and social benefit reductions that dragged down demand. For this reason contemporaries refer to the German Premier Brüning as the 'Hunger Chancellor'. Furthermore, authors such as Temin (2008, pp. 14-15) and Clavin (2000, pp. 124-125), among others, link the crisis of confidence to the government's *Tributaufruf* statement on June 6th 1931 indicating that Germany was using the 'last power of reserves (...) to tell the world: the limits of privations we have imposed upon our people have been reached'. The statement raised questions about Germany's ability to pay off its overseas debts and drastically undermined creditor confidence. In addition, the monetary authorities hesitated to undertake expansionary policy to counteract the economic slowdown or to devalue, in spite of the deteriorating economic situation[444].

There were two strong elements preventing the Germans from devaluing. On the one hand, any devaluation would have devastating balance sheet effects on the public finances because the reparations agreement fixed its obligation in dollars of constant gold content. But probably more influential was the perception that the memories of hyperinflation could unleash collective hysteria in case of abandonment of the gold standard. Hence to limit losses of gold and foreign exchange reserves, Germany imposed controls that affected capital movements as well as trade finance[445]. And this decision not only deepened the economic downturn, but also proved to have a profound impact on the future of Germany and Europe, as the political turmoil deteriorated. After the elections of September 1930, the strong electoral performance of the Nazi and Communist parties deprived the Brüning regime of any hope of parliamentary support. As Clavin (2000, p. 94) recalls, despite domestic causes of the downturn after 1930, in the eyes of the German public, internationalism and reparations were responsible for the crisis. The

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the proposed Austrian-German customs union, which France objected on the grounds that it was contrary to the Treaty of Versailles. See Kindleberger (1973, pp. 149-150).

[442] See for example James (2001, pp. 51-63) and Kindleberger (1973, pp. 152-153). With this background, Bernanke & James (2000, p. 96) concludes that the European financial crisis was at least partially independent of American developments.

[443] See James (1984, p. 71). However, Temin (2008, p. 16) disagrees with James. In his view, the German crisis was a simple currency crisis, caused by government policies incompatible with the fixed exchange rate, and not by any actions of German banks.

[444] See Romer (2003, p. 5).

[445] See Eichengreen & Irwin (1995, p. 10).

deteriorating economy only fuelled the increasing support of political extremists, notably Adolf Hitler, that eventually led to the collapse of the Weimar Republic.

The contagion in continental Europe reached the UK two months later, although in this case there were also internal conditions that made it vulnerable. During the twenties, British economic progress was not commensurate with that of other advanced industrial countries. The UK returned to the gold standard at the old parity in 1925, but it was unable to generate the pre-war income from foreign investments, so that it was increasingly hard to cover the cost of imports when demand was high. Thus, the Bank of England's interest rate had to be raised to attract short-term capital and retain its gold reserves, subordinating in this way the domestic market to the maintenance of the gold standard. Meanwhile, the social situation deteriorated as unemployment and civil strife prompted strikes as early as 1926. Thus, the UK was already in a weak position when the German banking crisis of 1930 spread and added to the worldwide downturn after 1929. In July 1931, a flight from sterling began, in what Temin (1993, p. 93) describes as a financial panic that did not know national boundaries. Financial pressure spread to Britain as trade credits extended to Germany by British merchant banks were frozen. The British depositors lost faith in their banks and currency. Previous increases in interest rates could not prevent gold losses, and the rising unemployment made the Bank of England reluctant to raise interest rates further. As a consequence, the need for intervention by a lender of last resort became an unavoidable decision[446]. The British government did not defend the pound through budgetary retrenchment either[447]. Finally, on September 19th 1931, the UK abandoned the gold standard and allowed sterling to depreciate, in a move that had worldwide repercussions.

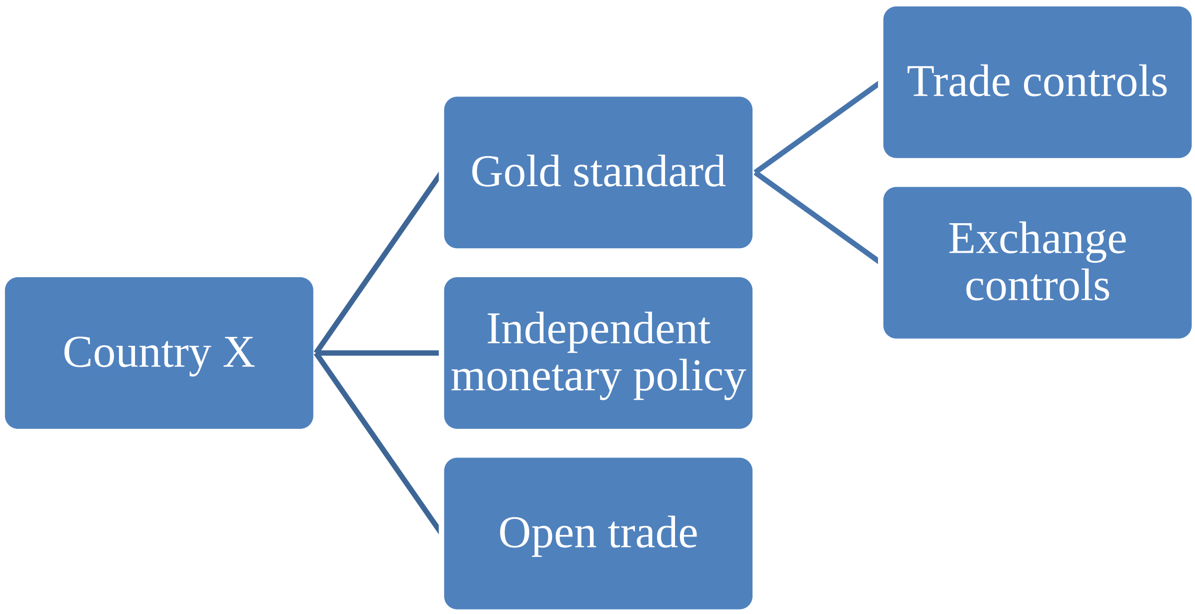
In order to understand the difficult choices that the policymakers worldwide had to deal with after the British departure from gold, we have to return to the role of the gold standard. Recalling Temin (1993, pp. 89-90), the Great Depression was transmitted internationally by a gold standard ideology, a mentality which decreed that external balance was the priority and that the speculation beneath the booming stock market in New York was dangerous. Following the reasoning of Irwin (2012, pp. 43-46) illustrated in Figure 19, in the first place the countries under the gold standard faced a difficult trilemma of economic policies in maintaining the gold standard parity, independent monetary policy and open trade. And taking the words of Krugman (1999, p. 61): "the iron law of international finance is that countries can achieve at most two of the three". In turn, for the countries that remained under the gold standard, there was another difficult choice between abandoning the convertibility by imposing exchange controls, as most Latin American countries and Germany did, or maintaining the convertibility but imposing trade controls as the gold bloc did.

Every country had to make a 'golden' choice after Britain's abandonment of gold between abandoning the gold parity, as the sterling bloc did in 1931, or not. As gold began to flow back

[446] See Eichengreen & Irwin (1995, p. 10).
[447] See Obstfeld & Taylor (2004, p. 137).

to the UK, many countries were forced to impose exchange controls or to devalue to curtail the outflow of the precious metal. Within days, countries such as Denmark, Finland, Japan, Norway and Sweden allowed their currencies to depreciate relative to gold. It was the beginning of a worldwide war of competitive devaluations. According to Eichengreen (1992b, p. 233), currency depreciation in the thirties was 'beggar thy neighbour' because shifting demand towards the products of domestic industry satisfied their growing demands for money and credit by importing gold and capital from abroad. Their reserve gains were reserve losses for countries still on gold. During September - October 1931 exchange controls were imposed by several countries such as Argentina, Austria, Bolivia, Colombia, Czechoslovakia, Greece, Iceland, Uruguay and Yugoslavia[448]. Although Germany did not devalue, the free purchase and sale of currency that was the hallmark of the gold standard was no longer allowed. The government continued to speak of Germany as being on the gold standard because the mark was maintained at parity, even though currency controls violated the fundamental activity of the gold standard and made the maintenance of parity a purely administrative matter[449]. The US became the outstanding international short-term debtor left on the gold standard. It faced the threat of a withdrawal of deposits and the dollar was vulnerable to attack in a similar way to in continental Europe[450].

Figure 19 Trilemma of economic policies and the gold standard parity

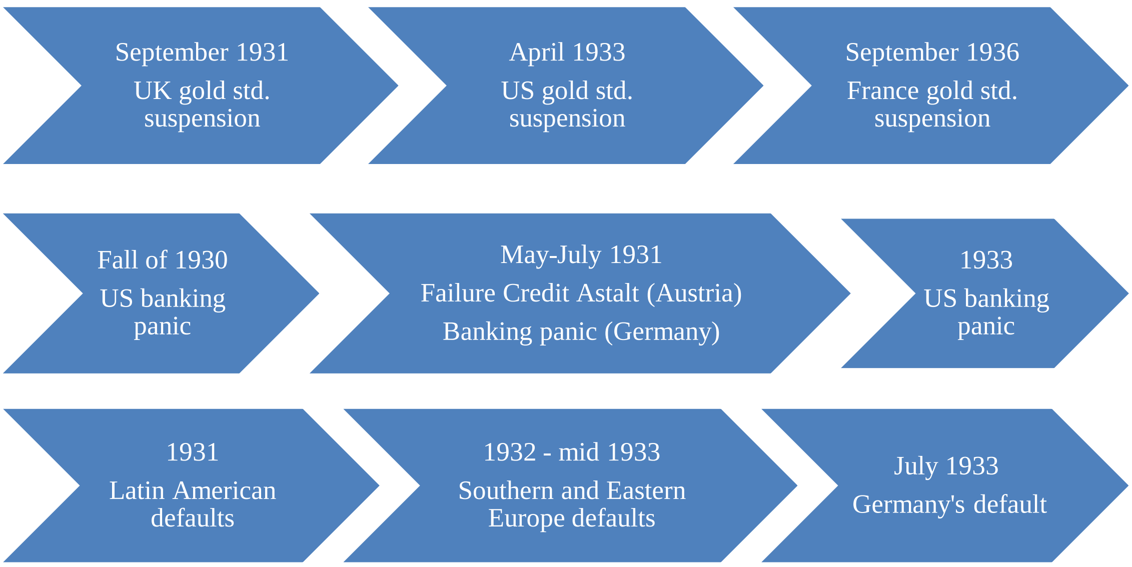


[448] See Gordon (1941, pp. 54-55). The British depreciation was almost universally viewed as a policy failure. Regarding this, Kindleberger (1973) affirms that Britain's devaluation was bad for the rest of the world, whether it helped Britain itself or not. Temin (1989, p. 74) considers that it was a limited policy success because it improved the trade balance and provided a stimulus to domestic production.
[449] See Eichengreen & Temin (2000, p. 203).
[450] See James (1992, p. 603).

It was in the end politics that broke the gold resilience. The electorate voted in November 1932 for a candidate that did not sound at all like a gold standard fanatic. Roosevelt fulfilled his mandate by abandoning gold shortly after taking office in March 1933 and then reaffirmed this decision at the London World Economic Conference in July[451]. For the French, there was a strong association of national pride with the maintenance of the gold standard. They claimed that sound money and fiscal austerity was necessary to keep economic stability[452]. Officials even blamed the depression on the failure of other countries to embrace the gold standard mentality. The Federal Reserve Board and the Bank of England, it was alleged, had succumbed to the lure of managed money. Having refused to obey the rules of the gold standard, they had committed 'abuses of credit'. Not surprisingly, only after the election of 1936 that brought to power the Popular Front, France ruled out deflation[453]. Given the choices made by different countries, it is possible to affirm that international exchange patterns during the thirties were consistent with four currency blocs: the sterling area; a group of inconvertible currencies tied to the German Reichsmark; a group that never joined or left the gold standard at various points, including Spain (never on the gold standard), Argentina and Australia (formally delinked from gold in December 1929), Canada (October 1931), Japan (December 1931) and the United States (April 1933); and a residual gold bloc, of which Belgium, France, the Netherlands and Switzerland were the last remaining on the gold standard[454].

In Figure 20 we summarize a sequence of outstanding landmarks of the Great Depression, including the parallel processes of the suspension of the gold standard, the banking crises and the defaults of the foreign debts that allowed countries to deal with imbalances and eventually led to the recovery.

Figure 20 Gold standard, banking panics and debt defaults



451 See Eichengreen & Temin (2000, p. 205).
452 See Bernanke & James (2000, pp. 16-17).
453 See Eichengreen & Temin (2000, pp. 195-196).
454 See Eichengreen & Irwin (1995), Griffiths (1987), and Arndt (1944), among others.

The world economy could only recover when the contraction policies of the gold standard were abandoned. Moreover, as concluded by Choudhri & Kochin (1980) and Eichengreen & Sachs (1985), among others, the sequence of abandonment determined the timing of recovery. Those countries that operated on fixed exchange rates suffered a severe contraction in both output and prices; those which were not in the gold standard and maintained a flexible exchange rate system such as Spain, virtually escaped the Great Depression; and those that allowed their exchange rate to float in the middle of the depression, also enjoyed greater independence in relation to the fixed exchange rate countries. Many countries were also forced to default on their foreign debt, due to the drought of foreign loans and the collapse of tax revenues from foreign trade. The defaults unfolded in three stages: the first in 1931 by mostly Latin American countries, a second stage from 1932 to the middle of 1933 throughout Southern and Eastern Europe, and the third coincided with the Monetary and Economic Conference of 1933, with Germany's default notorious[455]. The previously-analysed banking panics in many countries were also a natural outcome of the Great Depression that contributed to the demise of the gold standard.

ii. Argentina, Brazil and Uruguay, leading the flight

As we have seen, each country had to face the difficult trilemma of economic policies in maintaining the gold standard parity, independent monetary policy and open trade. In this section we see how ABU chose their way out of the gold standard.

Devaluation, depletion of foreign reserves and exchange control

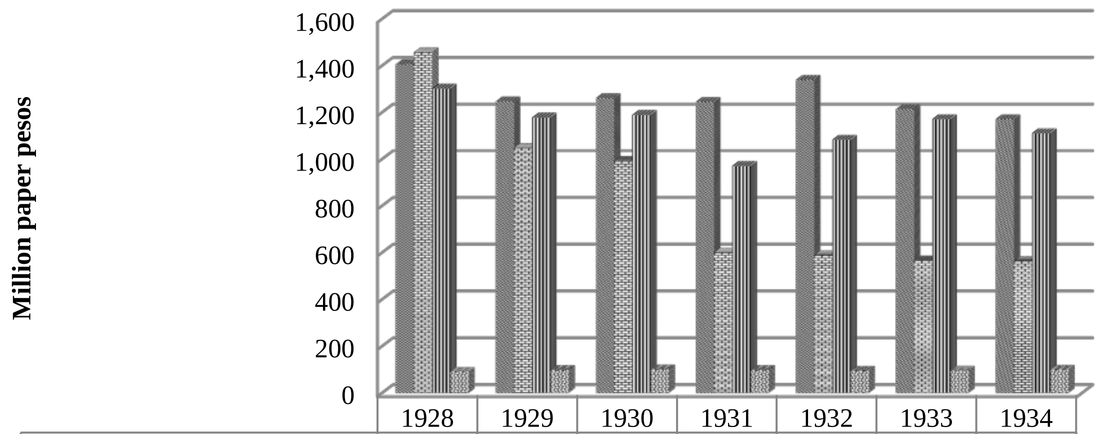
As mentioned before, during the period 1928-1929 Argentina was suffering from the outflows of capitals -fundamentally due to an US tighter monetary policy- and therefore, because of the fact that Argentina was in the gold standard since 1927, an important exodus of gold occurred. According to figures taken from the League of Nations' yearbook (1935), as Figure 21 details, whilst in 1928 the gold stock (in Conversion Office and banks) was the equivalent of 1,457 million paper pesos, in 1930 it was around 30% lower. And during the period 1931-1934 that figure was around 60% lower. This scenario is not a surprise because the government proceeded to close the *Caja de Conversión* (Currency Board) in December 1929, with the subsequent suspension of the gold standard and also stopped defending the value of the peso by means of intervening in the foreign exchange market. However, gold reserves continued to fall in part because the government withdrew gold to pay its foreign debt. These measures were taken during the second half of 1929, just after the collapse of the Wall Street Stock Exchange. When the crisis started to bite, exports decreased, imports did not decrease, capital outflows continued and government expenditures increased. As a consequence, the Argentine peso started to depreciate, prompting a potentially severe exchange rate crisis. And probably if the government had not decided on the closure of the Currency Board, the depreciation of the peso would have been much worse. Along with this situation, it is also possible to appreciate the money supply

[455] See Eichengreen & Portes (1990, p. 74).

contraction through the decrease in the note circulation, but this fall was mild in comparison with international standards because of, as we will see, the active polices implemented by the government. The notes in circulation (state notes) by the public and banks, were 11% lower in 1929 than in 1928 and 17% lower by 1934. Also, deposits in current accounts decreased around 25% from 1928 to their lowest point in 1931, starting to increase in 1932 and to decline again in 1934. As Figure 21 shows, bank savings deposits remained quite stable in the period of analysis at around 95 to 100 million pesos reaching their lowest point in 1932.

With regard to changes in interest rates, in this context they increased due to gold outflows and the depreciation of the peso. For example, according to della Paolera & Taylor (1999, p. 570) during 1928-1932 the bank's discount rates increased from 6.3% to 7.1%. And according to figures from the League of Nations (1936b, p. 260) for the same period, the yields on government bonds increased from 6.08% to 7.15%. However, from their peak in 1932, interest rates started to decline. For example, in 1933 the bank's discount rate was 6.1%.

Figure 21 Argentina: The money supply



	1928	1929	1930	1931	1932	1933	1934
Note circulation	1,406	1,247	1,261	1,245	1,339	1,214	1,171
Gold stock	1,457	1,048	991	600	589	566	564
Deposits in commercial banks	1,302	1,178	1,189	971	1,083	1,171	1,111
Saving bank deposits	90	97	100	97	94	95	99

Source: compiled from Statistical yearbook of the League of Nations 1934/35 (1935) from official budgetary documents. Economic Intelligence Service. Geneva. Notes: a) note circulation by public and banks; b) gold stock in Conversion Office and banks; c) deposits in commercial banks make reference to the deposits in the most important domestic banks, including the *Banco de la Nación*, and Argentine branches of foreign banks representing in all about 95% of total deposits in 1925; current accounts exclude inter-bank deposits; and d) P.O. (post office) savings only.

After taking information from the League of Nations' yearbook (1934, p. 201) the peso depreciated in relation to gold in November 1929 when the value of the paper peso reached 98.6% of its gold parity (2.27 paper pesos = 1 gold peso)[456]. In addition, as Table 65 shows, in December 1930, one year after the closure of the Currency Board, the peso had depreciated around 16% against the pound sterling and the dollar relative to 1928. However, in 1931 the world suffered a significant banking crisis originating in Europe, and when in September of that year the UK suspended the gold standard and the sterling depreciated (as well as the currencies

[456] See League of Nations (1934b, p. 201).

of the members of the British Empire as the main competitors of Argentina), the depreciation of the peso was higher, 35% and 46.5% respectively, using the same base year. Thus, part of the frozen funds of the Currency Board was used by the government to intervene in the foreign exchange market to avoid the growing depreciation of the peso**.** In this scenario, Argentina took a transcendental measure whose effects lasted for the next fifty years[457]: the imposition of exchange control in October 1931. It did so a few months after Uruguay and almost two years after the Brazilian temporary exchange control of January 1930 that lasted until the end of the First Republic in October that year.

Table 65 Argentina: Peso quotations in pounds and US dollars

Year	**Pesos per pound**			**Pesos per dollar**		
1928	11.500			2.358		
1929	11.600			2.391		
1930	13.300			2.738		
1931	15.500			3.455		
1932	13.700			3.886		
1933	13.400			3.233		
1934	**Average ask**	**Average bid**	**Free market**	**Average ask**	**Average bid**	**Free market**
	15.500	17.600	19.900	3.075	3.494	3.953

Source: Balboa (1972, p. 159-160) [458].

At first, the exchange control was an improvised system and although nobody knew how long this policy could last, it proved at least temporarily successful. Since by mid-1932 the balance of payments deficit had been eliminated and the frozen pesos partly financed the government or eased the credit shortage in the financial system. But then, in November 1933, just after the suspension of the gold standard and devaluation in the US, Minister Pinedo reformed the system in order to comply with the Roca-Runciman Treaty and searching for a rapid recovery for the Argentine economy. The reform not only was aimed at ensuring funds for the British remittances and to divert trade to the UK[459], but also at guaranteeing prices to producers, among others.

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[457] Argentina implemented exchange control during 1931-1981 applying over time several modifications. For more detailed information about the Argentine exchange rate policy see Fundación de Investigaciones Económicas Latinoamericanas (1989).

[458] Until the imposition of the exchange control the quotations are from the Buenos Aires market; later and until 1933 averages are obtained from official quotations. Since 1934 the quotations of the free market established in December 1933 and the average buying (ask) and selling (bid) rates from the official market are added. During the periods that multiple buying and selling rates existed, a weighted average was taken according to the foreign currency amount that was negotiated at each rate. It is important to note that to calculate this average the exchange rate negotiated in the transaction and not the daily exchange rate was taken into account (Balboa, 1972, p. 172).

[459] As a result of this treaty, British gains were achieved at the expense of US exporters (as well as Japanese and Italian exporters) rather than Argentine manufacturers. One can note the latter in the fast rate of growth of

The exchange control allowed the government to take advantage of the differences between buying and selling rates in the official market so that it could manipulate foreign trade and fiscal revenues at the same time. An important consequence of the reform of the system of exchange control in 1933 was that the discriminatory allocation of scarce foreign currency combined with high tariffs prompted an increase in transaction costs for importers. Hence, following the line of reasoning of Rock (1991, p. 26), many US exporters decided to set up operations in Buenos Aires, so that a welcome effect of these policies was the attraction of foreign direct investment (fundamentally from the US), which encouraged import substituting activities[460]. Certainly, the US investment was making rapid headway in Latin American countries, and in the case of Argentina the main investments were in chemicals, pharmaceutical industries[461] and textiles.

In 1932, according to Table 65 and as a response to the implementation of the exchange control, the peso started to appreciate against the pound but without reaching the level of 1928. Nevertheless, it continued depreciating against the dollar until 1933. Given that the US was the main supplier of Argentina, this situation meant high costs for the economy. Then, in 1933, when the US devalued in April of that year, in average terms, the peso appreciated against the dollar and the pound and in November the government decided to devalue. As Rock (1991, p. 20) argues, this devaluation was an effort to promote exports and help farmers. In December 1933 as a product of the introduced modifications to the exchange control system a free market was established. Table 65 shows the quotations in the free and official markets for 1934 due to the introduction of a dual exchange rate system.

The devaluation boosted grain exports and during following years triggered inflation[462]. Certainly, this devaluation maintained purchasing power because of its positive effect on export and import competing activities and by reversing the falling trend in domestic price levels during the period 1930-1933, a situation that had transferred income away from entrepreneurs with net debtor positions[463]. And, since the devaluation generated unexpected profits for exporters, the government appropriated a portion of it, Minister Pinedo declaring as much in a congressional debate. However, the original bounty did not last long, because once the exchange was established, domestic prices continued to increase to the point that the income vanished and the exchange differential (and later export taxes) came to amount to a tax burden for the export sector[464].

In 1934, when signals of recovery started to appear, one can appreciate that in the free market the peso depreciated 48.5% against the pound relative to the previous year and 73% relative to 1928. This depreciation was much higher than in the official market. In the free market the

import-substituting industries, e.g. cotton textiles. More than 50% of Argentine imports from the UK were made up of textiles and carbon coke.

[460] See Díaz Alejandro (1970, p. 265).

[461] See Villanueva (1975, pp. 71-72).

[462] See Rock (1991, p. 25). The cost of living in Buenos Aires rose by about 25% from mid-1934 to mid-1936.

[463] For example, in comparison with the US, by 1934 the Argentine devaluation meant that domestic wholesale prices were a bit above their 1929 level whilst in the US the wholesale price index for all commodities in 1934 was more than 21% below its 1929 level (Díaz Alejandro, 1970, p. 96).

[464] See Cortés Conde (2009, p. 97).

depreciation of the peso against the dollar was less than against the pound, reaching 22% relative to 1933 but 67% in comparison with 1928. It was higher than the official market, too.

In Brazil, the underlying problem hanging over the economy was the exhaustion of the gold reserves, which forced extraordinary measures. From October 1929, the combined effect of a stronger fall in export receipts than in imports and the outflow of capital due to internal political instability and an external deteriorating economic situation forced the authorities to take drastic actions. Blaming the sudden drain of gold on the excess of imports and on the desire of the foreign banks to create obstacles, the government increased tariffs, contracted debt with the *Banco do Brasil* and prohibited the foreign banks to overdraw from their headquarters. The prohibition on foreign banks forced their local branches to operate only with their own local capital and deposits, without the support of their headquarters abroad. Hence, credit extended by those international banks inside Brazil contracted and the already high interest rates soared[465]. In January 1930, the Ministry of Finance introduced temporarily an exchange control and the *Caixa de Estabilização* allowed the outflow of gold, which continued to run away from the country until March 1930, hence contracting the monetary base and fostering the deflationary pressures in the economy[466]. Table 66 illustrates the striking collapse of the country's gold reserves, which fell from 150 million dollars in 1929 to 11 million in 1930 and went depleted during 1931-1933. This trend tends to confirm the thesis of Franco (1985, p. 403), who asserts that the depreciation of the currency and the exchange control was more a consequence of the drain on the foreign reserves than a conscious innovative policy.

Table 66 Brazil: Central monetary gold reserves (million US dollars)

	1928	1929	1930	1931	1932	1933	1934
Brazil	149	150	11	-	-	-	4

Source: League of Nations Statistical Yearbook 1935.

In any case, Brazil was the first of our three country cases to establish exchange control, a feature that can be linked to the commitment of the Luís administration to the gold standard rationale and the fact that this country was the weakest in terms of gold reserves. It also needed to secure economic stability to win the elections of 1930 and to ensure the transmission of the executive power to President-elect Júlio Prestes. However, under the pressure of vanishing gold in spite of the exchange control, one of the last measures taken by President Luís was to abandon the gold standard in practice in October 1930, a year after Argentina did so. This measure became official with the closing of the *Caixa de Estabilização* on November 22nd 1930 by the new revolutionary government[467]. A few days later, with the foreign reserves almost depleted, the *Banco do Brasil* retired itself from the exchange market on December 7th 1930 in order to save what was left of them and convertibility was suspended.

[465] See Salgado Guimarães et al. (1982, p. 56).
[466] See Fritsch (1988, p. 156).
[467] See Smith (1934). However, according to the League of Nations (1933c, p. 265), for Brazil "the gold standard has not been legally established since the war".

The immediate consequence was the devaluation of the Brazilian currency, in a trend that became the main adjustment variable of the Brazilian economy to face its external imbalances[468]. During 1930 and 1931 the Brazilian currency in terms of milréis per US dollar was devalued by 10.2% in 1930 and 52.4% in 1931, as can be seen in Table 67. The behaviour in relation to the British pound is similar, except for the strong revaluation of the milréis after the UK abandonment of the gold standard, followed by a similar move of the US dollar in 1933. The matter was also a political issue, used by the provisional administration. Indeed, Vargas blamed the decline of the exchange quotations on the Luís administration, because it allegedly exhausted the national credit, contracting loans which totalled £43,673,500 and $142,780,000 and squandered the reserves in remittances abroad of more than £33,000,000, thus weakening still more the country's economy. Furthermore, Luís was blamed for leaving uncovered exchange estimated at not less than £14,000,000, of which £11,000,000 went through the Exchange Department of the *Banco do Brasil*[469]. It is important to point out that the devaluation of the Brazilian currency was a trend shared with Argentina and Uruguay.

Table 67 Brazil: Exchange rate milréis per US dollar and British pound (1928-1934)

	1928	**1929**	**1930**	**1931**	**1932**	**1933**	**1934**
Milréis / dollar	8.35	8.47	9.33	14.23	14.04	12.56	11.87
Var %	-1.1	1.4	10.2	52.4	-1.3	-10.6	-5.5
Milréis / pound	40.67	41.16	45.36	64.59	49.28	53.25	59.81
Var %	-0.9	1.2	10.2	42.4	-23.7	8.0	12.3

Source: calculated from Lawrence H. Officer (2011).

Another important alteration to the Brazilian exchange occurred after the US abandonment of the gold standard in 1933. The country depended upon its sales of coffee to the US for the greater part of the exchange required for all its foreign commitments, and the amount of dollars it was obtaining for a given quantity of coffee was worth about two thirds in other currencies what it was worth previously. This juncture added to the fact that the price of coffee in dollars had fallen in the previous few months[470]. The Financial Times reported that the London market was taken by surprise by the news of November 14th, 1933, that the *Banco do Brazil* had pegged its official sight rate on London at 60 milréis to the pound sterling, a value slightly above the average rate recorded in previous months. This linking of the milréis to sterling was significant because the US was the principal market for coffee which still constituted over 70% of the total of Brazilian exports. With the sharp depreciation in the dollar, the *Banco do Brasil* adjusted this rate so as not to let the milréis follow the dollar plunge[471].

[468] See Abreu (1986, p. 52).

[469] Extracted from the speech of Mr. Getulio Vargas, Provisional President of the United States of Brazil, delivered on October 3rd 1931, in the first anniversary of the Revolution of 1930. Attached to note from the British Embassy, Mr. J. Garnett Lomax, to Sir Otto Niemeyer, dated 18th November, 1931, in FO 371-15064, p. 408.

[470] See note dated September 8th 1933, from the British Embassy to Foreign Office, signature not legible, in BT 11/157.

[471] See The Financial Times, November 15th 1933, in CRT 203/33, part of BT 11/157.

In Uruguay, the combination of international economic and politic turmoil, as well as the continuous fall in the international terms of trade contributed strongly to the persistent fall in the value of the peso, which accordingly forced the authorities to increasingly intervene in the economy. Exporters and cattle farmers were affected not only because of the fall in commodity prices, but also because of the overvalued official exchange rate applied to the proceeds from their exports in order to stop the depreciation of the Uruguayan currency.

Indeed, according to the data provided by Maubrigades (2003), Vaz (1984) and Nahum (2007) reproduced in Table 68, in 1930 the peso depreciated around 14% with respect to the dollar and the pound sterling. But in 1931 the authorities faced a serious exchange rate crisis, as the peso depreciated 85.3% against the dollar and 44.1% against the pound, with the difference possibly a result of the British abandonment of the gold standard that year. In 1933 there was a significant appreciation of the peso against the dollar due to the US devaluation. Then, by 1934, most of the Uruguayan main trading partners or competitors had depreciated or devalued their currencies, including Argentina, the US, the UK and the whole British Empire, among others. The Uruguayan response could not possibly be other than to devalue, so that the peso lost ground in relation to the dollar around 44%. As a matter of fact, the depreciation of the national currency was a policy shared one way or another with Argentina and Brazil, although the fall of the Uruguayan peso was the most significant.

However, by mid-1931, the continuous fall of export prices which affected roughly one-fourth of meat and one-fifth of wool export receipts, along with an increase by one-fifth in import expenses and the foreign debt obligations, determined the biggest foreign imbalance since 1920. The consequence was a deep fall in the value of the peso of 65% during July-August 1931 and the last resort was the export of BROU's gold for a value of 5 million pesos[472]. Eduardo Acevedo described the events as 'panic' because of the people's fear of having to buy foreign exchange at higher exchange rates. In other words, there was a run on the currency, and the government had to stop it.

Table 68 Uruguay: Peso quotations in US dollars and pounds

	\$/USD	**Var %**	**\$/£**	**Var %**
1928	0.979		4.740	
1929	1.020	4.2	4.940	4.2
1930	1.160	13.7	5.670	14.8
1931	2.150	85.3	8.170	44.1
1932	2.110	-1.9	7.360	-9.9
1933	1.680	-20.4	6.980	-5.2
1934	2.413	43.6	6.370	-8.7

Source: average exchange rate dollar (ask and bid) from Maubrigades (2003) and Vaz (1984) and for pound sterling from Nahum (2007). Note: legal parity 4.70 gold pesos = 1 £ and 0.96 gold pesos = 1 USD.

[472] See Acevedo Álvarez (1934, pp. 83-97).

Regarding the terms of trade, in Table 69 we present a series that must be taken with care, because it is subject to several limitations already described in the “Introduction” of the thesis. The resulting series suggests that the country’s competitiveness fell during the first years of the Great Depression. In spite of the accentuating depreciation path of the peso, Uruguay was hit by an abrupt fall in the country’s terms of trade from 1929 to 1931. Not surprisingly, the worst year was 1931, when the British abandoned the gold standard and the terms of trade index fell 39%.

Table 69 Uruguay: Evolution of the terms of trade

	1929	1930	1931	1932	1933	1934
International terms of trade (1928=100)	96.2	81.1	61.0	68.2	86.4	106.1

Source: calculated from Bértola (1990, p. 140); base year was recalculated to 1928.

In relation to gold reserves, Uruguay managed during the twenties to overcome the scarcity of gold with new international debt issues, so that the international balance of payments remained relatively stable. Even, by mid-1928 the international financial situation had not significantly affected Uruguay and the country held significant gold reserves of 72 million dollars, equivalent of 9 months of imports[473]. However, the Great Depression provoked a scarcity of foreign currency that made it difficult to keep previous levels of income and consumption[474]. As mentioned, the trade surplus was reduced significantly during 1929 and in 1931 there was a trade deficit. After the remainder of the Hallgarten loan was gone, the peso started to depreciate during 1929. Thus, in this scenario, the government took advantage of the law of October 18th 1918 that allowed the BROU to dispose of the gold reserves in excess of 55 million pesos, and as it held gold reserves worth almost 70 million pesos, it used the difference to cover the 1929 foreign balance of payments deficit that amounted to 23 million pesos[475]. Although it is a distinctive characteristic of Uruguay that it did not run completely out of reserves, the downward trend of the Uruguayan gold reserves can be observed in Table 70, especially during the period 1928-1932. As we will analyse in detail, Uruguay nevertheless chose to apply an exchange control that was functional in September 1931.

Table 70 Uruguay: Central monetary gold reserves (millions of US dollars)

	1928	1929	1930	1931	1932	1933	1934
Gold reserves	72	68	61	53	48	50	48

Source: League of Nations Statistical Yearbook 1935, p. 240.

Now, comparing the performance of the three countries, Table 71 illustrates the demise of the gold standard through the fall of gold reserves. It is possible to appreciate that even though in the three countries there was a noticeable reduction in the central monetary reserves during 1930-1931, only in the case of Brazil were they depleted. This can be attributed to the stronger

473 Figures calculated from the League of Nations Yearbook (1935, p. 240).
474 See Damonte & Saráchaga (1971, p. 115).
475 See Acevedo Álvarez (1934, pp. 48-72).

allegiance of the Luís administration to the gold standard and the need of the Brazilian government to avoid a collapse before the failed Prestes' administration's inauguration.

Table 71 ABU: Central monetary gold reserves (million US dollars)

	1928	1929	1930	1931	1932	1933	1934
Argentina	473	405	411	252	248	238	238
Brazil	149	150	11	-	-	-	4
Uruguay	72	68	61	53	48	50	48

Source: League of Nations Statistical Yearbook 1935, p. 240.

On the contrary, for Argentina and Uruguay, the availability of a generous stock of gold was a matter of national pride and security more than a proof of their allegiance to the gold standard ideology. They were indeed constrained by the fact that their main trading partners and lenders were in principle committed to such a system, but for Argentina and Uruguay, a fast departure from the gold standard was not a taboo, it was just a necessary measure in light of the circumstances. For these countries, losing all foreign reserves was simply not an option to follow a declining ideology imposed from the core.

In this regard, it is relevant to point out the number of import months covered by the gold reserves as another indicator of the relative vulnerability of each country. As Table 72 shows, while Uruguayan reserves covered in 1928 roughly 9 months of imports, the Brazilian ones only 4 months. This suggests that from this point of view that Brazil was the most vulnerable and Uruguay the least.

Table 72 ABU: Gold reserves, average monthly imports and number of months in 1928 (million US dollars and number of months)

	Central monetary gold reserves (a)	Average monthly imports (b)	Number of months (a)/(b)
Argentina	473	67	7
Brazil	149	37	4
Uruguay	72	8	9

Source: Calculated from the League of Nations Statistical Yearbook 1935, p. 240, Figure 12, Table 42 and Table 43.

The fall of the gold standard can be also traced through the devaluation of the national currencies. All three countries witnessed a strong devaluation of their national currencies during 1930-1931, especially against the US dollar. However, the case of Uruguay is again interesting because in spite of the fact that it held significant foreign gold reserves, the reluctance of Uruguayan authorities to burn them is consistent with the strong path of currency devaluation. The Uruguayan peso suffered the stronger devaluations. Indeed, in Table 73, we see that especially in 1931, the devaluation of the Uruguayan peso triples the devaluation of the Argentine peso, and is more than 30% higher than the Brazilian milréis devaluation. And even though the Brazilian authorities ran out of foreign currency in 1930-1931, as a matter of fact, the Brazilian milréis actually revalued in 1932, in a similar way as in Uruguay. However, it is worth noting that, by contrast, while the Argentine devaluation of 1931 was the lowest of the three countries, in 1932 Argentina was the only of the three that devalued. Further, the instability of the Uruguayan peso continued strongly in 1934 and to a lesser extent in Argentina, influenced by the devaluation of November 1933 in the latter. Something similar could be said with regard to the exchange rates with the British pound, although the devaluations of the Brazilian and Uruguayan currencies are similar in 1931 (see Table 74). The appreciation of the currencies in 1933 against the US dollar is more a consequence of the departure from the gold standard of the US, rather than a sign of strength of ABU currencies. All in all, if the average annual devaluation during 1929-1934 is taken into account, it is quite clear that the Uruguayan peso fell on average much more than its neighbours, especially against the dollar. It is not the same case with regard to the British pound, but the devaluation against the dollar is more relevant because foreign trade was handled mainly in US dollars.

Table 73 ABU: Exchange rate variation - Local currency per US dollar

	1929	1930	1931	1932	1933	1934	Average 1929-1934
Argentina	1.4	14.5	26.2	12.5	-16.8	8.1	7.6
Brazil	1.4	10.2	52.4	-1.3	-10.6	-5.5	7.8
Uruguay	4.2	13.7	85.3	-1.9	-20.4	43.6	20.8

Sources: for Argentina, from Balboa (1972, pp. 159-160); for Brazil, calculated from Lawrence H. Officer (2011); and for Uruguay, from Maubrigades (2003) and Vaz (1984).

Table 74 ABU: Exchange rate variation - Local currency per British pound

	1929	1930	1931	1932	1933	1934	Average 1929-1934
Argentina	0.9	14.7	16.5	-11.6	-2.2	31.3	8.3
Brazil	1.2	10.2	42.4	-23.7	8	12.3	8.4
Uruguay	4.2	14.8	44.1	-9.9	-5.2	-8.7	6.6

Sources: for Argentina, Balboa (1972, pp. 159-160); for Brazil, calculated from Lawrence H. Officer (2011); and for Uruguay, average exchange sterling from Nahum (2007).

The closure of the Currency Board and exchange control in Argentina

By 1929 Argentina was under a currency board regime. Thus, due to the more attractive US interest rate, there was a significant gold flight in 1928 that created 'monetary tension'. This tension added to the impact of the Wall Street Stock Exchange crash in October 1929 and the slump in Argentine exports. In the middle of 1929 banks were losing reserves -aggravated by the bank's loans expansion-, the interest rates increased due to the constant and accelerated gold outflows and the peso was depreciating. As a consequence, the first measure of the Yrigoyen administration was to close the Currency Board in December 1929[476]. It was a decision that had been under debate for some months and preceded the closure of the Brazilian *Caixa de Estabilização* the following year. Since then, issues were nonconvertible and individuals could not withdraw gold[477]. The closure of the Currency Board avoided a greater loss of reserves and

[476] Of the 36 countries which suspended the gold standard between April 1929 and April 1933, Argentina was the second country to do so after Uruguay (Alhadeff, 1986, p. 103), although there are several debates to the present day about the adoption of the gold standard by the latter.

[477] See Campos (2005, pp. 538-547).

prevented a serious credit contraction. According to Cortés Conde (2009, p. 78), with less currency[478], the banks increased their reserves without renewing credit to customers, because the initial contraction of the monetary base was increased by the banking multiplier.

In this context and always with the ghost of the 1890 financial crisis in the minds of the authorities, they did their utmost to fulfil their financial obligations abroad in spite of the multiple suggestions to default. Part of the funds that were frozen at the Currency Board was used by the government to pay foreign debt, and part was spent on intervening in the foreign exchange market, in an attempt to avoid the growing depreciation of the peso. According to della Paolera & Taylor (1999, p. 576) for these transactions the Conversion Office continued to exchange gold pesos for paper pesos at new par 2.27. In this regard, Raúl Prebisch, the second man under the Minister of Finance during the provisional government, argued that the large quantities of gold exported for the debt service between 1930 and 1931 were meant to safeguard the value of the peso. The government believed that gold exports were necessary when the Conversion Office was closed to maintain confidence in the peso and prevent it from plummeting. In the event Argentina lost about half of its gold reserves in the space of two years[479].

After the closure of the Currency Board, Argentina began a close dependence of the money supply on the balance of payments. However, the fall in international prices, which was not compensated by a depreciation of the peso, only added more distress to the economy, especially in the agricultural sector, and these difficulties spread to other sectors. The great indebtedness of that sector to the banks threatened its solvency and that situation became more difficult due to the fact that the government itself was indebted to the same banks[480]. Thus, in this scenario, Argentina began an independent monetary policy, because as della Paolera & Taylor (1999, p. 573) argue, the government was conscious that even in the economies of the core, the power of fiscal policy was not able to insulate the economy from the recession. But, it lacked sophisticated policy tools, so that institutional innovation was not only necessary, but it was also a priority for the country's recovery. In this regard, authorities started to think of the possibility of having a Central Bank. For that reason, various projects were prepared with that purpose and the creation of the *Banco Central de la República Argentina* (BCRA)[481]. The project to create the BCRA and other institutions to give support to an independent monetary policy was built on the advice of the British expert Otto Niemeyer, who took as a model the banking reform in

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[478] The fall in money supply was around 17% between 1928 and 1934. See also Figure 21.
[479] See Alhadeff (1986, p. 104) and Figure 21.
[480] See Cortés Conde (2009, p. 80).
[481] Projects to create a Central Bank and to sanction the first legislation for the regulation of banking activity in Argentina were put forward before Pinedo took office in 1933. In January 1931, the provisional government declared itself openly in favour of creating a Central Bank, and a project was put forward under Minister Perez. A few months later, Minister Uriburu presented a new banking scheme based on the revaluation of Argentina's gold holdings. Minister Hueyo abandoned this idea, and prepared instead a law regulating banking activity and rediscount operations. In 1932 the government asked Sir Otto Niemeyer for advice, and early in 1933 he submitted his plans for a Central Bank and a banking law. Economic recovery, however, became apparent only towards 1934. It was after that date that the financial reforms were eventually made into law (Alhadeff, 1986, p. 112).

India. The efforts were successful as they ended with the creation of the BCRA in 1935, whose main objective was to control and regulate the money supply fluctuations as well as to clean up the financial system[482]. It was also created the *Instituto Movilizador de Inversiones Bancarias* (IMIB - Institute for Mobilizing Bank Investments), designed to buy the nonperforming loans from the private banks in exchange for bonds. This innovation would be called nowadays as a 'bad bank', in charge of receiving and selling the toxic assets[483].

In the meantime, in order to face the crisis Uriburu's government decided to assign a new role to the Conversion Office. In 1931, it deviated from its previous money-creation rule and started to rediscount commercial papers from the *Banco de la Nación Argentina* (BNA, Bank of the Argentine Nation), applying the controversial 1914 Law. Then, rediscounts based on government debt, which meant deposits as a portion of the bonds from the Patriotic Loan authorized in 1932, were allowed. This expansionary attempt prevented a severe monetary contraction and permitted the financing of the government. In fact, by that time, the big bet for Argentina was an imminent change of monetary regime. In relation to this, della Paolera & Taylor (1999, p. 568) argue that that was crucial to Argentina's recovery between 1931 and 1933 in that it helped to avoid a devastating collapse of prices and potentially of output. After that, Cortés Conde (2009, p. 83) argues that in 1933 and 1934 the government pursued a more contractive policy. Rediscounts at the Currency Board dropped slightly and according to the calculations from Figure 21, the currency dropped by 9.3% in 1933 in relation to the previous year and by 3.5% in 1934.

In relation to the sort of policy applied by the authorities, della Paolera & Taylor (1999) affirm that the Argentine government, instead of following the US and other countries terribly affected by the global crisis, chose to destroy deflationary expectations. With this purpose by 1933 the *ex-ante* extremely high real interest rates[484] were lowered. Thus, following the work of Temin (1989)[485] cited by della Paolera & Taylor (1999, p. 568), if we consider that the recovery of the Great Depression came through two channels: via the 'Keynes effect' and via the 'Mundell effect' and that Argentina was still tied to its intellectual and economic history with a fear of inflation, it is possible to think that there was no 'Keynes effect' in this area because the government did not inject money to stimulate aggregate demand directly. According to these authors, the channel through which the change in monetary regime based on institutional change

[482] The Central Bank, with funds from the revaluation, restocked the exhausted reserves of the banks, paid off government loans, and assumed its rediscounts to the banking system cancelled against the submission of credits that went to the IMIB (Cortés Conde, 2009, p. 103).
[483] See Cortés Conde (2010, p. 15). To this purpose, the government used 390 million pesos, more than 50% the amount coming from the revaluation (Ibid, p. 19).
[484] In this regard, Díaz Alejandro (1970, p. 98) states that the authorities were unable to stop the rise in interest rates during the worst years of the depression, creating an important obstacle to handling the economy.
[485] Temin (1989) argues that recovery from the Depression came through two channels. First, a direct injection of liquidity could lower interest rates and stimulate aggregate demand, something he terms the 'Keynes effect'. Second, a decisive change in monetary regime could convince agents to discard their pessimistic expectations of deflation, with favourable implications for economic activity via lower ex ante real interest rates, improved balance sheets and asset quality, and so on, all of which Temin terms the 'Mundell effect'. See also Eichengreen, 1992.

had real effects was via the destruction of deflationary expectations, which means the 'Mundell effect'.

With regard to the exchange rate policy, Argentina took a big step, intervening for the first time in the foreign market in March 1931[486] and then in October of the same year in an attempt to prevent a further depreciation of the peso. These interventions marked a clear departure from the recent past, as for many years Argentina had kept its official exchange rates fixed in sterling, although the country was not generally regarded as a member of the sterling bloc[487]. On October 10th 1931, following the example of numerous other countries and one month later than the suspension of the gold standard in the UK and the depreciation of the sterling, Argentina imposed by decree a system of *control de cambios* (exchange control). And it gave the management of the system to the newly created *Comisión de Control de Cambios* (Exchange Control Commission). All transactions in foreign currency had to be conducted through authorized banks in the Federal Capital, at a rate to be determined daily by the Exchange Control Commission. Furthermore, a January 25, 1932 decree, which revised the previous decree of October 10th 1931, required exporters to present a document showing previous permission in which all currency exchanges by the banks were detailed[488]. According to Prebisch (1991b, pp. 13-14), by this mechanism the government centralized the currency exchange in order to face the crisis and ensure the availability of funds to service the foreign debt. However, the first phase of implementation was completely improvised and under the pressure of circumstances.

The exchange control constituted a powerful instrument of economic policy and proved at least to be temporarily successful. Firstly, the government achieved control of the value of the peso and by mid-1932 the balance of payments deficit had been eliminated. One of the chief objectives of the *de facto* government of 1930-1931 had been reached. The strong depreciation of the peso by around 35-45% against the pound and the dollar in 1931 in relation to 1928[489] was used as an instrument to reduce the trade deficit. Secondly, the government did not hesitate to set priorities for the use of the currencies not only affecting different sectors but also the two great trading partners: the US and the UK. These priorities on the powerful official market included, as aforementioned, in the first place servicing the debt, followed by covering the costs

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[486] In March 1931 it was reported in the City of London that the Argentine government had as its purpose a slight appreciation of the peso to allow trade, both exporters and importers, to arrange its finances without any fear of the disorganizing influence which a violent monetary readjustment would cause. A certain number of authors have insisted on the overvaluation of the Argentine peso between 1931 and 1933. But, it is difficult to know what exactly the natural equilibrium rate was. However, it is possible to conclude that a key objective of the Exchange Control Commission was to prevent any additional fall in the value of the peso (Alhadeff, 1986, p. 104). In this regard, according to a report of the British Foreign Office and the Board of Trade in "Exchange restrictions. Proposals regarding allocation of foreign exchange to UK requirements" in BT 11/215, the depreciation of the peso was more directly the action of the government and the peso was overvalued and the government had allowed it to get nearer to its true value.

[487] See League of Nations (1944, p. 47).

[488] See Cortés Conde (2009, p. 86).

[489] See Table 65 of the previous chapter.

of the ‘necessary’ imports[490], and finally providing the funds for public service companies such as railways[491]. But the results were not so satisfactory and there were various issues of concern. One of them was the so-called ‘frozen pesos’, which really helped to finance the government and strengthen the financial system. Railway companies, insurance and banks, among others, particularly British ones, were faced with the dilemma that their profits in pesos could not be converted into pounds to be remitted abroad. The total accumulated funds that remained frozen reached a significant volume. The holders of those unwanted pesos deposited a part of them in banks and another part in public bonds, lowering the interest rate. Furthermore, the Minister of Finance Alberto Hueyo feared for a possible depreciation of the peso if those frozen pesos were suddenly converted to pounds[492], a situation that could create more indebtedness for Argentina. In this regard, disagreements started between Vice-President Julio Roca, who was in favour of granting the solution to this problem to the UK, and Hueyo; resulting in the resignation of the latter two months after the signature of the Roca-Runciman Treaty[493].

Federico Pinedo took over in August 1933 as Minister of Finance and did not wait to implement an important series of innovative ideas. The devaluation of the US dollar in April had encouraged the devaluation of the peso in Argentina and strong decisions were needed. Thus, in November of that year the government reformed the system introduced in 1931 in a more planned and ambitious move than in earlier stages of the exchange control. By that time, the government was motivated by the idea of a gradual closing of the economy as part of a tough fight against the crisis. This change in the system, considering the shortcomings[494] of the old Exchange Control Commission, encouraged the formation of a new commission, so-called the *Oficina de Control de Cambios* (Exchange Control Office), which operated under the Treasury.

On the one hand, the new system established by law that, in order to cancel obligations abroad and prevent the accumulation of debts due to remittances, each and every import had to have permission from this commission. Furthermore, the government started to force exporters to sell to it the foreign exchange from their transactions, which it afterwards resold in open auction[495]. On the other hand, the government directly affected Argentine foreign trade, incorporating a dual exchange rate system, which meant that the peso had two recognised rates: the official rate and the free rate, but considering the existence of selling and buying rates we are in a scenario of multiple exchange rates.

The official market, regulated by the government, controlled the exchange of the traditional agricultural exports, which meant that the official rates were applied to most of the transactions that were carried out in the country. In this respect, it is important to clarify that the buying rates

[490] They were considered indispensable imports: raw materials for national industries, fuel, and so on (Cortés Conde, 2009, p. 86).
[491] See Prebisch (1991, p. 165) and Cortés Conde (2009, p. 86).
[492] See Cortés Conde (2009, p. 87).
[493] See Diario Hoy (February 13th 2005, p. 4).
[494] For example, although a decree of March 1933 allowed more transactions in the official market, the new norms could not be applied because of the lack of personnel at the commission (Cortés Conde, 2009, p. 86). See also “Memorandum on organization and operation of the Exchange Control Commission in Argentina” in “Exchange restrictions. Proposals regarding allocation of foreign exchange to UK requirements” in BT 11/215.
[495] See Rock (1991, p. 20).

were applied to traditional exports and selling rates to financial transfers and some imports declared essential[496]. In this regard, as one can see in Table 65, the buying rates applied to traditional exports were lower than the selling rates offered to importers[497]. Thus, there is no doubt that these rates were disadvantageous for importers. This feature, along with the lack of funds to face obligations and the imposition of import duties, encouraged the creation of a 'black market' in order to obtain foreign exchange for imports.

Then, in December 1933 the government authorized the existence of a free market. In the free market, the smaller amount of remaining foreign exchange was bought and sold freely. There, capital was channelled, as well as non-traditional exports such as industrial goods and imports of consumer and capital goods that companies needed. Although in the free market *laissez-faire* seemed to prevail, it is evident that the authorities used the free market as a sort of safety valve, controlling the spread between the official and free rates in various ways for the achievement of their priorities[498]. With reference to this situation, Cortés Conde (2009, pp. 96-97) argues that the government intervened in this supposedly free market with the pretext of preventing serious volatility and not to modify market trends. Without doubt, this is not a very credible argument! In this regard, the League of Nations (1944, p. 164) concludes that in Argentina the system was devised so as to insulate commercial transactions, the bulk of which were settled through the official market, from any disturbing fluctuations caused by capital transfers on the free market.

In addition, the year 1933 was a year marked by the pressure exerted by farmers on the government, which was reaching its zenith. In this regard, in an attempt to promote exports and help farmers, the government encouraged the devaluation of the peso in the framework of the 'National Economic Action Plan' of November of that year. Furthermore, in relation to 'exchange differential', 'margin of exchange' or what nowadays is called 'spread', obtained by calculating the differences between buying and selling rates in the official market, the government offered to use that differential to buy wheat from producers at a fixed price, then above the world market price[499]. In fact, the government implemented a mechanism of 'support prices' for grains through the *Junta Reguladora de Granos* (JRG, National Grain Board), which was established by the end of 1933 because their international prices had plummeted. Then, because the prices improved by 1934, the margin was primarily used to make payments on foreign debt.

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[496] See Cortés Conde (2009, p. 96).

[497] In the official market, the devaluation was not great although a differential of 20% was established between the buying and selling rates (Romero, 2002, p. 66). In this regard, according to the Royal Institute of International Affairs (1937, p. 271) "it has been asserted that the rate for non-government transactions represents an artificial depreciation of the peso; but no real evidence has been adduced in support of such a conclusion and therefore the complaints continually made by British-owned railways companies that they are making enormous exchange losses are difficult to understand". For more detailed information about the exchange losses of the British railway companies, see García Heras (1990, pp. 488-490).

[498] For more detailed information see Díaz Alejandro (1970, p. 102).

[499] The government also argued that this exchange differential would be utilized to pay the increased cost of service on the debt generated by the depreciation of the peso (for which the additional 10% tax was insufficient) (Cortés Conde, 2009, p. 97).

Finally, another important event in 1933, which brought out into the open the issues derived from the exchange control in Argentina, was the signature of the Roca-Runciman Treaty between Argentina and the UK. Certainly, the large amount of frozen pesos was a permanent obstacle in the bilateral negotiations between them. Thus, under this treaty Argentina bound itself to grant most-favoured-nation treatment to the UK in allotting foreign exchange for imports. In fact, the Argentine controls from 1933 were designed in order to secure systematically preferential allotment to the UK.

As Table 75 shows, practically all imports from countries with which Argentina had an export surplus were allotted foreign exchange at the official selling rate. Not only had the UK as the chief Argentine partner benefited from this arrangement, but also countries such as the Netherlands, Belgium and France. On the contrary, exchange for imports from other countries, fundamentally the US, had to be obtained largely through the free market at appreciably higher rates[500]. In this regard, international reports indicated that the UK had the ability to persuade Argentina to operate its exchange allocation in such a way as to increase its purchases of British goods! According to Chalmers (1953, p. 131), by 1934 the common characteristic in bilateral negotiations was the pressure exerted by each country for Argentina to provide exchange at the favourable official rate, without considering the volume of purchases of Argentine products by each of those countries. In this way, those claims took as a model the Anglo-Argentine treaty of the previous year. As in that case, the insistence of counterparts upon preferential exchange treatment being extended to traders and creditors in those European countries was based upon the fact that these countries normally had a need for imports of the main Argentine products more than Argentina did for their export commodities. The availability of foreign exchange in the free market, although at somewhat higher rates, tempered the restrictive effect of these agreements upon the possibility of sales in Argentina by producers in countries whose balance of trade was not favourable to Argentina.

The allotment of foreign exchange was also possible because of the so-called Roca-Runciman Loan. The UK granted a loan to Argentina to unfreeze the pesos. The treaty stipulated that the equivalent of 12 million pesos in pounds sterling remained available for remittances from Argentina to the UK during 1933, in order to make payments in cash up to a sum that would be determined by the UK government and that of Argentina, with regard in each case to balances in pesos that, until May 1st, 1933, were waiting to be exchanged to pounds sterling and remitted to the UK. It held that the Argentine government would issue bonds in pounds sterling in exchange for balances in pesos that may have remained on May 1st 1933, awaiting exchange in pounds sterling to be sent to the UK, after the 12 million paper pesos had been used up. These bonds were supposed to be issued at the same time, redeemable within five years, and were to accrue 4% interest annually. The conversion rate and other conditions of the bonds were to be negotiated by the Argentine government and a commission of the representatives of the holders of the bonds in question[501].

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[500] See League of Nations (1944, p. 174).
[501] See Cortés Conde (2009, pp. 89-90).

After a description of how exchange control was working by that time, it is possible to conclude that with the early departure from the gold standard and the enactment of the exchange control, the Argentine government not only avoided a severe exchange rate crisis but also that it had a powerful weapon in commercial terms. The control of foreign exchange and the tariff policy gave Argentina discretionary powers with regard to imports. This country could regulate the amount of foreign exchange used to make payments on the foreign debt with the UK, as well as the amount used to buy British products or to remit the profits of British companies with operations in Argentina. In a context characterized by a scarcity of foreign exchange and strong demands from the US trade interests; this issue became extremely important for the UK.

Table 75 Argentina: Trade balances by main export destination (million US dollars)

Main countries	1928	1929	1930	1931	1932	1933	1934
United Kingdom	133	147	65	94	73	65	88
Netherlands	102	74	39	41	39	31	50
Belgium	51	58	20	26	28	26	28
Germany	46	-3	-27	-5	9	-1	8
Italy	17	-20	-35	-11	-5	-17	-9
Denmark	8	6	3	7	7	4	7
Brazil	8	4	-2	-8	-8	-3	-1
Sweden	6	3	1	5	3	2	0
France	3	14	-3	13	18	8	8
Chile	3	3	2	1	1	0	-1
Spain	-1	3	-16	-9	-2	-6	-5
Uruguay	-2	-2	0	1	0	3	2
United States	-103	-127	-87	-29	-18	-6	-22
All others	-61	-74	-65	-44	-29	-33	-42
Total:	**210**	**87**	**-104**	**83**	**116**	**72**	**110**

Source: calculated from "Trade Statistics of Sixty-Four Countries" in Memorandum on International Trade and Balances of Payments (various years). League of Nations, Geneva. Notes: a) special trade, only merchandises; b) original data expressed in gold pesos during the period 1928-1931 and in paper pesos during the period 1932-1934, in order to obtain the figures in current million US dollars, the US dollars/gold pesos exchange rates from Officer (2011) and the parity 1 gold peso = 2.27 paper pesos were applied; c) it is important to highlight that the values expressed in current million dollars are the closest possible to the transaction values taking into account the monetary and exchange rate instability for the period of analysis; and d) for 1928 and 1929, the figure for UK includes Irish F. State.

Short-lived allegiance to gold in Brazil

As Fritsch (1990, pp. 58-70) explains, between 1927 and 1930 Brazil was kept under the gold standard system with a fixed exchange rate. This was the logical approach of a country that was experiencing a positive influx of increasing primary products prices, an increasing influx of gold and foreign currency and favourable external credit conditions. In this context the gold standard prevented the monetary authorities from dealing with the increasing currency issues, so that economic activity could expand in a context of cheap credit, foreign and domestic, private and public.

Unfortunately, this recipe for the good times entailed grave vulnerabilities for the bad ones. Indeed, the adoption of the gold standard during cycles of foreign credit availability tended to increase the vulnerability of the peripheral countries by several means. The balance of payments, on which the monetary base ultimately depended, was heavily vulnerable to the single price of the most important export product, coffee, and the willingness of the foreign lenders to provide funds to the economy. The vulnerability increased as those two key variables were prone to change in the short-term. And if the imports were still at a peak, a fast trade balance and capital account deterioration could be expected, with a corresponding fall in the monetary base and the inevitable contraction of economic activity. This view coincides with the analysis of Alec Ford, cited by Salvucci (2006, p. 256), who argued that the automatic and smooth adjustment of macroeconomics under the gold standard was illusory. Furthermore for a peripheral economy engaged in exporting primary commodities, the operation of the gold standard amplified booms and busts rather than mitigating them, so that domestic adjustment to international imbalances was anything but smooth. In other words, the gold standard operated pro-cyclically in the periphery[502].

In spite of the evidence of strain in the economy due to the deflationary pressures, President-elect Prestes unsuccessfully tried to save what was left of the stabilization programme and negotiated access to new lines of credit in New York and London. He could not agree the terms with the American financial counterparts and the British kept pushing for a visit of a foreign mission to assess the real situation of the Brazilian economy (Fritsch, 1988). To this end, the famous mission headed by Sir Otto Niemeyer arrived on January 14th 1930, and produced an important report in July. The main suggestion was the reestablishment of the gold standard, for which the national budget was to be balanced, a Central Bank with the power to induce recession if necessary was to be created and coffee support was to be abolished. Nevertheless, the completely orthodox main recommendations of Niemeyer became obsolete in a few months' time, with the suspension of the gold standard in Great Britain.

From the monetary point of view, and in line with the gold standard, the Luís administration applied a restrictive credit policy that tended to exacerbate the downturn. During the second quarter of 1928 the reversal of the previously buoyant balance of payments position induced a reduction in the rate of growth of the Stabilization Office note issues, which stagnated by the end of the year. In Figure 22 the data from IBGE (2006) evidently shows the reduction, both in the money supply (M1) of 0.55 million contos de réis or 20.7% between the peak of December 1928 to the trough of September 1930, and the circulating medium of 1.22 million contos de réis or 23.4% between the peak of September 1928 and the trough of September 1930[503]. This

[502] According to Salvucci (2006, p. 260), "Brazil, for instance, was able to adopt the gold standard when ample capital imports allowed it to do so, but remaining there proved difficult. The domestic fluctuations in macroeconomic activity described by Ford occurred with an appreciating exchange rate (which raised opposition from coffee exporters); rising imports; a deteriorating balance of payments; and, inevitably, pressure to suspend convertibility altogether. The gold standard brought price rather than macroeconomic stability to Brazil, historians of its operation have concluded".

[503] The data hereby displayed follows the view expressed by IBGE (1990, pp. 513-514). Although the *Banco do Brasil* performed some functions proper of a monetary authority, it cannot be considered as such, and as a consequence the monetary base can be defined simply as the currency in the hands of the public and the banks, including the *Banco do Brasil*. There are several shortcomings in the data before 1945, and it is important to stress that most of it corresponds to estimates made by researchers from primary statistics made by the treasury or bank statements published over time. After June 1927, the currency issued includes the permissions of the national treasury, *Banco do Brasil*, *Caixa de Conversão* and the *Caixa de Estabilização*. The currency issued

assessment of monetary contraction is similar to a document in Salgado Guimarães et al. (1982, p. 56), which affirms that the measures of the *Banco do Brasil* provoked a contraction of 1.5 million contos in 1928, and continued well into 1929[504].

Indeed, the initial reaction of the *Banco do Brasil* during the second half of 1928 was to support banks and big companies in which financial stability was endangered by the sudden turnaround in credit availability and the monetary contraction from the diminishing *Caixa de Estabilização* issues. However, soon enough, harsh criticism was thrown at the *Banco do Brasil* from the supporters of orthodoxy, who feared the suspension of the gold standard and the conversion of the *Banco do Brasil* into a full Central Bank[505]. Those points of view prevailed and the bank reversed its position, by reducing the credit to the private sector, fostering a deepening of the downturn during the first half of 1929. The stagnation of the monetary base became a reduction, in line with the fall in the gold stocks held at the *Caixa de Estabilização*[506].

This debate about the proper response to the crisis prompted changes of policies and authorities during the Great Depression. Leão Teixeira, who replaced Mostardeiro Filho at the presidency of the *Banco do Basil* in August 1928, restricted sharply the bank's lending activities to the private sector by September 1928 in a move that contributed to the fall in the economy after November. With mounting bankruptcies, the business community complained about increasing difficulties for companies to keep working in a seriously contracting economy. The lobbing of the government resulted in the resignation of Leão Texeira on June 3rd 1929, who was replaced ad interim by Silva Gordo, then head of the Exchange Department and former President of the São Paulo Coffee Institute. Eventually, Silva Gordo was replaced in the *Banco do Brasil* presidency on September 1930, by the carioca banker and industrialist Guilherme de Silveira, in a move directed to re-enact the restrictive credit policy[507]. However, as already shown in Figure 22, the monetary policy was consistently restrictive during at least September 1928 - September

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by the *Banco do Brasil* was expropriated by the National Treasury in October of 1930 and incorporated into the treasury's own issue from 1931. Later, the bank issued new currency in 1930, but it was gradually retired until 1935. The *Caixa de Estabilização* was closed in October 1930 and the remainder of its issues was taken by the National Treasury. The remaining issues of the *Caixa de Conversão* lost their value from January 1931. As a consequence, from thereon the bills issued were only a responsibility of the national treasury. One shortcoming of the data is that it does not include the coins in circulation, but only the paper currency.

504 See document from an unknown author dated November 1929, in Salgado Guimarães et al. (1982, pp. 56-57).

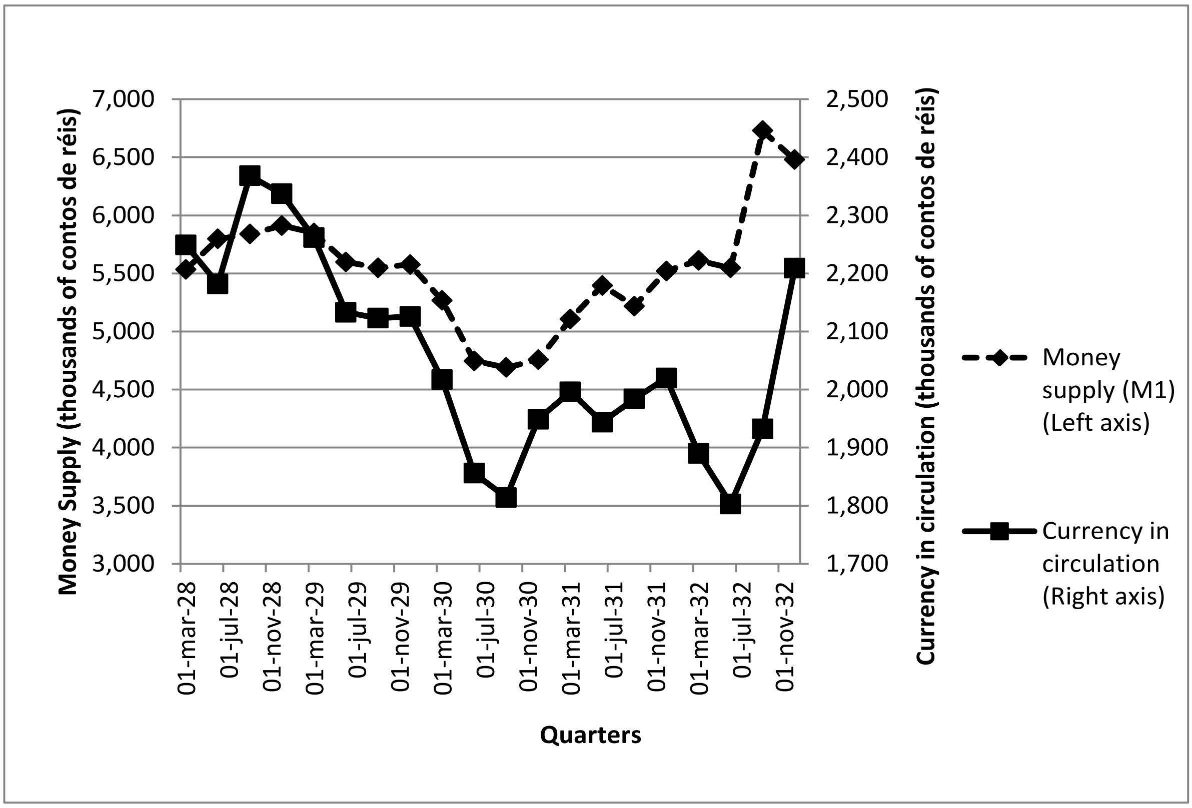
505 To be more precise, the idea of a Central Bank was not understood as today, but a bank more in the lines of the gold standard orthodoxy. As described by Fritsch (1988, pp. 140) referring to the long standing debate for the establishment of a Central bank "This orthodox opposition to the proposed banking reform did not object in principle to the transformation of the *Banco do Brasil* into a Central Bank, but was utterly against taking any step in that direction before full convertibility was achieved at a revalued exchange rate. Most of all, they wanted to divest the monetary authority of all discretionary power to vary the monetary base, preferring a 1:1 gold backing on the lines of the pre-war Conversion Office (…)". And Washington Luís shared these views. Subsequently he would state: A Central Bank has to assume the obligation to make all our fiduciary currency convertible and should only issue notes convertible into gold and rediscount bills which can be converted into gold (...) It is easy to establish a bank to issue paper money and to open rediscount portfolios with paper money (...) However, its economic and financial effects are harmful, as the formidable losses suffered by all of us demonstrate" (Ibid., p. 56).

506 See Fritsch (1990, pp. 60-61).

507 See Fritsch (1988, pp. 147-151).

1930, even during the period of Silva Gordo at the *Banco do Brasil*. This restrictive policy certainly took its toll on economic performance within a context of global economic downturn.

Figure 22 Brazil: Money supply (M1) and currency in circulation



Source: IBGE (2006).

And contemporaries were aware of this policy. According to Simonsen (1930-1931, pp. 20-26), an influential *paulista* historian, politician and industrialist of the time, the Brazilian crisis was a result of the coffee overproduction, the international financial crisis, the deflationary policy of the *Banco do Brasil*, the political agitation and the lack of elasticity of the circulating medium. Regarding monetary policy, he argued that during 1929 the crisis was deepened by the *Banco do Brasil*. Instead of increasing the circulating medium to face the evaporation of the only source of growth, the foreign capital, the *Banco do Brasil* prioritized the stability of the currency value and accumulated deposits. In this way, approximately 300.000 contos or 10% of the circulating medium were held by the bank, and were not compensated by new issues of the Stabilization Bureau. The increase in the *Banco do Brasil* deposits and the relative unchanged value of issues, meant a contraction of the monetary base, and consolidated a deflationary policy in the first half of 1929.

This contractive policy added to the already mentioned political agitation of the second half of 1929 which contributed to the flight of capital, the increase of imports due to tariff reductions (especially in textiles[508]) and the relaxation of the coffee stock releases which reduced the value of coffee exports and contributed to the deterioration of the external position of the country.

[508] In 1928 a bill to lift the tariffs on textiles was introduced, which accelerated the imports of those products and contributed to damage the external position of the country (Simonsen, 1930-1931, pp. 23)

With the lines of credit nearly exhausted, the *Banco do Brasil* intervened in the market in March 1929 in order to avoid the outflow of gold, and the Coffee Institute did its own bit by contracting a new debt of 5 million pounds in London. However, the collapse of the New York Exchange in October started a worldwide crisis, commodity prices plunged and inevitably the brief stabilization achieved with those measures ended.

After the coup of October 1930, the new provisional Varga's government found itself with a worldwide depression and with a deteriorating Brazilian economic situation. To face this uncomfortable situation, Vargas appointed José Maria Whitaker, a lawyer, politician and banker from São Paulo, as his Minister of Finance. His policy was a sort of 'wait and see', mostly delaying the adoption of more radical economic policies while waiting for an improvement on the international economic situation and new loans that would restore the foreign balance of the country. The first exchange measures were oriented by primitive liberal rhetoric. The first measure was the suppression of the exchange monopoly established at the end of the old Republic in January 1930, under the assumption that it would prevent the economy from returning to normality.

In 1930-1931 an apparently liberal exchange policy was adopted, but it was mostly restrictive with several successive moratoriums on the foreign debt. Even though the monetary base was shrinking, there were no changes in the exchange regime. The efforts focused on reducing expenditures when possible, on raising taxes to balance the national budget and on using the remainder of the gold reserves to avoid as much as possible a full devaluation.

After it became quite clear that the international situation was unlikely to change in the foreseeable future, some decisions were taken in order to spare foreign currency. Whitaker only lasted until November 1931, when Oswaldo Aranha was appointed as the new Minister of Finance in November, a post in which he would remain until September 1934. Among his main decisions, he promoted a decree published on September 30th 1931 referring to the abnormal situation of all financial markets and to the necessity of controlling exchange operations in order to avoid speculation which would be to the general detriment of the country[509], and reintroduced the exchange monopoly under the *Banco do Brasil*. The sale of the export proceeds to the *Banco do Brasil* became mandatory and the distribution of the foreign currency was awarded according to priority in the following order: official needs and payment of foreign debt service; essential imports; other remittances, including dividends, imports in consignment and trade delays. The immediate consequence was that the difference between the official rate and the curb rate increased in October 1931. While the *Banco do Brasil* bought cheques at 60 milréis to the pound

[509] The decree provided:
"(1) That export bills and money transferred abroad shall be dealt with only through the *Banco do Brasil*.
(2) That the cover thus acquired shall be apportioned among all the banks, having regard (a) to necessary requirements of the Federal government and the State governments or municipalities; (b) importation of goods; (e) other necessities as occasion demands.
(3) That questions respecting distribution shall be left to a special committee comprising a representative of the *Banco do Brasil*, the President of the Bankers' Association of Rio de Janeiro, and the President of the Bankers´ Association of São Paulo". See note from the Board of Trade signed by Mr. H. Fountain, dated October 9th 1931, in FO 371-15063, p. 119.

sterling, or slightly more, sterling had been brought at the Curb between 75 milréis and 80 milréis, and dollars from 17 milréis to 20 milréis [510].

The exchange control was essentially unchanged until 1934, when the non-traditional export receipts and other receipts not associated with exports were exempted from the control. By 1933 there existed concurrently three distinct foreign exchange markets in Brazil. The *Banco do Brasil* normally had complete control of exchange, and the first of the markets was the official exchange bourse centred in that institution. The second was known as the ‘grey’ market, which more or less had official cognisance - if not recognition - as it consisted of a percentage of export bills which was released to brokers by the *Banco do Brasil*. It was meant to provide exchange cover for some of the market requirements which the bank itself was not prepared to care for at the official rate. The quotation in the ‘grey’ market was roughly one-fifth above the official rate; thus there was a premium of 11 milréis in mid-October in the ‘grey’ market over the official 90 days' sterling rate of 55 milréis. There was a third market, known as the ‘black market’, where, on the same date, the rate was 71 milréis, showing, therefore, an even weaker exchange value than the ‘grey’ market. As late as October 19th, a new government decree made exchange operations illegal unless transacted through authorised banks, with the permit of the *Banco do Brasil*. The concealment of cover with respect to exports and the increase of prices of imported goods for the purpose of obtaining unwarranted exchange cover were actions liable to heavy fines[511].

In contrast to Argentina, even though the Brazilian exchange control during the thirties did not discriminate between countries according to their positive or negative trade balance with Brazil[512], the allotment of exchange was biased. For example, the funding loan mirrored the deteriorated bilateral relations between the new provisional government and the US. The difficult relationship was the result of the reluctance of the US government to accept the change of regime and its support for the old Republic, and opened the door for a brief resurgence of British influence, that was also supported by the availability of credit in better conditions offered in London at the time. It included a warranty for the payment of the service of the previous funding loans of 1898 and 1914, and stipulated that the payment of the rest of the federal debt would be paid with Brazilian papers of the 1931 funding loan. The amortization of the federal debt would be suspended and nothing was mentioned about the debt from Federated states and municipalities. Over time complaints mounted over the allotment of the scarce foreign exchange, which was clearly detrimental to American interests, and for that reason in May 1933 the American Chamber of Commerce made representations to their Ambassador, complaining that Great Britain was obtaining more favourable treatment[513]. And the British were aware of their advantage and chose not to press further the Brazilian government because the only serious complaints of preferential treatment were made by the Americans and others on

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[510] See note from the Commercial Secretariat of the British Embassy to the Department of Overseas Trade dated October 20th 1931, in FO 371-15064, p. 362.
[511] See The Financial Times, article dated June 11th 1933, in CRT 203/33, in BT 11/157.
[512] See Abreu & Svirsky (1985, p. 548).
[513] See note from Mr J. Shaw from the Bank of London and South America Limited, dated January 11th 1933, in BT 11/157.

the grounds that Brazil allotted an undue proportion of her available exchange cover to repay the Rothschild consolidated overdraft[514]. Moreover, they concluded that the Americans, French and Germans were only getting their trade requirements, the Americans somehow more because of their investment in the power company *Empresas Elétricas Brasileiras,* but in general they 'grumbled bitterly' that the exchange was allotted to the British[515].

To sum up, the policy directed to ensuring the viability of the gold standard in Brazil would only work during a period of positive external balance. Most crucially, it depended on the continuity of favourable external economic conditions, which could change fast. In that case, the deflationary pressures from the automatic fall in foreign reserves would submerge the economy in a sudden downturn.

Uruguay and the dilemma of the exchange rate

In 1914 Uruguay declared the inconvertibility of the currency, but the value of the Uruguayan peso with regard to gold remained stable, although the convertibility and the free trade of gold could not be re-established again[516]. One of the biggest problems that Uruguay had to face was the exchange rate crisis. During the twenties, the BROU intervened in the exchange market, through open market operations, to keep the parity at the legal fixed exchange rate of 4.70 gold pesos per pound sterling and 0.96 gold pesos per dollar. In spite of the depreciation of the peso shown in Table 68, during the administration of the CNA the official exchange rate significantly overvalued the national currency. This feature could be considered counterintuitive for a country so pressured to promote exports and save hard currency in the turmoil of the crisis. According to Zunino (2009, pp. 14-15), there were two main objectives behind this policy: to ensure monetary stability as the priority and to prevent the contracting effect of the crisis on the purchasing power of wages. In this regard, it is important to comprehend that in a country with a limited internal market, strongly dependent on foreign intermediate and consumer goods (including oil), every depreciation or devaluation in the exchange rate translated quickly into raising internal prices, fuelling in this way inflation and consequently straining the relations between the government and the working classes.

In April of 1929, seven months before the crash of the New York Stock Exchange, and despite its best efforts, the BROU was forced to stop intervening in the market as its funds diminished dangerously and the country's external position continuously deteriorated[517]. Thus, the Uruguayan peso started to depreciate and the suspension of the gold parity became unavoidable[518]. It did so the same month as Argentina (December, 1929), and almost a year

[514] See memorandum Nr. 077 from the Commercial Secretary of the British Embassy, dated May 24th 1933, in BT 11/157.

[515] See memorandum Nr. 15 from Garnet Lomax, Commercial Secretary, dated January 27th 1933, in BT 11/157.

[516] See Román (2010, p. 11).

[517] See Díaz (2003b, pp. 114-115).

[518] The issue of whether Uruguay adopted or not the gold standard has been controversial. According to the League of Nations, Uruguay suspended the gold standard in December 1929 and added that in this country the gold standard had not been legally established since the war but it reverted *de facto* to the gold parity. In this

before Brazil (November, 1930). Recalling Table 68, the depreciation was very parsimonious, no more than 15% from the legal parity against the dollar and the pound by 1930. The government accepted this trend because it favoured exports, made imports more difficult, and tended to protect the national industry. But afterwards, as mentioned previously, the depreciation accelerated its pace and threatened to damage the economy whilst the cost of living increased too quickly. In this regard, it is worth mentioning that since the Uruguayan economy lacks an important internal market, trade and capital flows have always strongly conditioned the fate of the exchange rate, which in turn has directly influenced the cost of living, since most consumer goods are imported or produced locally from a strong dependence on foreign inputs[519]. However, it is not right to blame the Uruguayan peso free fall only on exogenous forces. The exchange rate crisis also could be explained by domestic factors. Evidence of this is that the peso began to depreciate in April 1929, some months before the crash in the US. For example, Díaz (2003b, p. 115) argues that the depreciation of the peso could have been a result of the strong growth of the BROU's credit to the private sector in the period 1924-1929, which increased at an annual average rate of 11%, well above 3% of annual GDP growth rate.

As a consequence of the great depreciation of the peso in 1931, the Minister of Finance, Javier Mendívil, established the *Comisión de estudio sobre la desvalorización de la moneda* (Commission to analyse the depreciation of the currency). This commission was composed of personalities such as Eduardo Acevedo Álvarez (later Minister of Finance), Ricardo Cosio, Emilio Frugoni, Octavio Morató (manager of the BROU), Carlos Quijano, José Serrato (ex-President of the Republic) and Luis Supervielle (banker), among others. It devoted its efforts to studying the depreciation of the currency and to analysing other alternatives for the monetary policy and allowed for a rich exchange of ideas. For example, Frugoni proposed the return to the gold standard arguing that the currency was strong enough from the point of view of

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regard, Román (2010, p. 11) explains that in 1914 Uruguay, like other countries, had declared the inconvertibility of the currency and during the twenties the Uruguayan peso maintained its legal value in relation to gold, but the convertibility and the free trade of the metal were not established. The disjunctive on returning or not to the gold standard was a debated subject during the decade. On the other hand, Díaz (2003b, pp. 114-115) gives an interesting argument about the alleged suspension of the gold standard in an 'exchange rate crisis' context. Following this author, according to Yeager (1966) in 1929 the financial international press announced that Uruguay had left the gold standard. But, really, as Román argues, Díaz maintains that Uruguay had abandoned the system in August 1914, and it had never returned to it, unlike other countries (e.g. the UK in 1925 and France in 1928, whereas the US had remained in the gold standard through all the war and subsequently until 1933). Probably, the international observers had erroneously perceived that Uruguay had left the gold standard just in 1929 because until then the BROU participated in the exchange market to prevent the exchange rate from failing to meet the official parity; and when at a certain moment the BROU stopped doing it, the peso depreciated more than normal, in a move that was perceived as a change of regime, when in fact it was hardly a change of policy. That illustrates how 'a sufficiently managed floating exchange rate system' can reproduce for distant observers the same panorama as a fixed parity system. Nevertheless, if one takes the information provided by the League of Nations as the most official one (knowing that it should have been based on official Uruguayan sources) and the most suitable to do international comparisons for that period, although we know now that Uruguay only abandoned *de facto* gold parity, it is possible to conclude that the most suitable ending date for the gold standard in Uruguay is December 1929. But also in this respect, some researchers, such as Román (2010), maintain that the definitive suspension of the gold standard was in 1931 when Uruguay imposed the exchange control.

[519] Although the official records collected by Bertoni & Sanguinetti (2004) show null inflation for 1930, 1931 and 1934, we find that outcome most unlikely. However, for 1932 and 1933 data show a deflation of 1.8% and 4.9%, respectively.

consumption and production. However, Supervielle defended the free flotation system in force since April 1929 after the BROU was forced to withdraw. His argument was that the current flotation helped producers in a strongly recessive juncture. However, other members defended the thesis of the exchange control, a view that ultimately prevailed in the final report. The suggestions included the fixation of the price and quantity of money by means of direct intervention by the authorities and for that there were a variety of reasons. Quijano, Serrato and Acevedo Álvarez argued the inconvenience of exporting gold, Morató the need to avoid speculation and capital flight and again Serrato and Acevedo Álvarez the inadvisability of restricting the BROU's credit that the monetary discipline of the gold standard regime would suggest[520]. Thus, all these arguments coincided on disregarding the old belief that the gold standard system was suitable for boosting prosperity in that context.

In this scenario with the exchange rate more dependent on the market conditions of foreign currency and less on the gold backing of the national currency and as a result of the conclusions of the commission, it was unavoidable to intervene in the capital flows in order to support the official exchange rate. As we will discuss, during 1931-1932 the enactment of the exchange control, the ban on import goods considered competitive with the national production, the imposition of surtaxes on imports, the creation of the export controls and the creation of the *Caja Autónoma de Amortización* (Amortization Fund) were all measures taken with the aim of supporting the exchange rate at a stable level. However, this was not an easy task. The system was implemented by a 'trial and error' process, suffering continuous modifications, like in the case of Argentina. When considering the target for the exchange rate, the authorities not only had to take into account the availability of foreign reserves, but also the delicate balance between ensuring suitable profitability for the cattle farmers and exporters, keeping the cost of imported goods for traders affordable and maintaining the buying power of the incipient national industry and the consumers[521].

The *Contralor de Compra y Venta de Moneda Extranjera* or simply *contralor de cambios* (exchange control) was created by Law 8729 of May 29th 1931, which started to operate in September 1931[522] under the responsibility of the BROU as the country's currency regulator. This decision was one of the most transcendental ones in Uruguayan economic history, not only because it abolished the free exchange rate flotation that was in place since the BROU stopped its intervention in April 1929, but also because it became a permanent feature until June 1974[523]. It was also a measure that predated by approximately one month the Argentine exchange control, a situation that signals the close interaction of the policies applied by both countries at the time. Along with the already acquired position of promoting the economic activity granted

[520] See Díaz (2003a, pp. 315-316).
[521] See Damonte & Saráchaga (1971, pp. 387-388).
[522] According to the League of Nations Yearbook (1934) the formal imposition of this tool of monetary policy was in September 1931. Díaz (2003b, p. 117) affirms that the exchange control was totally implemented since October 1931.
[523] The exchange control was in force almost without interruptions between 1931 and 1974 with the exception of the interesting liberalizing experience of the Minister of Finance Juan Eduardo Azzini during the period 1959-1963. It ended in June 1974, with the Minister of Finance Alejandro Végh Villegas, under the harsh dictatorship that ruled the country from 1973 to 1985.

in 1928[524], the power of regulating the price and the quantity of foreign currency consolidated the BROU as a main actor in a new era of a state controlled economy.

The enforcement of severe controls was aimed at banning those dealings that did not respond to regular and legitimate economic and financial activities, preventing speculation against the Uruguayan peso and ensuring the availability of foreign currency in case of monetary imbalance or international crisis. But soon enough other objectives were pursued, such as balancing foreign accounts, increasing the tax revenue, boosting the national industry and diversifying exports. Thus, the need to create the export control arose and the so-called *Contralor de Exportaciones* (Export Control)[525] was put into effect by a law of October 16th 1931. This *contralor* forced exporters to sell all hard currency obtained from foreign trade to the BROU, at the official exchange rate under the assumption that this procedure would prevent hard currency from slipping into the black market. Furthermore, in the same year the *Contralor de Importaciones* (Import Control)[526] was also created, which prohibited economic agents from proceeding with payments abroad without proper licences issued by the BROU. But more importantly, this control mechanism enabled the government to further restrict the import of goods similar to or competitive with national production or from countries that did not offer conditions of reciprocity to Uruguayan exports. However, this sort of control was fully implemented by 1934[527].

One downside of the exchange control was the accumulation of unpaid debts (or blocked pesos' credits) by residents who carried out transactions abroad. The growing dissatisfaction with the exchange control, both at home and abroad, was evident. In this regard, the rural interests under the banner of the *Federación Rural* announced a demonstration meeting of producers; the British Chamber of Commerce had much to say in criticism; and both the US and Germany considered the problem so pressing that they dispatched official missions to Uruguay, as well as other South American countries, in order to formulate proposals for treaties, with a solution of the exchange problem as their basis[528]. Thus, the government was forced to propose modifications. In order to address this mounting problem, in July 1932 the *Caja Autónoma de Amortización* was created to assist importers and public companies in their payments abroad, by allowing them to spread out the payments and to give time to the national economy to face those payments[529]. The BROU assigned the highest priority in the distribution of the available exchange to the payment of interest and amortizable obligations at the *Caja Autónoma*. The remainder was assigned according to the following order of priorities: fuels, government inputs,

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524 In 1928, the BROU had begun to assume the functions of an Institute of Development, as the industrial credit scheme was organized, and also the Fruit Market allowed the bank to extend financial assistance to producers with the products deposited on it as securities (Damonte & Saráchaga, 1971, pp. 120).
525 See Law 8711/1931 and Decree of April 4th, 1935 (Zunino, 2009, p. 22).
526 See laws of August 20th and October 10th of 1931, Decrees of July12th and August 1st, 8th, 14th, 20th and 24th of 1934, and Law 9440 from *Plan de Reajuste Económico y Financiero* (Economic and Financial Readjustment Plan) of November, 1934, enacted by Terra and his Minister of Finance Charlone (Zunino, 2009, p. 22).
527 See Zunino (2009, p. 11-14) and Acevedo Álvarez (1934, p. 115).
528 See note from the British Legation dated July 28th 1934 signed by A. Murray Simpson in "Uruguay Exchange and Currency Restrictions", BT 11/244.
529 See Nahum (2008, pp. 141-142).

public services, inputs for the national industry, essential goods for the population and other obligations or needs[530].

In 1933, the creation of the '*tipo de cambio compensado*' ('compensated exchange rate') was probably the most important decision benefitting the interests of the cattle farmers after the coup of 1933 that overthrew the CNA and consolidated a government prone to favouring them[531]. This innovation granted up to a 40% bonus over the official exchange rate to some exports, which was in essence compensation to cattle farmers for the damaging overvaluation verified during the CNA's times. The compensation was at different levels for different export commodities and was intended to approximate the uncontrolled market rate. It was approximately the arithmetic mean between the official and the free exchange rates. Another important problem of the exchange control was that the parallel market evaded the official control and operated under a significantly higher value. For example, the official exchange rate was at least twice the free one in July 1934: the British pound was valued at 6.32 pesos at the BROU and 12.70 pesos in the free market, while the dollar was valued at 1.25 and 2.51 pesos, respectively. As per the compensated exchange rate, it was somehow between those ranges[532].

The official rate continued to be used to meet public and private external debt obligations and remittances. The differences between the official, the compensated and the free rates of exchange were so great that the ability of one particular importer among competing importers to act at the government controlled rate conferred him an absolute advantage. In order to illustrate this situation, the British Chamber of Commerce mentioned the case of an importer of a certain commodity, who after taking up $100,000 of gold bonds in respect of frozen funds accumulated up to 1932, found himself unable to obtain exchange for more than 20% of his requirements and had to cover the balance in the free market. At the same time his rivals were able to obtain official exchange, with the result that he found himself forced to abandon the market to them[533]. Another shortcoming of the exchange control was 'smuggling'. For example, it is possible to think that a considerable proportion of the 1934-1935 wool exports had been illicitly passed through as goods in transit, with the result that exchange in respect of probably some 16 million kilos had been lost to the open market. Furthermore, the figures cited by the newspaper *La Mañana* proved that there was ample exchange by that time to meet all of the country's obligations, but that about 30% of that exchange did not go through the hands of the Exchange Control Board for distribution and consequently was not available at official rates of exchange[534].

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[530] See Acevedo Álvarez (1934, p. 135).
[531] For more detailed information see for example Damonte & Saráchaga (1971, pp. 391-392) and Finch (1981, p. 107).
[532] See Acevedo Álvarez (1934, p. 134).
[533] See internal memorandum of the Board of Trade dated June 15th 1934 in "Uruguay Exchange and Currency Restrictions", BT 11/244.
[534] See note from the British Legation dated April 6th 1934, signed by E. Millington-Drake to Mr. Craigie in "Uruguay Exchange and Currency Restrictions", BT 11/244.

As a response, the government made an attempt to prevent illegal activities from taking place, and in a similar way to Argentina and Brazil, adopted a dual exchange rate system in 1934[535]. As such, the official market remained completely under control and was used for foreign trade. The other market operated with a *tipo de cambio libre* (free exchange rate), later renamed as *libre financiero,* which was recognized for the current account transactions on 'invisibles' and for transactions falling into the capital account[536]. In addition, in 1934 a *tipo de cambio libre dirigido* (controlled free exchange rate) was created that allowed the exporters to negotiate a percentage of their proceeds in hard currency from foreign trade in the free market with no other limitation than the obligation to exchange those amounts at designated banks that held corresponding import licenses. This rate followed the logic of the compensated rate but with the difference that it covered a greater range of export products, and as a consequence prompted a higher average exchange rate in the economy[537].

This complex system of *tipos de cambio multiples* (multiple exchange rates) affected the trade flows considerably. The reason for the imposition of this system was very evident: to subsidize some producing activities and to tax others. Not surprisingly, it was perceived more as a way of taxing primary production than a subsidy for goods with higher value added. In general terms, this scheme not only involved a sort of 'hidden devaluation', but also allowed the authorities to devalue in different proportions depending on the value added to the primary goods. With regard to imports, it was possible to regulate the percentage of devaluation according to the degree of competitiveness of the merchandise with the national production and an evaluation of its essentiality for the economy. It was an effective new weapon added to the protectionist arsenal. Indeed, the government chose to promote diversification of export by benefiting sectors with higher value added. For example, in the case of an export, the authority discretionarily resolved which percentage of the total value of the foreign currency obtained from each transaction was paid at the official rate and which at the compensated rate. As a rule, the higher the value added of the export good, the higher the compensated rate applied. According to BROU's regulations, the percentages of the exports that were paid at compensated exchange rate were as follows: farming produce, 100%; scoured wool, 70%; raw wool, 50%; dried ox-hides, 60%; salted ox-hides, 20%; and linseed, 50%. That meant, for example, that the exporter of raw wool received 1.86 pesos per dollar and the exporter of scoured wool 1.97 pesos per dollar, therefore representing a subsidy of 6.2% for the exporter of scoured wool or the equivalent tax for the less industrialized product[538].

Then, in 1934, the *Comisión Honoraria de Importación y Cambios* (Honorary Import and Exchange Committee) was created by a law of November 9th [539] as an institution in charge of

[535] See Bethell (1994, pp. 82-83).
[536] See Díaz (2003a, pp. 316-317).
[537] See Zunino (2009, pp. 13-15).
[538] See Díaz (2003b, p. 119).
[539] See translation of the law of November 9th 1934, establishing an Honorary Import and Exchange Committee, and providing for economic and financial readjustment, in "Uruguay Exchange and Currency Restrictions", BT 11/244:

the control of international trade in the framework of the 'Economic and Financial Readjustment Plan' promoted by Minister of Finance César Charlone[540]. The objectives of this plan included in Law 9400 were: a) to control and channel imports; b) to consolidate and pay the deferred exchange rate originated in unpaid commercial obligations after July 1932; and c) to use part of BROU's gold with exchange rate stabilization purposes[541]. The honorary commission included a strong representation of employer's unions such as the chambers of commerce and industry, the *Asociación Rural* and the *Federación Rural*. The mechanism of control was for example as follows: if frozen beef was exported to the UK, the BROU received the corresponding British pounds for the transaction and sold those pounds at the fixed exchange rate to the importers designated by the *Contralor* or to the companies that requested 'quotas' of pounds to send to London as dividends of their shares in railway, tram, gas, etc. Thus, the government was not only controlling the imports, the trade balance and the balance of payments, but also defending the peso and protecting the national industry. In this regard, we agree with Nahum (2008, p. 161) that such a discretionary system allowed for the distribution of foreign currency or import

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"Article 1. An Honorary Import and Exchange Committee is hereby established, which shall undertake the individual distribution of exchange and shall grant import licences in accordance with the quotas which the Bank of the Republic shall fix periodically, by countries and groups of commodities, bearing in mind the available amounts of controlled "free" exchange and official exchange produced by exports to the various countries, and in accordance with treaties and commercial agreements already in force or which may be concluded hereafter.

The Committee shall assign to the different importing houses or firms individual quotas within each group of commodities. For this purpose the committee shall endeavour to obtain the collaboration of the various trade bodies.

In addition, the Honorary Import and Exchange Committee shall authorize the introduction into the country of articles or products when the importers can show that they possess the necessary exchange or bills, provided that the Bank of the Republic, which must first be consulted, is of opinion that the various groups of imports and the general interests of national economy will not be altered fundamentally or unsuitably thereby.

Notwithstanding the provisions of the preceding clauses, the Bank of the Republic may authorize the importation of indispensable foodstuffs in a proportion not lower than that of similar imports during the year 1933 plus 10%.

Any debt abroad, arising from the import of products or merchandise, which has been carried out in infringement of the provisions of the present law, shall be regarded as a simple natural obligation (article 1441 of the Civil Code); as a consequence no legal action may be brought for the purpose of compliance with such obligations.

Article 2. Import licences granted by the Honorary Import and Exchange Committee with official exchange or controlled "free" exchange will be in proportion to the exchange quotas assigned by countries, by groups and by different classes of exchange, the distribution of which shall be periodically by the Bank of the Republic, after retaining the sums necessary for its own requirements and those of the State.

During the remaining months of the present year the Bank of the Republic shall endeavour to arrange that the exchange quotas thus granted to each country shall not be less than 75% of the exchange produced by the export of Uruguayan produce to the respective purchasing countries. From 1st January, 1935, this percentage shall be regarded as a minimum.

These exchange quotas shall comprise

a) Payment for the respective countries exports to Uruguay;
b) Financial services of public and private debts, and of public services;
c) Freight insurance and personal drafts;
d) All transfers of funds for the respective countries.

Article 3. The Customs Houses of the country shall not deal with any import permits unless they have been previously furnished with a certificate of the corresponding license granted by the Honorary Import and Exchange Committee (…)".

[540] See Bertino et al. (2001a, p. 17).

[541] See Román (2010, p. 16).

permits according to acquaintance and favouritism, beyond the national interest. As Díaz (2003a, pp. 317-318) explains, among several other analysts, these measures of 1934 completed a process in which the exchange control lost most of its monetary meaning as it resulted in a more than evident intervention in foreign trade. In addition, this intervention also provided important revenues for the public sector. Indeed, the spread in the official market produced for the BROU a profit of 25% over the purchase value, which nurtured a special fund created for the purpose, known as the *Fondo de Diferencias de Cambio* (Exchange Rate Differences Fund). This fund received the treatment of a fiscal source and was used to fund many projects under the oversight of the BROU.

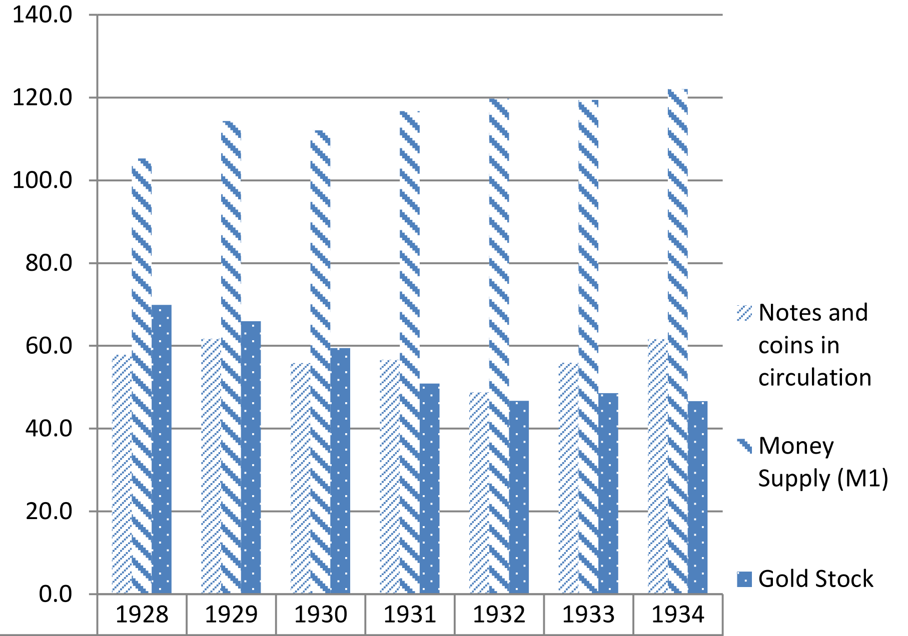
As we have been analysing, for many countries the exchange control was used as a tool not only to save hard currency, but also as a source of revenue for the public sector in times of trouble. However, for Uruguay this policy became so long lasting that the results were adverse. According to Díaz (2003b, p. 117), it is difficult to find in the history of Uruguay another measure with so intense an influence, prolonged and adverse for the local economy. Certainly, it is remarkable that most politicians discussed how to ration the available foreign currency, but few questioned the convenience of keeping the system in the long-term. Nevertheless, the introduction of a dual exchange rate system in 1934 had a beneficial effect in relation to exports and imports of ‘invisibles’ (e.g. tourism) and the flow of capital because these sort of flows remained beyond government intervention. The freedom with which the capital movements operated in spite of the exchange control, attracted foreign investment and partially compensated for the tense political environment and the livestock sector stagnation. Thus, it is even possible to think that the existence of a free market worked as an anchor against the fiscal irresponsibility and the political unrest.

Regarding monetary policy, in December 1929 the charter of the BROU was modified and the previously existing ceiling imposed in relation to the Bank’s capital for the issue of bills was abolished. From then on the issue of bills was limited only by a 40% mandatory gold bank reserve in order to meet the deposits and currency in circulation and a maximum limit was set for the lower issue of 20 million Uruguayan pesos meaning coins less than ten pesos value. While these measures increased the issue capacity, the difficulties in the exchange market lowered the potential issue currency as the gold reserves got reduced. However, the stock of gold still conditioned the BROU’s capability to issue currency. But, by Law 8830 of January 20th, 1932, as a consequence of the international financial crisis, the BROU was authorized to increase its issue capability by allowing the inclusion of the external debt in the mandatory bank reserve[542], so that it could issue currency further. In Figure 23 it is possible to follow that even though the gold reserves constantly fell during 1929-1932, actually the currency in circulation only mildly contracted in 1930 (-9.5%) and 1932 (-13.8%) and the money supply (M1) kept rising during the period, with the exception of 1930. Thus, the contraction of the monetary base as expected for a country under the gold standard regime did not happen in Uruguay, a

[542] See Román (2010, p. 15).

behaviour that is consistent with the perception that this country was not following that system. However, the allegiance to gold as a key national insurance and to restrict the issue operations of the BROU was undoubtedly important in the design of the monetary policy.

Figure 23 Uruguay: Money supply and international reserves (million pesos)



	1928	1929	1930	1931	1932	1933	1934
Notes and coins in circulation	57.9	61.7	55.9	56.6	48.8	55.9	61.6
Money Supply (M1)	105.3	114.4	112.1	116.7	119.7	119.4	122.1
Gold Stock	69.9	66.0	59.5	50.9	46.7	48.6	46.6

Source: Román, 2010, p. 46 and p. 51

As a summary, all three countries suspended early the gold standard and eventually chose to enact exchange controls. Although their control systems started to work effectively in September - October 1931, the temporary Brazilian exchange control of January - October 1930 and the Uruguayan exchange control law of May 29th 1931 constitute key backgrounds for the region.

iii. Conclusion

In the context of the contradiction between the gold standard ideology that dictated a strong commitment with deflationary forces, and the need to avert the economic depression, ABU had to make hard choices. And when the UK and the US themselves departed from the gold standard, it was a death sentence to the system that in a way validated the preceding course of action of ABU.

Indeed, ABU chose to depart early on from the gold standard and established instead exchange control systems, also devaluing strongly their national currencies. Argentina and Uruguay were quicker than Brazil. As a matter of fact, Argentina suspended the Currency Board in December 1929, and in Uruguay there is even a view among researchers that the country had not returned to the gold standard after its departure in 1914, although the League of Nations states that this departure was in December 1930, the same month as Argentina.

The case of Brazil has a different tinge, because the Luís administration made a stronger commitment to the system. The contraction of the monetary base in 1929 is a sign of that commitment. The hesitation regarding the coffee policy also added to the negative flow of foreign assets. In fact, Brazil was among the three countries the one that suffered the most dramatic loss of gold reserves.

The stubbornness of the Luís administration in adhering to the gold standard aggravated the crisis because the government lacked instruments to soften the deflationary forces, and furthermore the need to secure the transition to the elected president Prestes delayed the measures needed to face the crisis. That is why the Brazilian government let the foreign reserves fly away, while waiting for the world to fix for itself. However, this posture was not only followed by the Luís administration, but also during the first year of the Vargas one.

It is possible to say that in a way Argentina and Uruguay were more prepared to depart from the gold standard logic both because of the conviction that the stocks of international reserves needed to be preserved and for internal political reasons. Brazil eventually followed in November 1930, but during the first months of the downturn, it was relatively more vulnerable because of the hesitations regarding the departure from the gold standard. The depletion of the gold reserves and the political instability eventually made this decision inevitable. It is also important to point out that at least during 1929-1930, there is evidence that these three countries faced monetary contractions that added to the deflationary forces.

In any case, ABU were in the first group of countries to suspend the gold standard and they all chose to also apply instead exchange controls effectively working in September - October 1931. Both measures contributed to reducing country vulnerabilities to the worldwide deflationary forces, at least during this period of analysis.