British Banking in Brazil during the First Republic

Banco Britânico no Brasil durante a Primeira República

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Abstract

This paper delves into the workings of British banks in Brazil in order to assess how they affected the development of the domestic Brazilian banking system during the First Republic (1889-1930.) The paper is concerned with the role of British banks within the domestic economy, in contrast to the role of the banks in the global trading network. It assesses five avenues of influence by which British commercial banks had a role in the Brazilian banking system in ways that differed from domestically owned and managed counterpart: providing a model for a "national" banking system, serving as a business model for domestic banks, offering foreign exchange services beyond the constraints imposed on domestic banks, injecting new capital and reserves in periods of crisis, and supporting the expansion of business transactions within Brazil. The paper also documents the decline of British presence during the period and considers the reasons for the decline.

Keywords

British banks. Banking system. Competition. Political system.

Resumo

Este artigo investiga o funcionamento de bancos britânicos no Brasil, a fim de avaliar a forma como elas afetaram o desenvolvimento do sistema bancário doméstico brasileiro durante a Primeira República (1889-1930). O artigo está voltado para o papel dos bancos britânicos dentro da economia doméstica, em contraste com o papel dos bancos na rede de comércio global. Ele avalia cinco eixos de influência pelo qual os bancos comerciais britânicos tiveram um papel no sistema bancário brasileiro de maneira que diferiam da propriedade interna e gerida contraparte: o fornecimento de um modelo para um sistema bancário "nacional", servindo como um modelo de negócio para os bancos nacionais, oferecendo serviços de câmbio, além das restrições impostas aos bancos domésticos, injetar novo capital e reservas em períodos de crise, e apoiar a expansão das operações de negócios no Brasil. O artigo também documenta o declínio da presença britânica no período e considera as razões para o declínio.

Palavras-chave

Bancos britânicos. Sistema bancário. Competição. Sistema político.

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Foreign business and foreign capital have long been a source of academic and political controversy in Brazil. They have been variously characterized as both promoter and impediment of Brazilian business and economic activity. Whether foreign business has introduced capital, technological and organization innovation or has extracted resources and shaped Brazilian business and the economy for the needs of outsiders. Because of its ubiquitous role in business, capital and finance and the institutions centralized in orchestrating capital – banks and capital markets – are often at the center of these controversies. However, the actual internal workings (goals, structure, activities and transactions) of these institutions have much less often contributed to the analysis of foreign finance. This article remedies that lacuna. It delves into the workings of British banks in Brazil in order to assess how they affected the development of the domestic Brazilian banking system during the First Republic (1889-1930.) Modern commercial banking emerged during these years, and until the second decade of the twentieth century British organizations dominated the foreign banking sector. The paper is concerned with the role of British banks within the domestic economy, in contrast to the role of the banks in the global trading network. It also documents the decline of British presence during the period and considers the reasons for the decline.

The article finds five avenues of influence by which British commercial banks had a role in the Brazilian banking system in ways that differed from domestically owned and managed counterpart: providing a model for a "national" banking system, serving as a business model for domestic banks, offering foreign exchange services beyond the constraints imposed on domestic banks, injecting new capital and reserves in periods of crisis, and supporting the expansion of business transactions within Brazil. In successive sections, the paper analyzes the banking system and British activity within it, British bankers' understanding of Brazilian political economy, and competitive pressure within the sector. The conclusion returns to consider these specific avenues of influence.

In contrast to much of the existing economic historiography, this article focuses on the business practices of banking in the private sector, rather than on federal monetary policy or government international long-term debt. Policy and international debt are considered for their effects on the private sector banking practices[1]. Also departing from the

[1] As a result, the article considers policy debate, money supply and the institution of the Banco do Brasil to a lesser extent than is typical in the financial historiography. For a consideration of the relatively weak impact of the Banco do Brasil on the practices of private sector banking during the First Republic, see G. Triner; "The Formation of Modern Brazilian Banking, 1906-1930: Opportunities and Constraints Presented by the Public and Private Sectors"; *Journal of Latin American Studies* vol. 28 (1996).

general direction of existing historiography, this article shifts the relative weight of explanation for the declining influence of British finance in the Brazilian economy from the shift in international economic relations toward development within the Brazilian economy and the inadequacy of British understanding of Brazilian political economy. The published balance sheets of foreign and domestic banks, archival holdings of the major British banks and the lively contemporary financial publications support these findings.

Brazilian Banking and British Banks

The Brazilian-British trading system, centered on commodities (largely coffee) and finance, successfully created globally integrated and very efficient markets for commodities and money. Coffee was the product that most prominently connected Brazil to international markets during the First Republic. In its early stages, expanded coffee production required relatively little capital and import/export merchants attended to the necessary financial arrangements of extending short-term credit to bridge the needs of each stage of the production and trading cycles. Separate financial institutions were not necessary to accommodate commercial needs[2]. Indeed, attempts to establish domestic banks did not succeed prior to the end of the nineteenth century[3]. However, the rapidly growing coffee trade significantly increased demands on the financial system. By the end of the nineteenth century, the volume and risks of coffee financing were sufficient that coffee merchants were anxious to remove themselves from financing the commerce[4]. Small domestic commercial banks appearing through the nineteenth century partially filled the need to finance Brazilian merchants, of whom coffee-related merchants were among the most important[5].

2 J.E. Sweigart, *Coffee Factorage and the Emergence of the Brazilian Capital Market* (New York: Garland Publishing, 1987) and M. de Moraes Ferreira, "A crise dos comissários de café do Rio de Janeiro," (Tese de Mestrado; Niterói: Universidade Federal Fluminense, 1977.)

3 See M. B. Levy "História dos bancos comerciais no Brasil" (Rio de Janeiro: IBMEC, 1972) on the inability of commercial banks to establish a continual foothold in Brazilian commerce during the nineteenth century. C. Pacheco *História do Banco do Brasil* (4 vol; Banco do Brasil, 1977) outlines the attempts during the nineteenth century to establish a national bank servicing the public sector. The establishment of British banks, the earliest foreign entries, is discussed below.

4 Moraes Ferreira, shows this for the province of Rio de Janeiro, where coffee production peaked and declined earlier than in São Paulo.

5 Some of the banks that were organized at this time, which survived into the twentieth century, include B. de São Paulo, B. Commercial, B. de Comércio e Indústria (SP) and B.

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British banks were among the most prominent institutions spreading European business interests in Brazil. Both merchant and commercial banks were active[6]. Although, they had overlapping interests, they financed different types of activities and incurred risks of different natures. British merchant banks, most notably represented by the Rothschild family banking house, did not invest in or lend to Brazilian borrowers; nor did they necessarily raise "British" capital. The firm served as an intermediary broker, selling to investors the debt issued by the Brazilian government. Even so, merchant and commercial bankers had in common the function of providing for flows of finance that connected the different individuals, organizations, activities, economic sectors and geographic regions. They also seemed to share opinions on appropriate financial structure and business procedures.

From their appearance in the mid-nineteenth century, British commercial banks engaged in business of a relatively consistent nature: serving British export merchants. The London and Brazilian opened in 1863; and the British Bank of Brazil started in 1864; and the London and River Plate began Brazilian operations in 1892[7]. The first two banks merged into the Bank of London and South America (BOLSA) in 1923. BOLSA acquired the British Bank of Brazil during the 1930s. Finally, in the 1960s, Lloyds Bank acquired BOLSA[8]. British commercial banks, with their history of trade finance, ties to European markets, and early establishment benefited from the specialization of commercial finance.

At the end of the nineteenth century, the credit businesses that Brazilian and British banks conducted were dissimilar. During the nineteenth century, small groups of business associates owned the few (and short-lived) domestic banks, which offered them the opportunity to combine commercial and investment financing and to undertake equity

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Lavouro e Commercio (G. Triner, "Banks and Brazilian Economic Development, 1906-1930;" Ph.D. Dissertation, Columbia University; 1994 Table A.1).

6 D. Ross; "Commercial banking in a market oriented financial system: Britain before the War" (*Economic History Review*, vol. XLIX, No. 2, May, 1996) offers a good discussion on the types of banks.

7 Bank of London and Brazil, *Annual Report to Shareholders* (various years); Bank of London and River Plate, *Annual Report to Shareholders* (various years) and British Bank of Brazil *Annual Report to Shareholders* (various years). See also D. Joslin, *A Century of Banking in Latin America* (London: Oxford University Press, 1963), Ch. 4. These organizations were what Mira Wilkins identified as "free-standing companies." Each was organized independently of other firms within a British "house," which operated multiple, similar firms. (M. Wilkins and H.G. Schröter, *The Free-standing company in the world economy, 1830-1996* (Oxford New York: Oxford University Press, 1998).

8 Bank of London and South America, internal correspondence, maintained at University College of London Library Official documents and Lloyds Bank correspondence are held in the archives of the Lloyds Bank. (Hereafter, BOLSA.)

investment in the partners' other business enterprises[9]. At times, the Treasury granted specific banks the right to issue notes based on their own creditworthiness. When granted these rights, the domestic banks used them actively[10]. These opportunities were not available to British firms. Further, the Banco do Brasil offered short-term transactions to commercial interests at the same time that it provided services to the state[11].

Foreign and domestic banks provided short-term credit to span the period between a merchant's acquisition of a tradable commodity and the receipt of revenue from selling that commodity. They advanced credit by purchasing at a discount commercial paper guaranteed by the commodity (typically coffee) or the personal guarantees of the merchants. If the client defaulted, the bank had recourse to the payment from the original mercantile transaction on which the client had originally based the note. Providing on-going services for their clients could effectively convert short-term arrangements into long term financing, to the extent desired. However the scarcity of bank credit and the personalistic nature of many financial transactions resulted in an informal credit sector that probably eclipsed formal banking[12].

From its inception in 1889, the financial structure of the First Republic suffered periods of severe disruption. Beginning in the 1890s, shortly after the abolition of slavery and the monarchy, an unbridled financial expansion led to a crash, widespread corporate and bank failure and a prolonged depression[13]. The London merchant banking house of the

9 See, for example, Visconde de Mauá "Autobiografia (Exposição aos Credores)" (bankruptcy deposition, not dated), Joslin, 101 and C.G. Guimarães, "A Casa Bancária Mauá, MacGregor & Cia. (1854-1866) e o império no Brasil" (Universidade Federal Fluminense, Niterói, 1996). This is similar to patterns that N. Lamoreaux found in New England (I*nsider Lending: Banks, Personal Connections, and Economic Development in Industrial New England*. National Bureau for Economic Research, New York: Cambridge University Press, 1994.)

10 Franco, *Reforma monetária*.

11 On the nineteenth century, see A. Villela, "The Political Economy of Money and Banking in Imperial Brasil, 1850-1870" (London School of Economics, 1999). T. Gambi, "Centralização política e desenvolvimento financeiro no Brasil império (1853-66)", *Vária História* 28, no. 48 (2012).

12 The best sources on nineteenth-century banking are C.G. Guimarães, "Bancos, economia e poder no Segundo Reinado: o caso da sociedade bancária Mauá, MacGregor & Companhia (1854-1866)" (1997); C.G. Guimarães, E.S. GUIMARÃES, and M.M.M. MOTTA, "O Império eo crédito hipotecário na segunda metade do século XIX: os casos do Banco Rural e Hipotecário do Rio de Janeiro e do Banco Comercial e Agrícola na década de 1850," *Campos em disputa: história agrária e companhia*. São Paulo: Annablume (2007); J.J. Ryan, "Credit Where Credit is Due: The Evolution of the Rio de Janeiro Credit Market, 1820-1900" (UCLA, 2007).

13 The best recent source on the monetary instability during the first years of the Republic is G.H.B. Franco, *Reforma monetária e instabilidade durante a transição republicana* (Rio

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Rothschilds underwrote a loan to re-finance the Brazilian government debt in 1898[14]. The conditions of the Refunding Loan severely constrained the government's discretion in fiscal and monetary policy. These conditions pledged customs revenues to loan repayment, restructured ownership of government infrastructural investments, imposed expenditure constraints, implemented a gold standard, and mandated the withdrawal of currency from circulation[15]. During this prolonged crisis, bank regulation remained lax. Banks charters were issued by individual states, capitalization requirements did not include require high levels of paid-in capital, accounting standards did not mandate that banks mark their balance sheets to their market values. The Banco da República (the proto-national bank of the early Republic) failed at the end of 1900 because of the regulatory weaknesses. This failure triggered a much wider series of bankruptcies, rendering the banking system virtually inoperative[16]. The real value of bank deposits declined by 41% between 1898 and 1900. In Rio de Janeiro alone, the 68 banks that operated in 1891 had been reduced to ten by 1905[17]. From the end of 1900 until 1906, British commercial banks were the major providers of financial services in Brazil[18]. Widespread

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de Janeiro: BNDES, 1987.) It is also usefully discussed in Neuhaus "A Monetary History of Brazil, 1900-1945" (Ph.D. dissertation, University of Chicago, 1974), 5-7; Peláez and Suzigan, *História monetária do Brasil* (Brasília: Ed. Universidade de Brasília, 1976, 177-181); W. Cano *Raízes da concentração industrial*; M.B. Levy "O Encilhamento", in P. Neuhaus (ed.) *Economia brasileira: uma visão histórica* (Rio de Janeiro: Ed. Campus, 1980, 191-256); and R.W. Goldsmith, *Brasil: 1850-1984: Desenvolvimento financeiro sob um século de inflação*, (São Paulo: Ed. Harper & Row do Brasil, 1986), 106-107. For a consideration of the Encilhamento from the perspective of global finance, see G.D. Triner and K. Wandschneider, "The Baring Crisis and the Brazilian Encilhamento, 1889-1891: An Early Example of Contagion among Emerging Capital Markets?", *Financial History Review* 12, no. 2 (2005).

14 *Retrospecto Commercial de Jornal do Commércio* (Rio de Janeiro: Jornal de Commércio de Rodrigues e Cia., annual series; hereafter cited as RC), 1898, 19; A.V. Villela and W. Suzigan, *Política do governo e crescimento da economia brasileira: 1889-1945*, Monografia No. 10 (Rio de Janeiro: Instituto de Planejamento Econômico e Social, 1973) 84-92; Bouças, 160-164.

15 Rothschilds Archives (hereafter cited as RA), XI/8/1, memoranda and telegrams covering May 1898 – Mar., 1899, and XI/142/6, 7Jan, 1898, 17 Feb., 1898 and 7 Mar., 1898; and "Funding Loan, Accordo do Brazil com os credores externos realizado pelo governo do dr. Prudente de Moraes em 15 de Junho de 1898."

16 Bouças (183-188) lays the blame for the banking system failure on the restrictive conditions attached to the Funding Loan of 1898, especially the requirement to withdraw currency from circulation. P. Neuhaus, "Monetary History" 8-12; Triner, "Banking", 20-22; and C. Pacheco, *História do Banco do Brasil*, vol. 4.

17 G.D. Triner, *Banking and Economic Development: Brazil, 1889-1930* (New York: Palgrave Press, 2000), 47.

18 Brasil; Ministério da Fazenda; *Relatório apresentado ao Presidente da República dos Estados Unidos do Brasil*… Imprensa Nacional, yearly (hereafter, MF), 1907, LXIX.

restructuring of the failed banking system during 1905 and 1906, resulted in a substantially reformed financial system[19]. At the end of 1905, the Banco do Brasil was re-chartered, as the successor to the Banco da República, the Treasury's agent bank, (which led the failures in the 1900 crisis)[20]. A major component of the banking reform and organizational structure of the Banco do Brasil was the establishment of a Conversion Office (or currency board, in modern terminology) within the bank.

The Conversion Office put Brazilian currency on the gold standard, in anticipation of the continuing decline of the mil-réis to which coffee valorization would contribute[21]. Two considerations dominated the debate about valorization and the gold standard. The first was the ability of paulista producers to successfully affect world coffee prices. In this regard, they were relatively successful[22]. Determining the exchange rate that the Conversion Office would maintain was the second important issue of the debate. The two most visible economic concerns of the country had opposing interests in this question. Low exchange rates (£/mil-réis) favored exporters, but fueled domestic inflation and impeded the Treasury's ability to meet its international debt service burden. Supporting the mil-réis was intended to ameliorate the inflationary effects of the 1906 coffee valorization program. Ultimately, the Conversion Office supported a rate of 15 pence/mil-réis[23]. At least until 1914, this rate was somewhat below that which currency markets supported[24]. While often interpreted as an indication of the political strength of the coffee sector, these arrangements also set the framework for renewed domestic

19 Much of the restructuring reflected the demands the 1906 Coffee Valorization program and its borrowing in global markets. See M.B. Levy, "Foreign Capital," 363.

20 Goldsmith, 96-98; Topik, 40-43.

21 The exchange rate had fallen steadily from 26.4 pence/mil-réis in 1889 (annual average rate) to 7.4 pence in 1899; from 1901 a slight recovery brought the rate back to 12 pence until the 1906 reform. (Brasil, IBGE, Séries Estatísticas Históricas do Brasil, Vol. 3; *Séries econômicas, demográficas e sociais de 1550-1985* [hereafter, IBGE *Estatísticas históricas*], Table 11.10.) In more modern terminology, the Conversion Office was a currency board.

22 From 1908, global coffee prices reversed their sharp four-year decline and began a sustained period of increase. See W. Fritsch, *External Constraints on Economic Policy in Brazil, 1889-1930* (Pittsburgh: University of Pittsburgh Press, 1988), Table A.6.

23 From 1903 through early 1905, the market exchange rates hovered between 11.75 and 14 pence/mil-réis. Although the rate of 15 pence was a slight appreciation in the value of the mil-réis from the rates realized in the currency markets, it was the first official revision from an official par value of 27 pence in 1847. (IBGE, *Estatísticas históricas*, Table 11.10.) Even so, The federal Treasury retained sufficient borrowing capacity to continue new borrowing, contracting loans of £5 million and FF 100 million in 1908. (Neuhaus, 20-23; Bouças, 220.)

24 Topik, 41.

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banking expansion[25]. These countervailing interests were the core of the most intense political economy debates during the First Republic.

The reforms to the financial system simultaneously revitalized and constrained commercial banking. The newly-constituted Banco do Brasil acquired some functions of a central bank (though not formally as a lender of last resort). In addition to administering the gold standard, the bank was the agent for the federal government's financial transactions. The most profitable of its privileges were tariff collection (paid in hard currency), monopoly rights to conduct the Treasury's foreign exchange transactions, and a federal charter allowing it to establish branches across state boundaries. Along with its public sector functions, the bank had the largest private sector credit portfolio.

In contrast to earlier years, privately owned commercial banks engaged solely in financing short-term commercial transactions with rigorous procedures to protect against the risks of borrowers' failures. They funded their short-term investments with their own capital and deposits, rather than issuing notes that created insecure future liabilities[26]. Amended bank statutes and regulation precluded direct engagement in long-term finance and the issuance of unfunded notes[27]. Essentially, commercial banking served as a payments system to facilitate short-term working capital. It created credit to the extent that banks continually renewed funds advanced for short-term transactions. Risk minimization was an explicit and on-going goal of bank management. These characteristics were common to all publicly chartered banks, whose equity shares traded on the securities exchanges. Enhanced stability and legitimacy accompanied the reforms that restructured the banking system in 1906.

By 1906, once chartered, laws, regulation and taxation did not consider foreign banks differently from their local counterparts[28]. However, the nature of financial regulation offered foreign, and especially British,

25 Fritsch, *External Constraints*, 14-16 and Prado, *História econômica*, 230-232.

26 Triner, "Banking and Brazilian Economic Development", 101-108. A few banks did issue bonds in order to fully fund longer-term mortgage portfolios; but these required special management and regulation. See Triner; Hanley

27 Bankers did effectively convert short term finance into medium and long term facilities, but with a structure that allowed them to revert to the benefits of short term lending. (Triner, "Banking and Brazilian Economic Development," 105-106.)

28 E.S. Hurley; "Banking and Credit in Argentina, Brazil, Chile and Peru." US Bulletin of the Department of Commerce, Bureau of Foreign and Domestics Commerce, Special Agents Series #90. Washington DC: Government Printing Office, 1914; 44. Although, at times, foreigners apparently perceived discrimination against their position in commerce. ("Report by British Financial Mission to Brazil to Messrs. Rothschilds, Messrs. Baring Bros. & co. Ltd. and Messrs. J. Henry Schroder & Co. [hereafter, Montagu Report], 7.)

banks effective advantages not available to domestic organizations. The two most important areas if difference were with respect to conducting foreign exchange transactions and obtaining national bank charters.

British concerns appeared to be more risk-averse than their local counterparts. They limited their business to short-term, fully-funded, self-liquidating commercial transactions, especially in the foreign exchange market, in order to minimize their risks. Because "speculative" foreign exchange transactions were illegal after 1900, regulation prohibited foreign currency transactions which were not associated with specific commercial transactions. Therefore by servicing their compatriot export merchants, British bankers had an effective advantage in the sector of business that most required the exchange of currency. The British organizations earned a large share of their revenues, and conducted a large portion of their business by simply exchanging currencies, which involved no risk of credit exposure. In doing so, the banks profited both by the fees they charged and by their ability to realize gains from fluctuations in currency values. The money market for currencies was active both in London and Brazilian financial centers. By the beginning of the twentieth century, British banks telegraphed to their head offices the prevailing exchange rates at least daily. They aggressively pursued arbitrage opportunities to profit from exchange rate differentials between the locations[29]. British commercial banks displayed a reluctance to extend credit, and only slowly entered into general-purpose lending with personal guarantees. Although potential borrowers decried their risk-averse behavior, often with nationalistic overtones[30], British banks and their domestic counterparts clearly preferred the relative safety of exchange transactions, as compared to credit exposure[31].

Further, when extending credit, British commercial banks assessed their risk somewhat more severely than did their domestic competitors. In 1907, while the business community decried a debilitating lack of credit[32], a British consul reported that a "notable feature of the banking business during 1907 is the heavy amount represented by discounts and loans".[33] The British described much of the credit extended by Brazilian banks as accommodation notes[34], short-term credit extended

[29] See BOLSA G3/8 3Mar., 1906, for an early demonstration of arbitrage efforts. BOLSA G3/12, 31Jan. 1923, demonstrates the aggressive foreign exchange posture of the Bank of London & Brazil.

[30] Levy, "Foreign Capital," 364.

[31] RC, 1909, 24.

[32] RC, 1908, 8.

[33] British Consular Reports, 1908; Report No. 4054, 5.

[34] BOLSA, G3/8, 13Feb., 1907.

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to borrowers based on the personal relationship between the borrower and the banker. This form of lending was often seen as an expression of inefficient or "uneconomic" personalism. From the perspective of Brazilian bankers, however, a decision to extend credit secured by personal relationships could be an effective means of protection in an uncertain environment[35]. Interestingly, however, the credit portfolios of British banks did not match their rhetoric. For the period from 1906 to 1930, the distribution of credit between personally guaranteed short-term loans and purchases of discounted commercial paper was more heavily oriented towards loans for British banks than for the Brazilian organizations[36]. (See Figure 1.)

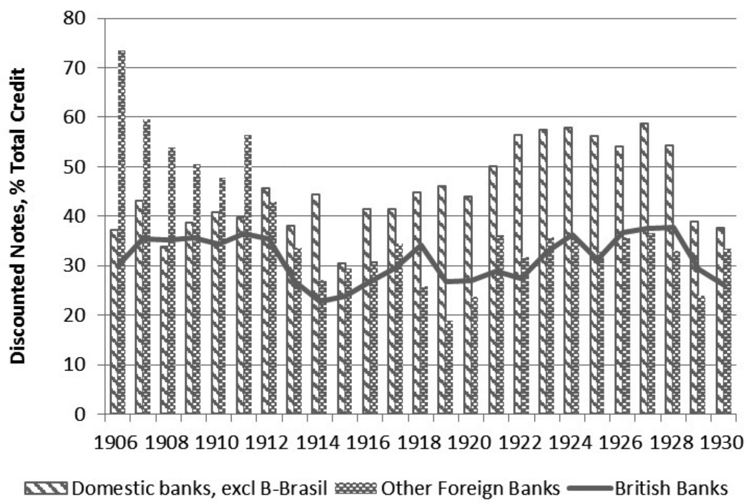

Figure 1: Composition of credit.
Source: Triner 2000, Appendix Tables.

The second advantage accruing to British banks after the 1905 reforms was their ability to retain national bank charters, rather than the state charters which domestic banks acquired. State-level regulation governed privately owned banks with respect to chartering and allocating capital to each office, as though each charter represented a separate institution. Foreign banks only needed one national charter which specified the number, but not location, of separate offices. British banks, with their very early presence in Brazil, were the clear beneficiaries of

35 Triner, "Formation."

36 Bank balance data are derived from the underlying data for Triner, "Banking", Data Appendix gives a detailed explanation of the data and its sources.

this arrangement. Each office within the British organizations shared information; they coordinated total credit limits to manage exposure to clients, shared financial and political information, and pooled their funding. Prior to the national expansion of the Banco do Brasil (slowly beginning in 1908), a consistently operating national bank was not reliably available in Brazil. Arrangements for note-issuing, deposit-taking, and funds transfers had been regional in nature. British banks offered one of the most expeditious ways of transferring funds inter-regionally.

British banks competed among themselves for regional representation. Pooling deposits of different offices, the banks maximized their business and enhanced their regional presence by allocating total resources to their most attractive opportunities, with little regard to geographic location[37]. They also competed for the ability to expand to new regions. For example, while rubber was still profitable, the Bank of London and Brazil worried when the London and River Plate opened a competing office in Manaus, the major rubber commercial center[38], In 1910, the London and Brazil complained that it had more difficulty obtaining permission to open local offices than the London and River Plate[39]. Even so, with the opening of the Banco do Brasil as a national bank, the London and Brazil did not initially expect competitive pressure on its local commercial business from regional Banco do Brasil branches[40].

Despite their implicit advantages, British commercial banks were dissatisfied with the results of the 1905 reforms for their activities within Brazil[41]. The benefits that the Banco do Brasil received from its quasi-public position were constant sources of complaint. Foremost among these benefits were its monopoly on foreign exchange transactions from the Treasury and customs collection[42]. Notwithstanding these complaints, the commercial operations of the restructured banking sector which emerged after 1905 was, in form, very similar to its British counterpart[43].

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37 BOLSA, G3/7, 23Feb., 1905; G3/8 15Aug., 1907 and G3/9, 9Apr., 1908 demonstrate typical efforts to combine funding among different regional offices of the Bank of London and Brazil.

38 BOLSA, B3/8, 5Sept., 1907.

39 BOLSA, G3/10 20Jan., 1910.

40 BOLSA, G3/9, 15July, 1908.

41 BOLSA G3/9 30July, 1908 and 5Aug., 1909.

42 BOLSA G3/8 30May, 1907, 5Sep., 1907; G3/9 14May, 1908, 30Jul, 1908; G3/10 2June, 1910.

43 Triner, “Banking,” Ch. 2.

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British bankers' understanding of the political economy

Despite the long and influential history of British commercial banks in the Brazilian financial system and the system's increasing stability, British bankers did not master the political economy of their environment during the First Republic. During the early period of bank restructuring and expansion, the Bank of London and Brazil, with the longest record in Brazil, made fundamental errors of judgment with respect to the political economy. In 1907, they did not expect the newly constituted Banco do Brasil to survive; nor did they expect that the Treasury would support a federal guarantee for the coffee valorization loan[44]. They professed to be surprised by the loan, even when it was eminent[45]. They further expected that the administrative bureaucracy of the procedures for maintaining the gold standard would not survive[46].

A few years later, rather surprisingly, the Bank of London and Brazil did not expect the British ban on coffee and cocoa imports, because of the financial and shipping demands of the military during World War I, to be important for Brazil. "After all, the USA is the largest purchaser of your [Brazilian] coffee and European neutrals appear to have all they require for some time to come [...]."[47] This response did not consider the complexity of the trading system in which they participated. The British-centered financial network supported a coffee trade that was very diverse. Germany had been the second largest importer of Brazilian coffee. Closing that market jeopardized the financial viability of the coffee trade. It also did not consider the additional difficulty that the London money market was also closed for Brazilian commercial paper and currency, making business transactions impossible.

Within Brazil, the weakness of their political judgment did not prevent British bankers from an intimate involvement with the business community. Although slow and modest in scope, from the 1910s, they began a shift toward financing Brazilian domestic enterprise, such as the textile and other consumer goods industries and domestically- oriented infrastructure projects[48]. These circumstances occurred during the

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44 BOLSA, G3/8 31Jan, 1907, 13Feb., 1907 and 11Apr., 1907; G3/10, 17Aug., 1911.

45 BOLSA G3/9, 23July, 1908.

46 BOLSA G3/8, 2Jan., 1908. The gold standard suffered inconstancies, but it was not abandoned until 1914, and the Caixa de Conversão remained formally constituted until 1921.

47 BOLSA G3/11, 9Mar., 1917.

48 BOLSA, G3/11 2Feb., 1917 and B14/2 8June, 1926.

years from 1914 until the early 1920s, when World War I constrained access to international markets[49] and domestic financial markets became expansive. Monetary expansion through Treasury note issuance and the Banco do Brasil Rediscount Office fueled domestic expansion[50]. Although these policies had a relatively small effect on the private sector, at the time, commercial banks broadened their presence in sectors beyond agriculture. British banks increasingly participated in lending consortia and rescheduling arrangements for failing or troubled local concerns[51]. British banks also became more active in issues related to the structuring of the Brazilian domestic banking system. As one instance, in 1914, foreign bankers actively organized efforts to establish a unified bank lobbying position to respond to the Treasury's foreign debt restructuring proposals, with significant leadership from the London and River Plate[52].

The collapse of global commodity markets and international financial stringency threatened the viability of these expansive policies at the end of World War I. Increasing international and domestic debt burden, price inflation and the strong global post-war slump in commodities diminished the financial options for the Brazilian government by 1923. Through the mid- and late-1920s, the Brazilian economy was under pressure[53]. Reflecting economic and political realities, orthodox monetary policies regained political strength. At the end of 1922, a new government based its strength largely on an orthodox platform of tightened monetary policy and financial restructuring. The Montagu Mission, representing the houses of the Rothschilds, Baring Brothers and Schroders, undertook a study of Brazilian public finance in order to support a loan intended to restructure public debt in 1924[54]. Despite the convergence of goals between British financiers and the Brazilian government, issues of national sovereignty were not far from the surface. The Montagu Mission considered the question of maintaining

[49] Suzigan, *Indústria brasileira*, 195-211; and Fritsch, 28-33.

[50] Neuhaus, "Monetary History," 35-42; Peláez and Suzigan, 206-207; and Villela and Suzigan, 140-142.

[51] Their actions during the 1915 bankruptcy negotiations of the Cia. de Tecidos de Botofogo provide a good example. See Triner, "Formation," 70-71.

[52] RC, 1914, 13.

[53] W. Baer; *The Brazilian Economy: Growth and Development* 4th edition (Westport CT: Praeger Press, 1995),; 32-35; and Goldsmith, 148-149.

[54] W. Fritsch, "1924;" (*Pesquisa e Planejamento Econômico*; vol. 10, no. 3 (Dec., 1980): 713-744) describes the relationship between the introduction of privatizing and deflationary policies and the Montagu Commission of 1924. The Commission was sent to Brazil to study the changes necessary to economic policy which would render acceptable to investors a £25 million loan for the purpose of liquifying domestic floating rate debt. Norman Monatgu, of the Bank of England, was the chief of the mission.

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a foreign financial oversight presence in Brazil. This point raised considerable opposition in Brazil[55]. The Treasury Minister's reaction to such a proposal was that: he would rather abandon all hope of restoring the financial position of Brazil than consent to the "fiscalization" of the Treasury … no Government that consented to it could live[56].

This period of economic contraction and restructuring coincided with the re-emergence of privately owned domestic banks as a strong force in the commercial sector[57]. Nevertheless, the British commercial banks focused on the contractionary aspects of their environment, and lowered their public profile. Internal communications focused on transferring funds among regional offices in order to accommodate credit commitments in a contracting banking system[58]. The benefits of inter-office transfers of funds were strongly demonstrated during 1924 and 1925 when monetary policy was severely contractionary. By actively managing their funding, the banks maintained their credit portfolios more than would have been the case otherwise. However, increased attention to allocation of funds among regions did not signify growing markets, as it had in earlier years, as much as it indicated more acute management. One telegram mentioned "the lack of safe and profitable investment and the consequent large cash holdings that practically every bank shows"[59]. Under these circumstances, foreign exchange trading also received renewed attention[60]. From 1923 to 1930, in Brazil, the Bank of London and South America (BOLSA) offices earned between 42% and 120% of their operating profits from foreign exchange operations. (See Table 1. Consistent data are not available for a longer period.) These profits often subsidized new offices and loan losses.

Table 1: Bank of London and South America Summary Income Statement, 1923-1932

		Provision	**Net**		**Provision**	**Exchange, as %:**	
	Operating Results	**For Losses**	**Operating Results**	**Exchange Profits**	**as % Operating**	**Operating**	**Net Results**
1923	4636	2043	2593	4147	44.07	89.45	159.93
1924	10284	1346	8938	6329	13.09	61.54	70.81
1925	16271	1369	14902	6953	8.41	42.73	46.66

55 Montagu Report, Covering summary addressed to mission sponsors, 20-21.

56 Montagu Report, Covering summary addressed to mission sponsors, 20.

57 Goldsmith (166-178) also recognizes this phenomenon.

58 BOLSA, G3/12 7Dec., 1923, 25Jan., 1924 and 26Sep., 1924 contain some of the most pertinent communications; though they appear frequently through 1924.

59 BOLSA, G3/12, 9Feb., 1923.

60 See for example, BOLSA G3/12 9Feb., 1923 and 18May, 1923.

Continuação da Tabela 1

		Provision	Net		Provision	Exchange, as %:	
	Operating Results	For Losses	Operating Results	Exchange Profits	as % Operating	Operating	Net Results
1926	6297	5356	941	3171	85.06	50.36	336.98
1927	8531	8172	359	5905	95.79	69.22	1644.85
1928	6540	4624	1916	4664	70.70	71.31	243.42
1929	7103	9893	-2790	4747	139.28	66.83	NA
1930	6296	13286	-6990	7572	211.02	120.27	NA
1931	-3678	5038	-8716	4415	NA	NA	NA
1932	-1858	11841	-13183	2217	NA	NA	NA

Source: Beane Report, 1933, Statistical Annex.

The pressure on public finance and the consolidation of the banking system continued through the remainder of the 1920s; and the financial situation remained precarious. The severe deflationary monetary policies (partially associated with the Montagu Commission recommendations) were in effect until 1926. They were followed by a sharp domestic recession, largely due to contraction in the textile industry. Immediately thereupon, came the global depression of 1929, which resulted in capital flight from Brazil and depressed international coffee prices. By the end of 1929, the benefit of allocating funds among branches had reached its limits. As deposits contracted in reaction to the uncertainty of the times, individual branches were unable to release funds to other branches[61]. London management permitted widespread overdrafts for the first time[62].

From the middle of June 1930, BOLSA officials in Brazil played down the political unrest which anticipated the coup of October. Local staff dismissed the seriousness of uprisings in the states of Paraíba and Rio Grande do Sul, and did not recognize the paralysis of the state government's finances in Minas Gerais as a political event[63]. At the same time, the Brazilian Treasury removed exchange restrictions[64]. The anticipated depreciation of the value of the mil-réis caused all banks to withdraw available funds immediately. Exercising their advantage in the foreign currency markets, BOLSA branches converted their mil-réis and shipped as much gold as possible out of Brazil, to London or New York[65].

61 BOLSA, B14/2 Dec., 1925; B14/3 Aug.,-Nov., 1927; B14/4 Apr., Oct. and Nov.,1929 offer examples of continual efforts to move funds within the BOLSA during periods of acute shortages. In Nov., 1929, branches claimed that they were unable to provide funds for transfer.

62 BOLSA, 26Oct., 1929; 28Nov.,1929.

63 BOLSA, B14/4, 18June, 1930, and 4 & 5 Sept., 1930, respectively.

64 BOLSA 30June, 1930.

65 BOLSA, B/14/4; almost daily telegrams on this subject from 5July, 1930.

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By this time, the federal Treasury's request for help to halt the outflow of gold had no credibility with BOLSA management[66]. Curiously, despite widespread political upheaval as a likely explanation of the capital flight, the first specific recognition that a coup was likely occurred on 3 October, 1930, one week before the event[67].

In 1931, seven years after the Montagu Mission, the Niemeyer Mission conducted another advisory trip to Brazil to propose changes in the structure of public finances[68]. The circumstances of this mission differed significantly from efforts in 1924. Rather than an abrupt end to an expansionary period, the Brazilian economy had suffered seven years of intense pressure. Under these conditions, potential lenders insisted on a comprehensive study of the financial system with recommendations for improvements as a prerequisite for another debt restructuring and increased borrowing.

The Niemeyer Mission proceeded despite the coup. The recommendations of the Niemeyer Report[69] in 1931 had the support of the traditional commercial press[70]. However, they lacked political support necessary for implementation. Despite initial lip-service to the commission's report and its orthodox policy prescriptions, its recommendations were not adopted. The new regime of Getúlio Vargas subtly, but quickly, showed protectionist tendencies. Indications that the Vargas Government either could not or did not intend to implement the recommended reforms came early[71]. In fact, the initial appearances of accepting the Niemeyer

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66 BOLSA, B14/1, 1Aug., 1930.

67 BOLSA B14/4 3Oct., 1930. From a casual reading of contemporary newspapers and from subsequent historiography, it is difficult to understand the delay in understanding the situation. (See for example, B. Fausto; *A revolução de 1930*; 12th edition, Rio de Janeiro: Ed. Brasiliense, 1989.)

68 These were the British equivalents of the US "money doctors" financial advisors who have roamed Latin America periodically offering financial advice, examined by Paul Drake and others. Edwin W. Kemmerer was the most famous of the "money doctors" in the first half of the twentieth century. (P. Drake; *The Money Doctor in the Andes: the Kemmerer Missions, 1923-1933*; Durham: Duke University Press, 1989 and P. Drake (ed.) *Money Doctors, Foreign Debt and Economic Policy*; Wilmington DE: SR Books, 1994) In fact, Júlio Prestes, the President-elect of Brazil before the 1930 coup, briefly proposed Kemmerer as the expert to advise Brazil on financial reformrs. The British, however, wished for British advisors to undertake the task. (B-Eng. Internal memo, by Mr. Stigment on his conversation with Lord Rothschild; OV103/1; 7 Aug., 1930.)

69 O. Niemeyer, et al., "Reorganization of Brazilian National Finance: Report Submitted to the Brazilian Government", (London and Rio de Janeiro: 1931).

70 RC, 1931.

71 See B-Eng., OV 103/40 17Aug., 1931 (telegram from Henry Lynch) and OV103/1 f97; 23 Oct., 1931. Not coincidentally, Vargas faced a coup attempt in the State of São Paulo in 1932.

Mission recommendations radically reversed within a year, when the Vargas Government announced a moratorium on its foreign debt in 1932. These actions supported the coffee interests concentrated in São Paulo. More intriguing, however, they supported the interests of emerging import-substituting manufacturing, also concentrated in São Paulo. They presaged later and more explicit development policies, based on protection of new import-substituting industries[72].

Competitive pressures

Further challenging their position in Brazil, British banks faced vastly increased competition from a variety of sources. At the end of 1906, immediately after the banking reforms, British banks represented about 16% of the banking sector in the major financial centers, as measured by size of their deposit base[73]. By 1930, these same banks accounted for 7% of bank deposits. (See Figure 2.) Credit extended by British banks increased four-fold between 1906 and 1930 in real (inflation-adjusted) volume; while private domestic bank credit increased more than seven-fold[74]. (See Figure 3.)

Rumors had circulated throughout 1923 of the possible merger of the London and Brazil with the London and River Plate. The Bank of London and Brazil denied the possibility as early as January[75]; the banks announced the merger in November[76]. The motivation for the merger had been to consolidate two organizations which were very similar, and had not been growing at satisfactory rates[77]. Changes to bank management policies did not accompany the new corporate structure; credit-issuance and deposit-taking continued without noticeable change. By the 1923 merger, the newly constituted bank had offices in fourteen widely dispersed locations[78]. Through 1924, they consolidated separate

72 Baer, 38-53.

73 Derived from Triner, "Banking," underlying data for Appendix Tables A.3 and A.5. These data include balances at the Banco do Brasil (which held about 25% of bank deposits over the course of the period).

74 These measures understate the importance of the British institutions in the financial system, since it does not take account of their tradition (though declining) foreign exchange business.

75 BOLSA, G3/12, 31Jan., 1923.

76 BOLSA, G3/12, 8 and 15Nov., 1923 and 25Jan., 1924.

77 Bank of London and River Plate, Annual Report, 1923.

78 The locations were Rio de Janeiro, São Paulo, Santos, Salvador da Bahia, Ceará, Curitiba, Maceió, Manaus, Maranhão, Pará, Pelotas, Pernambuco, Porto Alegre, Rio Grande [sic] and Victoria; BOLSA, Beane Report, Statistical Annex, 1933

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banking offices, staff and administrative arrangements. However, internal communications mentioned no changes of banking policies[79]. The ease of the merger reflected the similarity of the practices and businesses of the institutions. Despite an easy merger, British banks did not reverse their relative decline. (See Figure 2.)

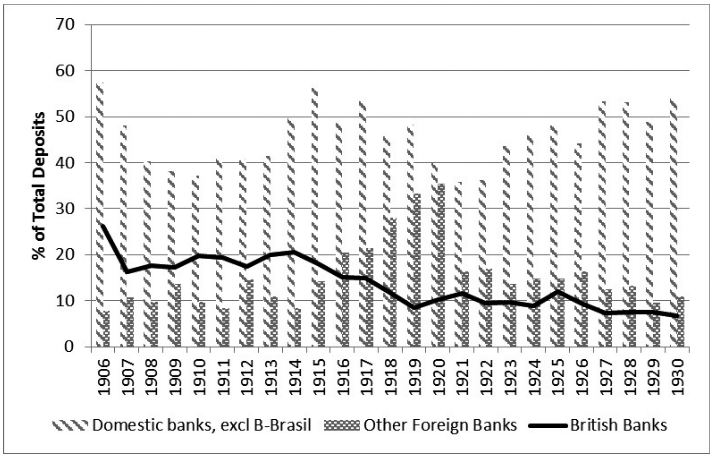

Figure 2: Share Distribution
% of Total Deposits, by nationality of bank ownership.
Source: Triner 2000, Appendix Tables.

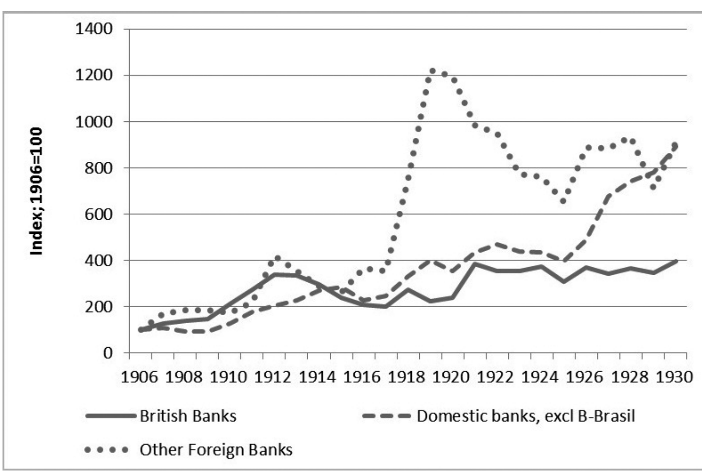

Figure 3: Growth of Credit; Index, 1906=100.
Note: Based on real growth, after adjusting for inflation.
Source: Triner 2000, Appendix Tables.

[79] BOLSA G3/12, 1924 passim.

The declining role of Britain in Latin American economies after World War I[80], reflecting a relative shift of international financial importance towards the US, may not have been as pronounced as generally believed[81], At least as important as changes in international economic positions, the relative decline experienced by British commercial banks reflected the growth of the Brazilian economy and the domestic banking system. As the First Republic progressed, the declining importance of British financial institutions reflected the growth and diversification of the domestic economy.

The evolution of the Brazilian economy made possible the shift in the type of financing that accompanied the change in its national origin. Important sectors of the economy were more committed to domestic than international markets. A significant portion of domestic development during the First Republic occurred in the realm of early industrial manufacturing. Between 1900 and 1930, industrial production increased 4.6 times, while all agricultural production (including coffee) increased 2.8-fold[82]. Further, available evidence suggests that the areas of most dynamic economic growth during the last decades of the First Republic were regions supporting domestic, rather than international, markets[83].

Domestically-owned private banks grew rapidly in number and size at this time, even after accounting for inflation and the formation of state government banks accelerated in the early 1920s, in response to the expansive conditions[84]. After strongly expansionary rediscount programs that shifted business to the Banco do Brasil from 1914 until 1923[85], private domestic banks re-emerged dynamically for the remainder of the decade. Brazilian owned banks increased their share of private bank deposits from 35% in 1921 to 53% by the end of the decade. (See Graphs 3 and 4.) During the late 1920s, the directors of the Bank of London and South America appreciated that they needed to re-consider the form of business that they conducted in Brazil[86]. By 1933, they recognized that

80 BOLSA G3/11, 8Feb., 1918 and RC, 1925, 105 (on new loan for $25 million issued by Dillon Reed). See also B. Stallings, *Banker to the Third World: US Portfolio Investment in Latin America, 1900-1986*; Berkeley: University of California Press, 1987.

81 Marichal, 174.

82 Derived from C. Haddad, "Growth of Brazilian Real Output: 1900-1947," Ph.D. dissertation, University of Chicago, 174; Table 1.

83 G. Triner; "Banks, Regions and Nation in Brazil: 1889-1930," unpublished manuscript, 1996; 14-19.

84 Triner, "Banking," Tables A.3 and A.4, and Baer, 245.

85 Triner, "Formation," 60-63.

86 BOLSA, B14/2 18May, 1926.

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the bank needed to shift its emphasis from facilitating trade transactions, avoiding credit, to develop a business more firmly rooted in lending funds:

> …in 1929/30 there was a general tendency to increase loans and discounts. This tendency was not, I am quite certain, the result of a decided policy by the Board, but rather the lack of any policy or of any control or consideration of the general rise in advances. To avoid this in the future I think that we should have laid before us a summary, … We shall almost certainly have to rely more and more in the future on our Banking profits rather than exchange profits, and good management and control will become more essential[87].

Production for domestic markets developed to a scale and complexity that it required and supported more dynamic financing arrangements. Brazilian-owned commercial banks accommodated these financing needs at least as well as their British counterparts. They did not require as much access to foreign exchange markets as the export trade, which had been the historic strong-point of the British organizations. Further, Brazilian organizations responded more sensitively to domestic conditions. As domestic concerns required financing, and accepted the ability of Brazilian organizations to meet those needs on an on-going basis, short term finance shifted towards domestic banks.

Foreign banks of other nationalities were another major source of competition for the British. The growth of manufacturing capacity to accommodate the increasing demand for consumer goods supported the growing predominance of direct foreign investment in emerging industries. General Electric, RCA, IBM, Ericsson, Philips, Burroughs, Pirelli, General Motors and Ford were some of the corporations investing and producing in Brazil for the use of the domestic economy by the end of the 1920s[88]. The presence of transnational corporations accommodated both the presence of a wider variety of nationalities among foreign banks and the relative decline of portfolio investment in financial assets[89]. The share of deposits in the Brazilian banking system from foreign banks <u>not</u> of British origin increased from 14% in 1915 to a short-lived maximum of 35% in 1920; and the real volume of foreign bank credit grew at the same rate as the domestic banks through the First Republic (though with greater fluctuations. See Graphs 3 and 4.) During the 1910s and early 1920s at least nine foreign banks opened offices in Rio de Janeiro

87 Lloyds Bank, file 2383, letter from F. Beane to F. Glyn; 1Aug., 1933.

88 Dean, Ch. 5.

89 Therefore, although not the subject of this paper, British pre-eminence in meeting the investment banking needs of Brazil also declined during this period.

or São Paulo[90]. Although not all of these organizations had long or successful lives, they increased the sense of competition and dynamism for commercial banking during the 1910s and early 1920s.

Conclusion

Relative to the five avenues of foreign bank influence identified in this paper's introduction, how do we assess the contribution of British banks to the Brazilian banking system and economy? Brazilian use of the British system as a model for a national banking system was selective. During the four years in which domestic banks did not operate, the British firms effectively provided a national network, and a few Brazilian banks did begin to operate nationally under separate state charters. However, the regulatory system remain rooted at the state, rather than national, level as in Britain. The attempts of British advisors in 1923 and 1930 (the Montagu and Niemeyer Missions) to institute the practices that they believed would be stabilizing and more effectively connect money with banking had only weak and short-lived influence. Nevertheless, British banks did serve as a business model for the domestic organizations. With the banking reforms of 1905, Brazilian banks largely confined their credit portfolios to short-term commercial transactions and fully supported foreign exchange business, as did the British counterparts. In meeting their customers' needs (largely, British import/export merchants) the British banks provided foreign exchange services that extended beyond the capability of Brazilian banks to support the domestic economy. Entering the Brazilian market in the middle of the nineteenth century, the British firms clearly injected new capital and resources into the Brazilian economy. However, in later periods of crisis, they did not increase their capital and reserves. During the early 1930s the BOLSA made a specific effort to concentrate resources and withdraw capital. Support of the expansion of business transactions by the British banks was strongest in the early years of their participation within the Brazilian coffee economy. With the later transition towards building an industrial economy, British banks slowly followed their Brazilian and other foreign competition.

90 These included two new German bank opened in 1911 (Allemão Transatlântico and Deutsch Sudamerikansche); two US banks opened (First National City of New York in 1915 and American Banking Corp. in 1919); Español y Rio de la Plata opened a Brazilian office in 1909; Hollandez - America do Sul appeared in 1917; the Norwegian Banking Amalgamation opened in 1918; Royal Bank of Canada came in 1919; and Yokohama Bank appeared in 1923. (Triner, "Banking," Table A.1 and BOLSA, G3/11, 8 Oct., 1918. Not all of these organizations had a long life in Brazil. See also, Joslin, 108-110 and Levy "Foreign Capital", 364-365.

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Symptomatically, despite their long and increasingly deep experience, British bankers suffered a disadvantage in Brazil. They did not become well versed in the political economy of their environment. Monetary policy was the core of profound political difference and debate throughout the First Republic. However, British bankers[91] did not display a deep understanding of the political tensions inherent in the differences of interests; and turns of political events often left them surprised. In large part, one can hypothesize that the interests of British finance in stability and maintenance of the profit dynamics of the commodity and money trading system remained constant, and it did not adapt to the changing realities of the Brazilian economy.

By 1930, the economic and political structure of Brazil was very different from the beginning of the First Republic. Brazil's comparative advantage in agricultural commodities and, more importantly, the desire to maintain that comparative advantage were under increasing pressure through the early twentieth century. Industrial manufacturing increasingly mitigated the predominating influence of the coffee sector. Domestic markets gained importance in the economy and nationalistic interests garnered strong political adherents. Government policy was increasingly willing to impose protective tariffs in support of domestic industry and to institute debt moratoria, rather than submit to the requirements imposed by rescheduling debt. The private domestic commercial banking system grew dynamically during the first third of the century, as its organizations more flexibly and reliably accommodated local requirements. The original relations were of decreasing importance.

This paper has demonstrated that British commercial banks continually assessed their circumstances in Brazil relative to their original relations because their profit dynamics remained relatively stable. For Brazilian business, however, the success of earlier activities for economic development and growth changed both the volume and composition of demand and the relative prices of goods and services. Producing for an enlarging domestic market, both to substitute for imported goods and to provide low-value consumer goods became increasingly viable[92]. British financial and commercial networks did not accommodate the fundamental shift in the balance between domestic and international markets in Brazil. An alternative interpretation is that Brazilian and other foreign banks responded effectively and dynamically to the opportunities that economic change presented.

91 It was also the case that, by design, Brazilians did not become bankers for British banks in Brazil. (Lloyds Bank, BOLSA Personnel and Training Notes; File 2384, 12Dec., 1929.)

92 Dean; and Suzigan, *Indústria brasileira*.

Archival abbreviations

BBB	British Bank of Brazil Archive
BCR	British Consul Reports
BE	Bank of England Archive
BLB	Bank of London and Brazil Archive
BLRP	Bank of London and River Plate Archive
BOLSA	Bank of London and South America Archive
JC	Jornal de Commércio
MFR	Ministério da Fazenda; *Relatório apresentado ao Presidente da República*
RC	Retrospecto Comercial de Jornal do Commércio

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