

London School of Economics and Political Science

**THE POLITICAL ECONOMY OF MONEY AND BANKING IN IMPERIAL
BRAZIL, 1850-1870**

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ABSTRACT

The thesis examines the development of monetary and banking policies during the apogee of the Brazilian Empire (1850-70). It adopts a political economy approach to Brazilian monetary history, with the objective of contributing to the debate surrounding the relative autonomy of the imperial State in relation to the planter class (*fazendeiros*). The research has established two major points of historical fact: the peculiar nature of the gold standard regime in force in Brazil during part of the period, and the role of the Bank of Brazil therein. The analysis has also extended current knowledge of two major contemporary events in the financial sphere - the 1860 banking and corporate law and the Souto crisis of 1864. The former is shown to have been less draconian than claimed by historians while attention is drawn to the hitherto neglected role of private banks in fuelling the 1864 crisis. The thesis argues that between 1850 and 1870 the imperial government followed an approach to monetary and banking policy that could be termed “pragmatically conservative”. This tended to involve the “hard money” combination of monetary restraint and adherence to the gold standard, although on crucial occasions - such as during the Souto crisis, and the Paraguayan War - monetary prudence gave way to expansionist policies, as reasons of State took precedence over financial rectitude. The research reveals how, in the main, “hard money” policies were pursued in the period, to the detriment of demands from the planter class for monetary expansion. This evidence suggests that, at least in the sphere of money and banking, the imperial State displayed a relative autonomy vis-à-vis the economic elite.

(...) in order for a credit system to work smoothly, it needs an institutional framework which shall restrain it on the one hand, and shall support it on the other. To find a framework which can be relied on to give support when it is needed, and to impose restraint just when it is needed, is very difficult; I do not think it has ever been perfectly solved. Even in this day we do not really know the answer.

John Hicks, *Critical Essays in Monetary Theory*. Oxford, Clarendon Press, 1967, pp. 158-9.

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Abbreviations

ACD - Annaes da Câmara dos Deputados

ACE - Atas do Conselho de Estado

ASI - Annaes do Senado do Império

HAHR - Hispanic American Historical Review

HOPE - History of Political Economy

RBE - Revista Brasileira de Economia

*RMF - Proposta e Relatorio Apresentados á Assembléa-Geral dos Deputados pelo
Ministro e Secretário d'Estado dos Negócios da Fazenda*

SAJ - The Brazil and River Plate Mail and South American Journal

SFCE - Imperiaes Resoluções do Conselho de Estado na Seção de Fazenda

Usage

In view of the changing nature of Brazilian Portuguese orthography, the decision was taken to use the modern (post-Law 5705, 18 December 1971) spelling mode in the text and tables. Notes and bibliography, however, have retained the original forms in deference to scholarly accuracy. Finally, as a rule, Luso-Brazilian proper names (both given and surnames) have been modernised.

The Brazilian currency throughout the imperial period was the *milréis*, expressed as 1\$000. One thousand *milréis* made up a *conto de réis* (or *conto*, for short), expressed as 1:000\$. At the official 1846 parity of 27d/1\$000, one pound sterling amounted to 8\$890, or 8.89 *milréis*.

INTRODUCTION

For Brazil, the period 1840-1889 was a time of relative economic success. Economic growth, while not on a par with the performance of North-Atlantic countries, was definitely superior to that of the previous three-quarters of a century, which saw virtual stagnation. Most of the economic expansion from the 1840s onwards was accounted for by the growth of the coffee sector. Yet, it is widely believed that overall economic performance would have been better had it not been for constraints imposed by the government on the development of the banking sector. In other words, were it not for the prevailing orthodoxy, monetary expansion could have provided the productive sector with low interest rates, and higher growth. This thesis will not attempt to provide a counterfactual to the above story, that is, it will refrain from speculating on how might the economy have performed had the banking sector been allowed to develop more freely. Instead, it will look at the reasons for the pursuance of “hard money” policies - defined to include monetary prudence and exchange-rate stability.

The aim of the thesis is to study the evolution of monetary and banking policy during a crucial period of Brazilian economic and political history - the so-called apogee of the Empire, from 1850 to 1870. Yet, this is not a traditional monetary history of the period.¹ Rather, the focus will be on evolving institutionality in the monetary sphere, identifying the rationale behind official policies implemented. To this end, the methodology employed in the thesis is inspired in the “new political economy” approach. In general terms, this means giving pride of place to the political dimension of the policymaking process. This will allow for an examination of the effective constraints under which nineteenth-century Brazilian policymakers were operating. Moreover, the new political economy approach will enable the thesis to challenge traditional explanations about the nature of the imperial State, often inspired in Marxist thought.

¹ For this type of approach, the reader is referred to C. M. Peláez and W. Suzigan, *História Monetária do Brasil* (Brasília, Ed. da Universidade de Brasília, 1976, 2nd edn.). The original classic - that spawned similar research programmes in other countries, such as the one leading to the Peláez and Suzigan book - is M. Friedman and A. Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton, Princeton University Press, 1963).

Ultimately, the puzzle which the thesis sets out to solve can be summarised as follows. If monetary and banking policies in the 1850s and 1860s were characteristically orthodox - taking the form, amongst other things, of government-imposed restrictions on the banking system, the pursuit of convertibility and a bias towards an appreciated rate of exchange - what does this suggest about the underlying polity? More specifically, how do these facts square with the perceived hegemony of the land-owning class (*fazendeiros*) during the imperial period, given that for them “soft money”, and a depreciating *milréis*, would have been desirable?² A possible answer to this puzzle has already been provided elsewhere. Hanley rightly points out that

because of the importance given by many policy makers to exchange rate stability, a product of Brazil’s export-orientation, and because of the prevailing belief that growth in the money supply would undermine the exchange rate, the imperial government chose to limit the activities of banks to areas that bore no influence on the money supply.³

Unfortunately (or perhaps fortunately), Hanley fails to elaborate this point further, given that it is not at the centre of her research. This thesis, while basically confirming Hanley’s insight, will develop the argument in detail, in order to bring out some finer pieces of the large picture. Among other things, it will ask: “Was monetary policy in the period systematically orthodox?”; “What were the political constraints on economic policymaking?”; “What was the nature of the financial crises that occurred in 1857 and 1864?”; and “Was the 1860 banking and corporate law ultimately responsible for the 1864 crisis?”.

² This is broadly the point of departure in Fritsch’s work on the First Republic. See W. Fritsch, *External Constraints on Economic Policy in Brazil, 1889-1930* (London, Macmillan, 1988). In effect, “soft money” would have provided coffee (and sugar) exporters with cheaper credit, while a depreciated rate of exchange, *ceteris paribus*, increased their earnings in domestic currency terms.

³ Cf. A. G. Hanley, “Capital Markets in the Coffee Economy: financial institutions and economic change in São Paulo, Brazil, 1850-1905” (unpublished Ph.D. thesis, Stanford University, 1995), p. 41. As noted by Hanley, ‘concerned first and foremost with its ability to meet its budget obligations and maintain a stable currency, the Brazilian government followed a see-saw pattern of legislation in the nineteenth century that sent confusing signals to the financial sector. In fact, its policies throughout most of the period acted to stifle bank development’. *Ibid.*, p. 20. Although roughly agreeing with this claim, Saes notes that from the 1880s onwards the *paulista* banking system (with the exception of the local branch of the Bank of Brazil) managed to expand its commercial activities in spite of the overall restrictive monetary policy carried out by the central government. See F. A. M. de Saes, *Crédito e Bancos no Desenvolvimento da Economia Paulista, 1850-1930* (São Paulo, IPE/USP, 1986), Chapter III.

A set of stylised facts will highlight the issues to be addressed in the thesis and the major interpretations available in the literature. Since the mid-1840s the Brazilian government flirted with the idea of adhering to the gold standard. Concurrently, it aimed at creating a monopoly in the issue of banknotes, in an effort to prevent uncontrolled money creation. As a result, banking activity was firmly regulated during most of the imperial period, potentially compromising overall economic development.

Contemporary official accounts of events in the monetary and banking realm are testimony to an orthodox view of economic theory. They attach great weight to monetary restraint and emphasise the virtue of a fixed exchange rate, which would result from convertibility of the *milréis* into gold.⁴ Although this view was not unchallenged (as will be seen below), it was widely held during the period.⁵

The treatment that Brazilian monetary history has received from the literature over the past century has not been very satisfactory. Early-twentieth-century works and those written after the Second World War have been characterised by a certain amount of ahistoricism, that is, a tendency to read past events in the light of concerns uppermost at the time when authors were writing. Thus, writers in the late nineteenth and early twentieth centuries - when Brazil would finally join the gold standard “system” - praised the orthodoxy of monetary policy restraint and convertibility, typical of the mid-nineteenth century.⁶ Scholars writing after the Second World War,

⁴ See most of the Annual Reports of the Ministry of Finance of the period, the *Jornal do Commercio* (Rio’s main financial paper) and, especially, *Relatorio da Comissão de Inquerito Nomeada por Aviso do Ministerio da Fazenda, de 10 de Outubro de 1859* (Rio de Janeiro, undated); and *Relatorio da Comissão Encarregada pelo Governo Imperial por Aviso do Primeiro de Outubro e 28 de Dezembro de 1864, de Proceder a um Inquerito Sobre as Causas Principaes e Accidentaes da Crise do Mez de Setembro de 1864* (Rio de Janeiro, Typographia Nacional, 1865). Hereafter, *Comissão de 1859*; and *Comissão de 1864*, respectively.

⁵ For example, see S. F. Soares, *Notas Estatísticas Sobre a Produção Agrícola e Carestia dos Gêneros Alimentícios no Império do Brasil* (Rio de Janeiro, IPEA/INPES, 1977, originally published in 1860); and idem, *Esboço ou Primeiros Traços da Crise Commercial da Cidade do Rio de Janeiro em 10 de Setembro de 1864* (Rio de Janeiro, Laemmert, 1865); B. de Mauá, *O Meio Circulante no Brasil*, originally published in 1878 and reprinted in C. Ganns (ed.), *Visconde de Mauá, Autobiografia (Exposição aos Credores seguida de O Meio Circulante no Brasil)* (Rio de Janeiro, Zélio Valverde, 1942); A. Cavalcanti, *Resenha Financeira do Ex-Império do Brasil em 1889* (Rio de Janeiro, Imprensa Nacional, 1890); and idem, *O Meio Circulante Nacional* (Rio de Janeiro, Imprensa Nacional, 1893, 2 vols.).

⁶ Prominent among these are J. P. Wileman, *Brazilian Exchange: the study of an unconvertible currency* (Buenos Aires, Galí Brothers, 1898); J. P. Calógeras, *A Política Monetária do Brasil* (Rio de Janeiro, Cia. Editora Nacional, 1960, originally published in 1910); R. Ortigão, *A Moeda Circulante no Brasil* (Rio de Janeiro, Typ. do Jornal do Commercio, 1914); A. C. R. de Andrada, *Bancos de Emissão*

on the other hand, have tended to approach the whole question of money and banking in the Empire through “developmental” lenses, reflecting the then current debates surrounding Brazil’s experience of fast industrialisation. Consequently, their main concern was with the perceived failure of the imperial banking system to aid economic development. In this respect, three broad views stand out. The first one starts with Furtado’s landmark book.⁷ His analysis of monetary and banking policy in both the Empire and First Republic inspired most of later research on the subject. According to Furtado, monetary restraint and the pursuit of convertibility over much of the imperial period (1822-1889) and the First Republic (1889-1930) were detrimental to economic development and should be attributed to “mimicry”, that is, an uncritical importation of financial orthodoxy from Europe. Later writers echoed Furtado’s interpretation of the existence of a persistent orthodox bias in imperial monetary and banking policy which, coinciding with the arrival of the first British banks in the 1860s, allegedly furthered the interests of foreign bankers, rather than those of the country.⁸ This group of works is very close to Furtado. The main difference being that later contributions attempt to set monetary orthodoxy (especially as regards the centralisation of issuing powers) within a broader context of disputes between urban and agrarian interests (or the Rio financial community and “monetary circuits” in the Northeast).⁹ Finally, the third interpretation takes a radically different

no Brasil (Rio de Janeiro, Ed. Leite Ribeiro, 1923); and C. I. de Souza, *A Anarquia Monetária e Suas Conseqüências* (São Paulo, Monteiro Lobato, 1924). Their interpretation of monetary events in the nineteenth century were more often than not a repetition of the conclusions found in the reports of the commissions set up to investigate the commercial crises of 1857 and 1864. See *Comissão de 1857*; and *Comissão de 1864*.

⁷ See C. Furtado, *Formação Econômica do Brasil* (São Paulo, Companhia Editora Nacional, 1970, 10th edn.). It should be noted that Furtado’s objective was not the writing of a monetary history of Brazil, although the discussion of monetary and banking issues are central to his arguments in Chapter 27.

⁸ See, for instance, R. G. Granziera, *A Guerra do Paraguai e o Capitalismo no Brasil: moeda e vida urbana na economia brasileira* (São Paulo, Hucitec/Unicamp, 1979).

⁹ Several works reaffirm the point about an orthodox bias towards banking in the Empire. See, for example, M. B. Levy, *História da Bolsa de Valores do Rio de Janeiro* (Rio de Janeiro, IBMEC, 1977); M. B. Levy and A. M. R. de Andrade, “Fundamentos do Sistema Bancário no Brasil, 1834-1860”, *Estudos Econômicos*, Vol. 15, Special Issue, 1985, pp. 17-48; idem, “El Sector Financiero y el Desarrollo Bancario en Río de Janeiro (1850-1888)”, in C. Marichal and P. Tedde (eds.) *La Economía Financiera y la Formación de la Banca Central en España y Latinoamérica* (Madrid, Banco de España, 1993); A. R. de Andrade, “1864: conflito entre metalistas e pluralistas” (unpublished MSc. dissertation, Universidade Federal do Rio de Janeiro, 1987); A. M. C. Teixeira, “Determinantes e Armadilhas da Política Monetária Brasileira no II Império” (unpublished MSc. dissertation, Universidade Federal Fluminense, 1991); and C. G. Guimarães, “Bancos, Economia e Poder no Segundo Reinado: o caso da Sociedade Bancária Mauá, MacGregor & Companhia (1854-1866)” (unpublished Ph.D. thesis, Universidade de São Paulo, 1998).

stance from Furtado and his followers and argues, instead, that monetary and banking policy during the Empire was often of a counter-cyclical (proto-Keynesian) nature and, therefore, heterodox. The main proponent of this thesis is Peláez.¹⁰

The thesis will address the main questions raised by authors sympathetic to the orthodox view, as well as those put forward by writers in the “developmental” tradition. In the process, the research will clarify some crucial points of historical fact. It does so by adopting a subtler approach to politics than has been the case in the recent monetary historiography. Levy and Andrade, for example, posit a direct correspondence between events in the banking and political spheres. According to them, the move towards a monopoly of note issue in the early 1850s was the economic counterpart of the political process of centralisation achieved in the previous decade.¹¹ Likewise, plurality of note issue, instituted at the end of the *Conciliação* period, in 1857-8, would have reflected a conciliation between different positions concerning the right to note issue. Finally, Levy and Andrade suggest, perhaps inadvertently, that when promoting hard money policies the imperial government managed to impose its will on the land-owning class, thus displaying a degree of autonomy from the economic elite.¹²

Schulz, on the contrary, sees the financial policies of the Empire as being largely sympathetic to agrarian interests.¹³ Financial orthodoxy, in his view, was not as pervasive as imagined by authors such as Furtado. Similarly, Guimarães claims that financial policy was controlled, at least in the early 1850s, by economic interests based in Rio. This group included businessmen in the export and import trade, and, crucially, provincial *fazendeiros*.¹⁴ Additionally, and again in parallel with political events, it is claimed that Liberals tended to be in favour of the expansion of the

¹⁰ See C. M. Peláez, “The Theory and Reality of Imperialism in the Coffee Economy of Nineteenth-Century Brazil”, *Economic History Review* (2nd series), Vol. 29, No. 2, May 1976, pp. 276-90; Peláez and Suzigan, *História Monetária*; and J. Schulz, *A Crise Financeira da Abolição* (São Paulo, Edusp/Instituto Fernand Braudel, 1996).

¹¹ Levy and Andrade, “Fundamentos”, pp. 35-6. The development of the Brazilian banking system will be examined in detail in Parts II and III of the thesis.

¹² *Ibid.*

¹³ Schulz, *A Crise*, Chapter 1.

¹⁴ Guimarães, “Bancos”, pp. 41-2. This is also the opinion held by Melo, for whom the banking reform proposed by Itaboraí in 1853 aimed at ‘privileging big business in the Rio market and the related coffee interests of the Paraíba Valley’. Cf. E. C. de Melo, *O Norte Agrário e o Império* (Rio de Janeiro, Nova Fronteira, 1984), p. 98.

banking system (and, presumably, soft money), while Conservatives were associated with the centralisation of issuing rights and financial orthodoxy.¹⁵ Finally, Granziera has asserted that adherence to the gold standard and, implicitly, to a stable and appreciated currency, was pursued by the imperial government in the interest of English firms.¹⁶

Suggesting different underlying models of the polity, the above interpretations of the political motivation for financial policy in imperial Brazil are clearly at odds with each other. Some subscribe to traditional views that policy was set by the economic elite, which sometimes included foreign interests. Others appear to admit to a degree of autonomy on the part of the imperial State. Yet, none of the above contributions - nor, for that matter, other works on money and banking in the Empire - set out their underlying political model explicitly. This has major implications for the consistency of their analyses and conclusions. Policymaking does not take place in a void. Rather, it is a result of the political process.¹⁷ In placing monetary and banking history within an institutional context, this thesis will attempt to capture the political dimension of the policymaking process. Its main findings will also contribute to the debate about the relative autonomy (or otherwise) of the imperial State, hitherto analysed in respect to policy areas such as taxation, slavery, land policy, and railways.¹⁸ In the end, the thesis will assess the degree to which the ruling class of politicians and bureaucrats was independent of the dominant class, that is, landowners.

The focus of attention will be on monetary and banking policy between 1850 and 1870. This period is bounded by the formal end of the trans-Atlantic slave trade, the enactment of the Commercial Code, and the Land and Immigration Law - events that occurred in 1850 - and the end of the Paraguayan War, in 1870. This was the so-called apogee of the Empire, when, as already noted, the booming coffee sector awakened the economy from the lethargy of the previous three-quarters of a century.

¹⁵ Guimarães, “Bancos”, pp. 58-9.

¹⁶ Granziera, *A Guerra*, p. 75.

¹⁷ For a reaffirmation of this point, see A. Dixit, *The Making of Economic Policy: a transaction-cost politics perspective* (Cambridge, MA, MIT Press, 1996).

¹⁸ For a discussion, see J. M. de Carvalho, *Teatro das Sombras: a política imperial* (Rio de Janeiro, Vértice/Iuperj, 1988).

Within the space of slightly over a decade (from 1853 to 1866), monetary and banking policy in Brazil experienced considerable change, ranging from a situation of private monopoly of issue of convertible notes to a State monopoly of fiduciary currency. In between, both the monopoly of issue and convertibility were abandoned. From 1870 onwards, monetary debates were momentarily put aside, as the labour (slavery) question, and increasing regional and factional competition for social overhead capital dominated the political agenda. More than in any other period, then, the constant shifts in monetary and banking policy between 1850 and 1870 offer fertile ground to test the nature of the relationship between the State and the economic elite.

* * *

The thesis is divided into three Parts. Part I deals with the main aspects of the Brazilian political system and economy during the imperial period. Chapter 1 outlines the basic framework that will serve as the starting point for the remainder of the thesis. This involves identifying the preferences held by major actors in the political arena in relation to monetary policy and the exchange rate. The latter was a particularly important price in an open economy like Brazil, given the income and wealth shifts that fluctuations of the foreign price of the *milréis* would cause. Chapter 2 describes in detail the main elements in the political framework of the Empire and, in particular, of the so-called Second Reign, which lasted from 1840 to 1889. Additionally, it contains a summary of the evolution of some of the major economic indicators at the time, with special emphasis on monetary aggregates.

Part II comprises two chapters, examining the process of crisis and institutional change observed in the monetary and banking sphere between 1850 and 1870. Chapter 3, covering the 1850s, analyses the evolving nature of banking legislation. This period witnessed a tension between demands for the expansion of the banking system and the government's desire to control firmly the growth in money supply. Additionally, the chapter looks at the circumstances surrounding the first major financial upheaval in the Empire - the 1857 crisis. The 1860s saw a comparable state of institutional change in the banking realm. Chapter 4 begins by

looking at the 1860 banking and corporate law - enacted in order to address what some perceived as the financial excesses of the previous decade. It then goes on to examine the financial crisis of 1864, including its relationship with the 1860 banking and corporate law. The last part of the chapter is dedicated to an analysis of the impact of the Paraguayan War (1864-70) on the conduct of monetary policy.

Part III of the thesis examines the events explored in the previous Part, within the general framework presented in Chapter 1. First, in order to gain insight into the ideology and political motives surrounding preferences about the monetary regime, Chapter 5 analyses two sets of data: the records of the debates held in the Chamber of Deputies, and the resolutions of the Finance Standing Committee of the Council of State. The contrast between these two sources offer important clues as to the nature of relations between the State and the planter class. Chapter 6 discusses two main aspects of the banking question in the nineteenth century: issuing rights and convertibility. The capacity to “create” money via the issue of notes or other short-term liabilities was considered paramount, if the cost of credit to the productive sector was to be reduced. The government, meanwhile, was primarily concerned with ensuring exchange-rate stability, via adherence to the gold standard. As a result, the question of convertibility became crucial. Finally, Chapter 7 offers a categorisation of three approaches to the role of banks in the economy, which helps to capture the underlying *rationale* behind the different stance maintained by the government and landowners as regards the most suitable monetary regime. It will be seen that differing approaches to monetary management derived from particular views about the role that banks were expected to perform.

* * *

The thesis drew on a wide range of primary and secondary sources. Any study of Brazilian economic history must begin with the annual reports of the Ministry of Finance (*Relatórios do Ministério da Fazenda*). They are an incredibly rich source of both quantitative and qualitative information, and were used throughout the thesis. Also invaluable for their texts and statistical appendices are the reports into the financial crises of 1857 and 1864, to be found at the Biblioteca do Ministério da

Fazenda (BMF), in Rio. Also available at the BMF are printed copies of the records of the meetings of the Finance Standing Committee of the Council of State, used in Chapter 5. The records of the debates held in the Brazilian Parliament (*Annaes da Câmara dos Deputados*, and *Annaes do Senado do Império*) were also used in Chapter 5, and provide a colourful counterpoint to the more technical discussions held in the Council of State.¹⁹ The majority of the remaining printed contemporary material used in the thesis was found at the Biblioteca Nacional and Fundação Casa de Rui Barbosa, in Rio.

Archival work in Brazil concentrated on the minutes of the meetings of the board of directors of the Bank of Brazil, held at the Arquivo Histórico do Banco do Brasil, in Rio. The Arquivo also holds a wealth of printed information on the Bank, in the shape of the annual reports by the president (*Relatorio do Banco do Brasil*), reports by the Bank's inspectors (*Relatorio dos Fiscaes*), and those presented by sundry commissions set up to investigate matters of interest to the institution. Unfortunately, the other contemporary joint-stock banks left no trace of their history, the same applying to private banks, which were sometimes larger than joint-stock banks. The Arquivo Nacional, also in Rio, holds the 100 volumes of the *Livro de Registro Oficial de Cotações de Títulos e Valores*, spanning the 1850-1949 period. Maintained by the Rio Bolsa, these bound manuscripts list the daily quotation of a host of items traded in the stock exchange. The thesis made use exclusively of exchange rate data, although researchers working in the period will find other important prices listed there, including those for drafts, stocks, government bonds, specie, and coffee.

As every historian will know, trawling through the archives sometimes yields a poor catch. In that respect, a visit to the Arquivo do Museu Imperial, in Petrópolis, proved to be fairly fruitless, as its otherwise excellent collection of documents on the Empire contains very little on monetary and banking affairs. Likewise, reading the Cotegipe files, at the Instituto Histórico e Geográfico Brasileiro, and the Visconde de

¹⁹ The *Annaes* offer a transcription of the parliamentary debates, which, by definition, do not include every intervention during the discussions. Furthermore, they do not reveal the nature of requests sent to Parliament, neither the discussions held in the special committees. The latter material - which to this day remains untouched by the historian - may be part of the collection of the Arquivo da Câmara dos Deputados, in Brasília. For additional details, the reader is referred to A. L. Cervo, "Fontes Parlamentares Brasileiras e os Estudos Históricos", *Latin American Research Review*, Vol. 16, No. 2, 1981, pp. 172-81.

Rio Branco papers, at the Arquivo Histórico do Itamaraty, revealed virtually nothing about their spells as Minister of Finance, in 1856-7 and 1861-2, respectively. Tragically, the archives of the Ministry of Finance do not hold anything from the nineteenth century, due to a fire which consumed its collection in the late 1970s.

Research in British archives was mostly confined to the Public Record Office, at Kew. The thesis draws on Foreign Office records, concentrating on official correspondence between the British *Chargé d’Affaires* in Rio and his superiors in London. A search through the BOLSA (Bank of London and South America) papers, deposited at University College, London, bore very little result. Apart from the terrible physical state of bank letter books, their content proved to be disappointing for the purpose of the thesis. Yet, scholars working on other topics in the field of banking - and on a later period - may still find this source useful. Apart from the aforementioned collections, the British Library holds the complete series of the *Brazil and River Plate Mail and South American Journal*, a most useful source of information about British perceptions of political and economic issues in nineteenth-century Brazil. Although it partly drew on the local press for some of its reports, the *South American Journal* was one of the few foreign newspapers to maintain a Rio-based correspondent as early as the 1860s. This certainly provided it with a better insight on current Brazilian affairs than its competitors, such as *The Times*. Contemporary impressions were also gained from the *Diplomatic and Consular Reports* (“Blue Books”) of the British Foreign Office.

The secondary literature consists of books, articles and theses broadly divided into Politics and Economics. For many decades radical political economy inspired the political historiography of Brazil. More recently, several works have challenged traditional explanations of the nature of the imperial State. Theoretical works on the relationship between the State and society are used in Chapter 1, in conjunction with major contributions to the debate as applied to Brazil. Classical political histories of the Empire are also employed, providing the necessary historical background to the discussion in Chapters 3 and 4. This is complemented by recourse to the growing body of scholarly work on Brazilian social and political history, produced both in Brazil and abroad.

There are several monetary histories of Brazil. Those written at the beginning of the twentieth century are employed with parsimony, mostly because of their excessive partisanship in appraising events in the nineteenth century.²⁰ By contrast, the thesis makes extensive use of the majority of works published after the Second World War.²¹ They include books, articles and a few Masters and Ph.D. theses, most of which inspired by the research programme begun by Prof. Maria Barbara Levy.

Given the paucity of statistical data on banks in nineteenth-century Brazil, the thesis was unable to effectively revise current estimates of the main monetary aggregates at the time. As a result, from the outset a decision was taken to make use of the best available monetary series for the period, constructed by Peláez and Suzigan.²² The raw data collected by these authors, and reproduced in IBGE, *Estatísticas Históricas do Brasil*, is employed in calculating growth rates of the main monetary aggregates, as well as some other indicators.

Finally, from the outset it was clear that Brazil's rich banking and monetary history shared many traits in common with other countries. It is only natural, then, that the thesis make constant reference to monetary events and controversies in Europe and the United States. Nowhere was the similarity between events in Brazil and abroad more evident than in respect to debates between *metalistas* and *papelistas*, broadly akin to the Currency school vs. Banking school polemics in Britain. The comparative approach applied in Chapter 6 is reflected in the secondary literature, which comprises several works covering different aspects of the monetary and banking histories of the more advanced economies.

²⁰ See the works listed in footnote 6.

²¹ See footnote 9.

²² Peláez and Suzigan, *História Monetária*.

PART I - IMPERIAL POLITICS

Introduction

Part I is divided into two chapters. Chapter 1 brings an analysis of some of the theoretical aspects of the particular political institutions that developed in nineteenth-century Brazil. Section 1.1 provides a brief summary of both the general political science literature and the corresponding Brazilian historiography, in particular as regards State-society relations. This theme is followed up in the next section, which relates events in the international sphere to the domestic polity. Against this backdrop, the section concludes with a discussion of the preferences of the government and landowners, respectively, about the best combination of monetary and exchange-rate policies. This framework will serve as the starting point for the rest of the thesis, where the relative autonomy of the imperial State vis-à-vis the planter class will be tested, in the context of the monetary and banking policies followed in the 1850-70 period.

Chapter 2 examines the politics and the economics of the Brazilian Empire. It begins by providing a brief historical background to the whole imperial period (1822-1889), starting with the process of independence from Portugal. In this regard, emphasis is given to the conflict between centralisation and devolution, culminating in the consolidation of the monarchic system, in the early 1840s. Section 2.2 summarises the main characteristics of the Brazilian economy at the time. It begins with a broad indication of rates of growth, inflation, foreign trade and government finances. The chapter concludes with a section dedicated to money and banking, dealing with both its institutional aspects, and the evolution of the main monetary aggregates.

Chapter 1 - Politics in Theory and in Practice

The literature on Brazilian political history has dedicated much effort to explaining State-society relations. To that end, it has drawn on many theoretical models, prominent among which have been those in the Marxist vein. Radical political economy, in both its Marxist and *dependentista* guises, as well as structuralism, were for many decades the most influential approaches to the political and economic history of Brazil (and Latin America). Among their major works are some of the classical interpretations of the region's underdevelopment.¹ Contributions in the radical tradition tend to approach the political process with reference to the underlying class struggle. In this world, policymaking would reflect relative strengths amongst different social groups, with the most powerful capable of "capturing" the State in such a way as to advance its interests.

In contrast to the Latin American historiography, the mainstream view in political science theory in the United States since the 1960s has developed around market-based models of the polity. Fundamentally, these models build on neoclassical microeconomic theory, and liken the functioning of politics to the market. In this context, political agents are deemed rational and maximising. And, given the usual convexity assumptions, their actions lead to Pareto-optimal outcomes, as would obtain in competitive markets in general. Moreover, market-oriented reasoning presumes that rational individuals will secure any social outcome that they unanimously prefer.² Market-oriented models, although seldom utilised in the Brazilian historiography, provide a useful contrast to the predominant radical interpretation of the dynamics of the political process. In what follows, both types of model are compared with a third one - the new political economy perspective.³ The latter is shown to be more adequate for understanding the political framework of the Brazilian Empire.

¹ It should be noted that Marxist-inspired approaches were by no means alone in offering explanations for Brazil's underdevelopment. Rostovian-type modernisation theory, with its pro-market bias, was particularly influential in the 1950s. For a review, see R. Bielschowsky, *Pensamento Econômico Brasileiro: o ciclo ideológico do desenvolvimentismo* (Rio de Janeiro, IPEA/PNPE, 1988).

² See R. Bates, "Macropolitical Economy in the Field of Development", in J. E. Alt and K. A. Shepsle (eds.) *Perspectives on Positive Political Economy* (Cambridge, Cambridge University Press, 1990), p. 53.

1.1 - Politics in Theory

Radical political economy found fertile ground in Brazilian academic circles, developing into a highly influential intellectual tradition that had its heyday in the 1960s.⁴ Most works in this tradition, albeit to varying degrees, claim that at the root of Brazil's historical underdevelopment was its condition, first, as a formal colony of Portugal and, later, a "colony" of the growing world capitalist economy, or system.⁵ In this model, politics was the means by which economic power was secured and extended by the dominant class. In practical terms, the dominant class and the ruling class were one and the same.

Market-based reasoning, in turn, lays great emphasis on the capacity of the price system to provide socially desirable outcomes from individually optimising choices. It is argued that so long as property rights are appropriately defined and enforced, market forces will equate private costs and benefits to their social equivalents, thereby 'generating incentives for private decision makers to promote the efficient allocation of resources'.⁶ Accordingly, governments, when tampering with the price system in order to try to promote development, are thought to do more harm than good.

Both Marxist-inspired radical political economy and its antithesis, market-based political models, have been criticised by a third strand of theory, the so-called new political economy perspective. Widely disseminated by the works of Bates, this approach uses some of the premises of the market-based models, thus providing it with the necessary "microfoundation" of rationality so dear to contributions in this tradition. Nevertheless, the major insights of the new political economy approach

³ The adjective "new" is being employed here to distinguish market-based political economy from "old" political economy models, usually rooted in structuralism.

⁴ For the "genealogy" of economic thinking in Brazil, tracing the intellectual roots of the major twentieth-century contributions to the study of Brazilian development, see G. Mantega, *A Economia Política Brasileira* (Petrópolis, Vozes, 1984); and Bielschowsky, *Pensamento*.

⁵ Two highly influential Marxist contributions are Caio Prado Jr., *História Econômica do Brasil* (São Paulo, Brasiliense, 1977, 20th edn.); and N. W. Sodr , *Forma o Hist rica do Brasil* (Rio de Janeiro, Civiliza o Brasileira, 1979, 10th edn.). The structuralist classic is Furtado, *Forma o*.

⁶ Bates, "Macropolitical", p. 38. On the importance of property rights in the development process, see D. North, *Structure and Change in Economic History* (New York, Norton, 1981); and idem, *Institutions, Institutional Change and Economic Performance* (Cambridge, Cambridge University Press, 1990).

differ greatly from those of the other two perspectives. Insofar as it is useful for understanding contexts other than modern advanced democracies, it proves particularly rich in capturing the political dynamics of nineteenth-century Brazil.

In order to understand the main differences between the three approaches - Marxist (or radical), market-based, and new political economy - it is worth examining the position each of them takes on four key postulates:

1. The individual actor is the basic unit of analysis;
2. Individuals, including politicians, are rational;
3. Politics is relatively autonomous; institutions create incentives for politicians; and
4. Individual rationality implies social rationality.⁷

Figure 1.1

Approaches to Politics and their Stance on Some Major Postulates

Approach	Postulate 1	Postulate 2	Postulate 3	Postulate 4
Radical political economy	No	Yes	No	No
Market-oriented approaches	Yes	Yes	No	Yes
New political economy perspective	Yes	Yes	Yes	No

Source: Adapted from R. Bates, "Macropolitical Economy in the Field of Development", in J. E. Alt and K. A. Shepsle (eds.) *Perspectives on Positive Political Economy* (Cambridge, Cambridge University Press, 1990), p. 50, Table 2.1.

Looking at Figure 1.1, it is immediately clear that models in the radical tradition are distinct from the other two. For them, class, and not the individual actor, is the basic unit of analysis (postulate 1). Additionally, the "No" entry under postulate 3 indicates that for Marxists the dominant and ruling classes tend to coincide. In other words, models in the radical tradition offer little scope for State autonomy. In a similar vein, radical political economy, when applied to countries of the periphery, depicted them as passive victims of the international system, devoid of autonomy. From the standpoint of international political economy, the main shortcoming of explanations that lay great emphasis on unequal centre-periphery-type relations (or imperialism) is,

⁷ Bates, "Macropolitical", p. 51.

arguably, the strong assumption that economies in the periphery, in being constrained by their location in the world economy, lacked the capacity for choice.⁸

Market-based models and the new political economy perspective hold the same views as regards postulates 1 and 2. In other words, they share the same microfoundations of individuality and rationality. It is, therefore, in relation to postulates 3 and 4 that the models differ. And it is precisely in this respect that the new political economy approach provides a better model to understand the political dynamics of developing countries.

Developing economies possess all the usual sources of market failure: poorly defined property rights, production externalities, incomplete markets, and so forth. Like all economies, developing economies require public goods. Law, order, justice, and security, as well as roads, health and education, are relatively scarce, but highly desired in many developing societies. The inappropriate incentives that surround all public goods and the difficulty in organising collective action to secure their supply keep them from being provided. In a public goods environment, private individuals' maximizing behaviour simply will not yield the market equilibrium. Under such circumstances, market-based reasoning cannot explain how individually rational choices generate collective outcomes. Rather, attention must be turned to politics.⁹

From the above passage it becomes clear that Bates's critique of some aspects of the market-oriented model calls attention to instances in which the efficiency (Pareto-optimality) properties of the market equilibrium do not hold.¹⁰ These are generically referred to as market failures, and are particularly widespread in developing economies, such as nineteenth-century Brazil. Crucially, then, what sets Bates apart from writers who make use of the market-based approach is his recognition that

⁸ Ibid., p. 35.

⁹ Ibid., p. 40.

¹⁰ Moreover, the Pareto-optimality yardstick itself is viewed with reserve by Bates as a criterion on which to base normative and positive claims in the field of development economics and politics. In the normative realm, the presumption that Pareto-optimal equilibria are a measure of what is socially best is clearly unrealistic. For example, such a situation might be consistent with an economy where the majority of participants own very little in the beginning and, after exchange is undertaken, end up with very little too. Although efficient, this outcome can hardly be considered just. Perhaps more important from the standpoint of political theory is the frequency with which the positive aspects of this market-based approach are left aside. Given that departure from Pareto-efficiency considerations lead to the existence of social costs, most market-oriented thinking is dedicated to pointing out the evils emanating from rent-seeking behaviour and the "capture" of the State apparatus by private interest groups. It follows logically that resources that are allocated by decision-makers based on non-market criteria are deemed irrational. While important in themselves, considerations of social costs alone fail to address two fundamental questions, namely, 'why would rational political elites make socially irrational (i.e., inefficient) decisions', and 'if groups in fact impose economic costs on the rest of society while reaping economic benefits, how do they get away with it?' Ibid., p. 39.

market failures are often present in real life, notably in contexts distinct from industrialised economies.¹¹ This, of course, is in sharp contrast with orthodox market-oriented literature, which tends to view these very failures as exceptions to the rule of perfectly functioning markets. The crucial difference between the new political economy approach and traditional market-based models, as Figure 1.1 shows, concerns postulate 3 - the relative autonomy of political institutions, which allows them to create incentives of their own. This possibility - which is only endorsed by the new political economy perspective - when taken in conjunction with postulate 2 (“agents are rational”), gives rise to ‘political choices that are individually rational but economically perverse’ (postulate 4).¹² No one better than Bates summarises the subtle, but crucial, difference between the two approaches:

Market-oriented reasoning emphasises the benefits of the market. It stresses individual rationality, and, given the power of the analogy of the hidden hand, it presumes that rational individuals will secure any social outcome that they unanimously prefer. Political-economic reasoning would also stress the benefits of the market and would stress individual rationality. But it finds many reasons - some arising precisely from the rationality of individuals - why markets may not be created. It provides insight into why economic policies, which might enhance the collective welfare, would not be provided politically, even by rational individuals.¹³

In practice, Bates’s new political economy perspective allows for the existence of instances in which politics is to a degree independent from class struggle, or interest-group pressure. In this respect, it ties in with the debate in the political science literature about the possibility of the State being relatively autonomous from classes, or pressure groups. One strand of this literature is associated with a vulgar type of Marxist “economic reductionism”, whereby powerful groups capture the State and guide policy towards satisfying their objectives. In this world, the State is a mere instrument of the ruling class, having no interests of its own. On the other end of the debate are authors like Skocpol, who argue that in many historical cases states have proved to be autonomous from social groups, or classes, and pressed forward their

¹¹ Bates’s view is to a large extent shared by North. ‘From the viewpoint of the economic historian (the) neoclassical formulation appears to beg all of the interesting questions. The world with which it is concerned is a frictionless one in which institutions do not exist and all change occurs through perfectly operating markets. In short, the costs of acquiring information, uncertainty, and transaction costs do not exist. But precisely because of this nonexistence, the neoclassical formula does lay bare the underlying assumptions that must be explored in order to develop a useful body of theory of structure and change.’ Cf., North, *Structure*, p. 5.

¹² Bates, “Macropolitical”, p. 52.

¹³ *Ibid.*, p. 53.

own objectives.¹⁴ In between these two polar interpretations, more recent Marxist thinking, initiated by Poulantzas, argues for the possibility of states being relatively autonomous from classes.¹⁵ In the end, the degree to which a particular State is autonomous is an empirical question, which ‘can only be analyzed and explained in terms specific to particular types of sociopolitical systems and to particular sets of historical international circumstances’.¹⁶

As noted above, early Marxist contributions to the political history of the Brazilian Empire have tended to portray the State as dominated by the interests of the land-owning class (*fazendeiros*). As a result, official policies would to a large extent be implemented in order to advance the objectives of this powerful group. The corollary of this proposition is that the political and economic elites would overlap. For some time, this claim by Marxist historians about the dependence of the Brazilian State on or, even, its subservience to, the land-owning dominant class went unchallenged. Until, that is, Faoro advanced the radically opposite idea about the existence of an autonomous bureaucratic stratum, ‘which exercised tutelage and sovereignty over the nation, the people, agriculture and commerce’.¹⁷ Ultimately, Faoro posited the existence of an absolute divorce between the nation and the State, an issue that has since attracted much attention from scholars working on Brazil.¹⁸

To sum-up the argument so far, until recently there were two major opposing views on the nature of the Brazilian State in the Second Reign. The first, espoused by radical writers, highlighted the dominance of slavocracy, while the reaction led by

¹⁴ ‘State organizations necessarily compete to some extent with the dominant class(es) in appropriating resources from the economy and society. And the objectives to which the resources, once appropriated, are devoted may very well be at variance with existing dominant-class interests’. Cf. T. Skocpol, *States and Social Revolutions: a comparative analysis of France, Russia and China* (Cambridge, Cambridge University Press, 1979), p. 30. For a similar argument, see also P. Bardhan, *The Political Economy of Development in India* (Oxford, Basil Blackwell, 1984).

¹⁵ N. Poulantzas, *Political Power and Social Classes* (London, Humanities Press, 1973); and R. Miliband, “State Power and Class Interests”, *New Left Review*, No. 138, March-April 1983, pp. 57-68.

¹⁶ Skocpol, *States*, p. 30.

¹⁷ See R. Faoro, *Os Donos do Poder: formação do patronato político brasileiro* (Porto Alegre, Globo, 1976, 3rd edn.), p. 387. In a similar vein, see S. Schwartzman, “Representação e Cooptação Política no Brasil”, *Dados*, Vol. 7, 1970, pp. 9-41.

¹⁸ For a critical review of some of the major works dealing with this issue in the context of the First Republic, see J. L. Love and B. J. Barickman, “Rulers and Owners: a Brazilian case study in comparative perspective”, *Hispanic American Historical Review* (hereafter, *HAHR*), Vol. 66, No. 4, November 1986, pp. 743-765.

Faoro tended to see the State as a ‘leviathan dominating an inert society’.¹⁹ Later research has qualified both views, and suggested, instead, a partial separation between the imperial State and landowners. In other words, it has pointed to the existence during part of the Second Reign of both an economic and a political elite which often did not coincide. According to this interpretation, the elite was not homogenous in its social backgrounds and interests. This, in turn, precluded any immediate association of government policy with the demands of *fazendeiros*.

One of the first authors to identify more clearly instances of conflict between the imperial State and the dominant class was Carvalho.²⁰ His research confirms the existence of a political elite distinct from the economic one.²¹ The latter - defined to comprise *fazendeiros*, bankers and merchants - was hardly present in the cabinet and the Council of State, although it did have some weight in the imperial Senate.²² Given the primacy of these bodies in the political structure of the Empire, it follows that, in practice, representatives of the export/import trade were not in a position to influence directly the conduct of government policy.²³

A similar process of tension between the bureaucracy and the dominant class was described by Uricoechea, when examining the patrimonial nature of the Brazilian State.²⁴ Weber spoke of a patrimonial State ‘when the prince organises his political

¹⁹ The expression is in J. M. de Carvalho, “Political Elites and State Building: the case of nineteenth-century Brazil”, *Comparative Studies in Society and History*, Vol. 24, No. 1, January 1982, p. 393.

²⁰ See J. M. de Carvalho, *A Construção da Ordem: a elite política imperial* (Rio de Janeiro, Campus, 1980); and idem, “Political Elites”.

²¹ On a similar note, it has been argued that ‘the monarchic solution and the affirmation of the moderating power - subjecting and co-ordinating the working of the parliamentary and party system which, in turn, incorporated in the broader system the interests (...) of the local powers - were the political elements of the hegemonic consolidation (of the Empire). This system expanded to the limit the elements of consensus and representation of the dominant classes vis-à-vis the administrative apparatus without, however, transforming it into an object of direct dispute among different regional and local political factions’. Cf. R. Salles, *Nostalgia Imperial: a formação da identidade nacional no Brasil do Segundo Reinado* (Rio de Janeiro, Topbooks, 1996).

²² The political institutions of the Brazilian Empire are discussed in Chapter 2.

²³ Although Ridings has argued that *fazendeiros* actually did have substantial capacity to influence government economic policy, through commercial associations, his views are not entirely convincing. For example, by claiming that commercial associations were often heard before new policies were implemented is not sufficient evidence of their influence. Rather it indicates that they constituted one of the few bodies of expertise that the government could rely on for advice. See E. Ridings, *Business Interest Groups in Nineteenth-Century Brazil* (Cambridge, Cambridge University Press, 1994).

²⁴ See F. Uricoechea, *The Patrimonial Foundations of the Brazilian Bureaucratic State* (Berkeley, University of California Press, 1980). The patrimonial nature of the Brazilian State has been stressed in some of the most influential works on the political history of the country. Prominent among them is

power over extrapatrimonial areas and political objects - which is not discretionary and not enforced by physical coercion - just like the exercise of his physical power'.²⁵ Uricoechea, in turn, has made use of the hybrid concept of "patrimonial bureaucracy" to accentuate the 'transition from the particularisms of patrimonial rule to the universalism of a more bureaucratic society'.²⁶ The concept enabled him to reconstruct a synthesis of nineteenth-century Brazil characterised by an inherent tension between two elements: an 'administrative apparatus bureaucratically controlled by the state, pushing for the overall bureaucratization of government' and, on the other hand, 'the parallel existence of an administrative apparatus patrimonially controlled by the local classes and pressing for the prebendalization of office'.²⁷

A further author to suggest the existence of a partial divorce between the economic and political elites of the Empire, or the dominant and ruling classes, was Pang.²⁸ Based on an extensive examination of the process of ennoblement in nineteenth-century Brazil, Pang has concluded that politics had more appeal for elites of moderately rich to humble origins - therefore from gentry and mercantile families - than for powerful *fazendeiros*.²⁹ Members of the planter nobility, in contrast, tended to confine themselves to local and regional politics, that did not remove them from plantations for extended periods of time. This pattern is confirmed, for example, by examining the distribution of officeholders of the presidency of the Council of

Faoro, *Os Donos*, which emphasises the blurring of the private and public orders characteristic of patrimonial regimes.

²⁵ M. Weber, *Economy and Society* (New York, Bedminster Press, 1968), p. 1007, cited in S. Schwartzman, "Back to Weber: corporatism and patrimonialism in the seventies", in J. Malloy (ed.) *Authoritarianism and Corporatism in Latin America* (Pittsburgh, University of Pittsburgh Press, 1977).

²⁶ Cf. Uricoechea, *Patrimonial*, p. 44.

²⁷ *Ibid.*, p. 3. By prebendalization of office, Uricoechea means 'the process whereby an office is appropriated by its incumbent as an object of personal right, thereby negating the public and impersonal nature of office. The organic link between prebendalization and patrimonialism is apparent: prebendalization is a traditional form of political organization not checked by impersonal administrative canons, and patrimonial officers depending on prebends do their utmost to control access to office and to transform the prebend into a hereditary possession.' *Ibid.*, footnote *.

²⁸ See E.-S. Pang, *In Pursuit of Honor: noblemen of the Southern cross in nineteenth-century Brazil* (Tuscaloosa and London, The University of Alabama Press, 1988).

²⁹ Brought over from Portugal in 1808, the granting of titles of nobility was introduced by D. João VI as a sign of gratitude to his most favoured supporters and benefactors. Shortly afterwards, however, titles would be bestowed in accordance to political expediency, often with a view to forestalling any potential disloyalty to the Crown. Brazilian nobility was structured in five main grades: in ascending order, *barão*, *visconde*, *conde*, *marquês* and *duque*. Titles were for one life only and could be passed on to subsequent generations only if the Emperor explicitly rechartered them. In all, 980 men and women, holding a total of 1,278 titles, would constitute the nobles of the Southern Cross. *Ibid.*, p. 268.

Ministers. In the whole 1847-1889 period, as Pang notes, ‘only one Bahian prime minister could claim a tie to aristocratic roots and none belonged to a major agrarian dynasty by birthright. (...) Thus, except for Cotegipe, all Bahia-born prime ministers came from mercantile families or modest gentry families, whose economic stakes in capitalist agriculture were minor or marginal’.³⁰ The same pattern was found for the provinces of Pernambuco and Rio de Janeiro, ‘where the majority of the nobility was of gentry stock and humble origins’.³¹

The reasons for the formation of two separate elites (the economic and the political), according to Pang, were twofold. First, the pattern of political recruitment involving training and rotation of candidates constituted a problem for bachelors, who often ended up marrying into a family of another region.³² The second reason has already been hinted at, and is exemplified by the dearth of rural aristocrats among the Bahian political notables - the difficulty in those days of practising absentee ownership. This was particularly true of landowners from the North of the Empire, who were at a geographical disadvantage vis-à-vis their counterparts from the Centre-South. Unsurprisingly, therefore, ‘the agrarian and mercantile elite in the provinces of São Paulo, Rio de Janeiro and Minas Gerais were more successful in a dual career and were therefore more willing to enter politics and at the same time retain control over the family business’.³³ A political career, therefore, appealed more to those from humbler origins in the North, or for the economic elite of the Centre-South.³⁴

1.2 - Politics in Practice

The above discussion regarding the existence of a partial divorce between the political and economic elites in the Empire lends support to the notion of a State relatively autonomous from social classes. In this respect, it also fits in with Bates’s new

³⁰ Ibid., p. 82. Of the 30 Prime Ministers in the Empire, 11 were from the province of Bahia, by far the largest proportion.

³¹ Ibid. It is worth noting that 84 (38.4%) of those who served as ministers were nobles before, or ennobled during their tenures in office. The equivalent figures for Prime Ministers, senators and the second Council of State (1842-1889) were 65.2%, 39.6% and 56.9%, respectively. For details, see Pang, *In Pursuit*, pp. 58-9.

³² Ibid., p. 127. The process of elite training will be discussed in Chapter 2.

³³ Ibid., p. 128.

³⁴ Ibid.

political economy approach to politics, in that it recognises that politics itself is relatively autonomous, in other words, that it has its own dynamics. This point has been confirmed by research that has stressed the existence of several instances of conflict between different segments of the imperial elite, or between the elite and the State itself.

Examples of intra-elite conflict have been identified in regard to railway policy and immigration, in the 1870s and 1880s. Essentially, they expressed a rift between geographical regions. Landowners in the North, linked to less profitable sugar and cotton production, usually resented what they perceived as a bias in government policy towards *fazendeiros* in the coffee-producing regions of the South. Government financing of European immigration and guarantees for investments in railways benefited the southern region of the country disproportionately. In practice, they involved a subsidy from other regions of the Empire, giving rise to disputes between two opposing geographical groups within the agrarian oligarchy, northern and southern planters.³⁵

Inter-elite conflict, pitting the Executive (or the Emperor) against landowners, has also been subject to scholarly research. In fact, the thrust of Carvalho's claim for the existence of a partial divorce between the economic and political elites in the Empire stems precisely from his careful examination of instances where these two groups were at odds over crucial policy issues. On the question of land policy, the imperial government was defeated by the "barons", in its attempt to tax rural property.³⁶ It did, however, succeed in taxing the import/export sector, despite the

³⁵ For a detailed analysis of this "geographical" rift within the agrarian elites of the Brazilian Empire, see Melo, *O Norte*. Immigration is the subject of T. Holloway, *Immigrants on the Land: coffee and society in São Paulo, 1886-1934* (Chapel Hill, NC, University of North Carolina Press, 1980); and A. Gebara, *O Mercado de Trabalho Livre no Brasil, 1871-1888* (São Paulo, Brasiliense, 1986). On railways, see R. H. Matoon Jr., "Railroads, Coffee, and Big Business in São Paulo, Brazil", *HAHR*, Vol. 57, No. 2, May 1977, pp. 273-95; F. A. M. de Saes, *As Ferrovias de São Paulo, 1870-1940* (São Paulo and Brasília, Hucitec/Instituto Nacional do Livro, 1981); A. El-Kareh, *Filha Branca de Mãe Preta: a Companhia Estrada de Ferro D. Pedro II, 1855-65* (Petrópolis, Vozes, 1982); and C. M. Lewis, *Public Policy and Private Initiative: railway building in São Paulo, 1860-1889* (London, Institute of Latin American Studies, 1991). The political economy of railway policy is analyzed in W. R. Summerhill, "Market Intervention in a Backward Economy: railway subsidy in Brazil, 1854-1913", *Economic History Review*, Vol. LI, No. 3, August 1998, pp. 542-68.

³⁶ See Carvalho, *Teatro*, Chapter 3; W. Dean, "Latifundia and Land Policy in Nineteenth-Century Brazil", *HAHR*, Vol. 51, No. 4, November 1971, pp. 606-25; and E. V. da Costa, "Land Policies: the Land Law, 1850, and the Homestead Act, 1862", in *The Brazilian Empire: myths and histories* (Chicago, University of Chicago Press, 1985).

considerable political influence of groups linked to foreign trade.³⁷ The cessation of the trans-Atlantic slave trade and, later, the abolition of slavery, also proved to be instances where eventually the Executive's initiative overcame opposition from the land-owning class. In the former case, British pressure, coupled with a glut after years of heavy slave imports, helped overcome planter hostility, leading to the end of the trade in the early 1850s.³⁸ As to abolition, the process was also protracted, with many slave-owners opposing it until the last minute, in the late 1880s.³⁹

In the 1850s and 1860s the central point of discussion in Parliament, the Council of State and in the press, was monetary and banking policy, not abolition, nor railways. The reason for this can be found in the economic boom which followed crucial institutional measures taken in 1850, namely, the ending of the trans-Atlantic slave trade, the adoption of the Land and Immigration Law, and the promulgation of the Commercial Code.⁴⁰ At the time, labour shortage could still be averted via the internal slave trade. Railways, in turn, were still in their infancy in the country, the first one completed only in 1854. Labour and social overhead capital, thus, were not the major preoccupation in *fazendeiros'* minds in the early 1850s. Rather, and amid a process of greater economic integration into the expanding international economy, landowners and businessmen were more concerned with credit conditions, lest they

³⁷ See S. Topik, "The State's Contribution to the Development of Brazil's Internal Economy, 1850-1930", *HAHR*, Vol. 65, No. 2, May 1985, pp. 203-228.

³⁸ On the end of the trans-Atlantic slave trade, see L. Bethell, *The Abolition of the Brazilian Slave Trade: Britain, Brazil, and the slave trade question, 1807-1869* (Cambridge, Cambridge University Press, 1970).

³⁹ On abolition, see Gebara, *O Mercado*. The literature on slavery in Brazil is too vast to be cited here. A sample should include E. V. da Costa, *Da Senzala à Colônia* (São Paulo, Brasiliense, 1982, 2nd edn.); R. B. Toplin, *The Abolition of Slavery in Brazil* (New York, Atheneum, 1972); and R. E. Conrad, *The Destruction of Brazilian Slavery, 1850-1888* (Berkeley, University of California Press, 1973). On the profitability of slavery in Brazil, see H. P. de Castro, "Viabilidade Econômica da Escravidão no Brasil: 1880-1888", *Revista Brasileira de Economia* (hereafter, *RBE*), Vol. 27, No. 1, January/March 1973, pp. 43-67; and P. C. de Mello, "Aspectos Econômicos da Organização do Trabalho na Economia Cafeeira do Rio de Janeiro, 1858-1888", *RBE*, Vol. 32, No.1, January/March 1978, pp. 19-67.

⁴⁰ With the prospect of witnessing a substantial amount of capital being released from the slave trade about to be prohibited, the authorities were keen to provide the necessary institutional framework most suitable for productive ventures. By giving precise definition to different types of business companies, and regulating their operations, the government opened the way for Brazil's first business boom. In the end, the Land and Immigration Law, the cessation of the trans-Atlantic slave trade, and the Commercial Code provided an impetus to the capitalist modernisation of the country, and were all attempts to organise the markets for land, labour, and capital. See L. Bethell and J. M. de Carvalho, "1822-50", in L. Bethell (ed.) *Brazil: Empire and Republic, 1822-1930* (Cambridge, Cambridge University Press, 1989), p. 111.

miss out on the new opportunities being created by the expansion of the coffee frontier. Accordingly, larger money supply and expansion of the banking system were their main demands. But what were the broader circumstances in which these demands developed? They are summarised in Figure 1.2, which shows the relationship between the international environment, domestic institutions and political outcomes.

Figure 1.2 - Internationalisation, Institutions, and Political Change

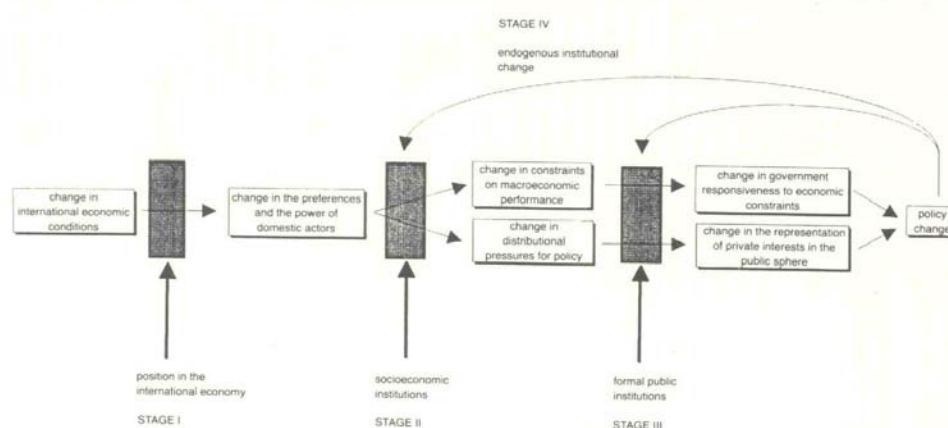


Figure 1. The international economy, domestic institutions, and political change

Source: G. Garrett and P. Lange, "Internationalization, Institutions, and Political Change", in R. O. Keohane and H. V. Milner (eds.) *Internationalization and Domestic Politics* (Cambridge, Cambridge University Press, 1996), p. 51.

Stage I constitutes the phenomenon of internationalisation itself and the way in which it helps shape domestic policy preferences. Stages II and III deal with the institutions in society which mediate the preferences originating in stage I, and which will eventually lead to policy changes. Note the presence of the feedback mechanism originating in the "policy change" box and going back to the institutions in stages II and III. Clearly, institutions do not exist in a vacuum and, also, they are constantly evolving as a result of shifts in the political forces operating in society. A final source of institutional change exists, and is endogenous (stage IV). It would constitute a more radical shift made by the government in order to mitigate the tension between

distributional politics and economic performance.⁴¹ It might take the shape, for example, of a corrective measure undertaken by the Executive power in order to better reflect pressures from emerging political forces not yet duly represented institutionally, thus speeding up the “natural” process summed up in the main part of the diagram.

Observing changes in relative prices is a convenient way to understand the influence of internationalisation on domestic policy preferences (stage I in Figure 1.2).⁴² In fact, given the crucial importance of prices in providing information about relative scarcity in an economy, and the fact that prices only have meaning in relation to other prices, it becomes clear that ‘virtually all developments of interest to economic agents have to do with relative price changes’.⁴³ The distinct impact of changes in monetary policy in closed and open economies helps illustrate this point. In the closed economy case, a monetary stimulus will raise prices, lower real interest rates and encourage spending. As a result, growth should ensue, as well as a fall in unemployment, which, together with the original price increase, entail ‘broad but diffuse effects’.⁴⁴ The latter could refer, for instance, to disputes between debtors and creditors bound by nominal, non-indexed, contracts. In this case, inflation resulting from an expansionist monetary policy will tend to benefit borrowers at the expense of lenders, or savers. The important point to be made is that in the closed economy case the nominal price level is affected by monetary policy, while relative prices remain unchanged.⁴⁵

By contrast, in an open economy, relative prices respond to monetary stimuli, through the latter’s direct impact on the exchange rate. Essentially, given capital mobility, covered (that is, exchange-rate-adjusted) interest rates between countries are

⁴¹ See G. Garrett and P. Lange, “Internationalization, Institutions and Political Change”, in R. O. Keohane and H. V. Milner (eds.), *Internationalization and Domestic Policies* (Cambridge, Cambridge University Press, 1996), p. 54.

⁴² This is the approach adopted by J. Frieden and R. Rogowski, “The Impact of the International Economy on National Policies: an analytic overview”, in Keohane and Milner (eds.), *Internationalization*.

⁴³ *Ibid.*, p. 29. It is worth noting that changes in relative prices are also responsible for bringing about institutional change as well, through their effect (along with changes in taste) on individuals’ incentive structure. On this point, see North, *Institutions*, Chapter 10; and *idem*, *Structure*, Chapter 6.

⁴⁴ Cf. J. Frieden, “Exchange Rate Politics: contemporary lessons from American history”, *Review of International Political Economy*, Vol. 1, No. 1, Spring 1994, p. 83.

⁴⁵ *Ibid.*

equalised and monetary policy operates primarily via the exchange rate. This does not mean that monetary policy does not have the same effects as described in the closed economy case, namely, on the nominal price level and interest rates. It does. But the open-economy view goes beyond the traditional closed-economy interpretation, which relies on the different preferences over the general price level and the accompanying creditor-debtor divide. In fact, the cleavages that emerge from analysing preferences over the real rate of exchange, instead of inflation, are much richer.⁴⁶ Indeed, the political economy of monetary policy in an open economy is naturally more complex than in the closed economy case. Given that in the former both absolute and relative price changes take place, a larger universe of economic interests will be affected.

The usefulness of the open-economy framework for an analysis of domestic policy preferences becomes clearer when it is known that nineteenth-century monetary and banking doctrine held that the sound way to regulate the currency was through the adoption of a gold-backed note circulation. The advantages of this system were that it economised on the use of gold, while at the same time ensuring against overissue and inflation.⁴⁷ On the foreign sector side, gold-backed issues, by tying the country to the gold standard, guaranteed exchange-rate stability. When joining the gold standard, then, policymakers in the nineteenth century sought to avoid sudden relative price changes, which could lead to important shifts in income and wealth. Consequently, a fixed exchange-rate regime was thus preferred to a floating one. At this point a brief digression on the main properties of both monetary regimes is warranted.

Textbook treatments of exchange-rate theory will usually summarise their discussion with a section dedicated to the comparison of fixed and flexible regimes, often with a pros and cons-type analysis of each. Both regimes are then shown to be fraught with trade-offs and problems, not least for peripheral economies.⁴⁸ For the purposes of the present discussion the main feature of a flexible exchange-rate system

⁴⁶ See J. Frieden, "Monetary Populism in Nineteenth-Century America: an open economy interpretation", *Journal of Economic History*, Vol. 57, No. 2, June 1997, pp. 367-95.

⁴⁷ Nineteenth-century monetary thought will be analyzed in detail in Chapter 6.

⁴⁸ For a historical perspective, see the essays in M. Bordo and A. Schwartz (eds.) *A Retrospective on the Classical Gold Standard, 1821-1931* (Chicago and London, Chicago University Press, 1984); and B. Eichengreen (ed.) *The Gold Standard in Theory and Practice* (New York, Methuen, 1985).

is the relative monetary independence it affords countries.⁴⁹ In theory, countries under a flexible exchange-rate regime should be able to choose their own monetary policy and, ultimately, inflation rate, not having to “import” the latter from abroad.⁵⁰ On the other hand, under a fixed exchange-rate regime (and with capital mobility), monetary policy is passive, in the sense that it follows balance of payments deficits and surpluses. A surplus increases the money supply, expanding demand, output, prices, imports and reducing the domestic interest rate. A deficit reduces the money supply, with the opposite results.

Nineteenth-century governments, including Brazil’s, were convinced of the unequivocal benefits of a fixed rate of exchange. The gold standard produced exchange-rate stability and monetary prudence. As a result, financial authorities at the time doggedly pursued convertibility, even though the gold standard was not welcome by everyone. Thus, it becomes necessary to examine more closely the forces that were rallied behind the choice of monetary regime, and their reasons for taking a particular stance. This will be done through the following figure, which summarises the main groups in imperial Brazil who were affected by different combinations of exchange-rate levels and national monetary independence. The latter, in the presence of capital mobility, accompanies exchange-rate flexibility.

Figure 1.3 presents the two policy choices confronting governments as regards exchange-rate regimes. If a fixed exchange rate is preferred, the country will have to surrender control of monetary policy. If the option falls on monetary autonomy, then the level of the exchange rate will be necessarily fickle. Since potential exchange-rate instability is the price to pay should monetary autonomy be deemed paramount, policies that attempt to keep exchange-rate oscillations within certain limits will become central. In the end, then, governments face a trade-off between exchange-rate stability and their capacity to influence the domestic money supply. These two goals,

⁴⁹ For a cross-country discussion of the characteristics of this type of exchange-rate regime, see P. Bernholz, “Flexible Exchange Rates in Historical Perspective”, *Princeton Studies in International Finance*, No. 49, July 1982.

⁵⁰ Still, the exogeneity of monetary policy does not mean that disturbances, even of a monetary nature, are not transmitted across countries operating a flexible exchange-rate system. As stressed by Corden, even under these circumstances there exist real links between economies, with capital markets and terms of trade as their main transmission mechanisms. Furthermore, at any given point in time, the exchange rate will depend both on current variables, such as monetary and fiscal policy, and expectations about future exchange rates. See W. M. Corden, *Economic Policy, Exchange Rates and the International System* (Oxford, Oxford University Press, 1994), Chapter 11.

in turn, will be given different weights by economic agents, including the government, depending on their positions in the economy.

Figure 1.3
Exchange-Rate-Policy Combinations

	High exchange rate	Low exchange rate
Low exchange-rate flexibility	central government <i>metalistas</i>	foreign investors foreign banks
High exchange-rate flexibility	producers of non-tradables	exporters of primary goods (<i>fazendeiros</i>) import-competing traded goods producers <i>papelistas</i>

Note: A “high” rate of exchange stands for a more appreciated currency, while “low” refers to a more depreciated exchange rate. As regards exchange-rate flexibility, “high” implies a freely floating system, and “low” a fixed rate (such as the gold standard).

Source: Adapted from Figure 1, in J. Frieden, “Exchange Rate Politics: contemporary lessons from American history”, *Review of International Political Economy*, Vol. 1, No. 1, Spring 1994, p. 85.

First, the distinction between exchange-rate oscillations and its upward or downward movements (that is, an appreciation or depreciation, respectively) needs to be made. In the case of nineteenth-century Brazil, three factors were thought to determine oscillations of the exchange rate. Namely, speculation carried out by private banks and import traders, the natural seasonality in the market for bills of exchange when crops were bound for exports, and the government’s periodic purchase of large amounts of bills in order to meet its international commitments. Changes in the level of the exchange rate (usually downward, i.e., a depreciation), usually resulted from a combination of monetary and balance of payments pressures.⁵¹ Given that in the

⁵¹ Given the weight of receipts from coffee in total exports under the Empire (roughly 50%), much attention has been given to studying its influence in determining the exchange rate in the period. In this regard, Furtado’s classic contribution, by pointing out the instability in the international demand for exports from primary-producing countries, highlights the disastrous consequences that sudden shifts in demand would have on export earnings from the periphery and, hence, the exchange rate of those countries. See Furtado, *Formação*, pp. 164 ff. Furtado actually reinforces an argument made earlier by Wileman, relating oscillations in the value of the *milréis* and the price of coffee. See Wileman, *Brazilian Exchange*, pp. 5-10. More recently, this relationship was challenged by A. Delfim Netto, *O Problema do Café no Brasil* (Rio de Janeiro, Editora da FGV, 1979), Chapter 1, who concluded that ‘in the long run the exchange rate was relatively little affected by the price cycles (of coffee).’ *Ibid*, p. 26. Since the 1970s there have been renewed attempts to analyze the main determinants of the exchange rate in imperial Brazil. Most of these works have sought to test the extent to which the evolution of the value of the *milréis* followed changes in coffee prices, monetary policy, capital flows, the terms of trade or a combination of these variables. The results are

period under study oscillations usually implied a falling rate of exchange, both were viewed by contemporaries as one and the same phenomenon.⁵²

In the context of imperial Brazil, the low/low combination - meaning a depreciated currency and low exchange-rate flexibility (which, in a world with perfect capital mobility, implies relinquishing control over the domestic money supply) - was favoured by foreign bankers and investors in general. These groups sided with economic prudence and, given their direct involvement in foreign trade and investment, were loath to see the local government indulge in inflationary financing. They feared this would jeopardise exchange-rate stability and, consequently, increase their exchange-rate risk.⁵³ Although in principle the main advocates of financial rectitude, foreign investors tended to favour a depreciated local currency when investing in the country, for this would provide them with more *milréis* for each pound sterling. But, obviously, favoured a firmer rate when remitting profits or repatriating capital.

For producers of non-tradable goods and services - who accounted for a significant, although politically diffuse, segment of Brazilian society - monetary independence was of great importance, given the positive impact that lax monetary

inconclusive, but most of the contributions tend to indicate that both domestic influences - linked to coffee output, money supply and wage setting behaviour - as well as international ones - via foreign lending and the international demand for Brazil's exports - had a bearing on the country's exchange rate. See E. A. Cardoso "Desvalorizações Cambiais, Indústria e Café: Brasil, 1862-1906", *RBE*, Vol. 35, No. 2, April/June 1981, pp. 85-106; G. H. B. Franco, "Taxa de Câmbio e Oferta de Moeda, 1880-1897: uma análise econométrica", *RBE*, Vol. 40, No. 1, January/March 1986, pp. 63-88; A. Fishlow, "Market Forces or Group Interests: inconvertible paper currency in pre-1914 Latin America", *Working Paper*, No. 8753, Department of Economics, University of California at Berkeley, September 1987; L. V. Catão, "The Transmission of Long Cycles Between 'Core' and 'Periphery' Economies: a case study of Brazil and Mexico, c. 1870-1940" (unpublished Ph.D. thesis, University of Cambridge, 1991), Chapter VI; and Teixeira, "Determinantes".

⁵² For a discussion along those lines, but covering a later period in Brazilian history, see W. Suzigan, "Política Cambial Brasileira, 1889-1946", *RBE*, Vol. 25, No. 3, July/September 1971, pp. 93-111.

⁵³ '(...) if the question be asked what is hum *milréis*, the integer of Brazilian currency, no one can give a precise reply. It not only depends, like gold, on its scarcity or abundance in the domestic market, but on the clearness or obscurity of the foreign and domestic political horizons, and on the weather, and on the chance of getting in crops unaffected by blight and the numerous contingencies to which agriculture is exposed. A difficulty in the River Plate, or a succession of short coffee crops, would again reduce the value of the *milréis* to half or less of its value today. Nothing but the unusual profits which are expected when unusual risks are concerned can tempt an investor to convert hard cash into the paper currency of Brazil'. Parliamentary Papers 1875, LXXV, *Report by Consul Lennon-Hunt on the Trade and Commerce of Rio de Janeiro for the Year 1873*, p. 309.

policies could have on aggregate demand.⁵⁴ Also, since the real exchange rate can be interpreted as the ratio between non-tradable prices and internationally-determined tradable prices, a drop in the latter, caused by an appreciated exchange rate would move relative prices in favour on non-tradables. Hence the high/high scenario preferred by producers of non-tradables.

The thesis will concentrate on the two remaining preference combinations in Figure 1.3, the high/low and low/high. This allows for a contribution to the aforementioned debate on the nature of State-society relations in the period. From the government's viewpoint, the high/low combination associated with hard money summarised its preferences about exchange-rate levels and variability.⁵⁵ In this respect, the main point to consider is the extent of foreign-exchange payments. Capacity to honour its foreign debt commitments cautioned the government, particularly from the mid-1860s onwards, against a depreciating rate of exchange, since a slipping value of the *milréis*, other things being equal, increased the domestic currency equivalent of its payments. On this count alone the government would in principle favour an appreciated *milréis*. Yet, there was another reason for this preference. Given the great reliance on customs taxes for official revenue, an appreciated *milréis* would, *ceteris paribus*, lead to increased imports and, hence, higher proceeds from customs houses.⁵⁶ In short, depreciation of the exchange rate was to be blamed to a large extent on lax monetary management, the government had strong *prima facie* reasons for playing by the *metalista* script of monetary restraint.

⁵⁴ This result, of course, presupposes a degree of monetary illusion on the part of economic agents. Interestingly, this was clearly perceived by a contemporary. Speaking in the Chamber of Deputies, Paulino José Soares de Souza (Visconde de Uruguai) remarked that 'the superabundance of circulating medium, by breaking the relationship of value between the *numéraire* and the volume of goods and services, causes prices to rise, increases income derived from land and buildings, and leads owners to believe they became richer as a result of the increase in the value of their property; it raises the price of merchandise, and merchants believe that, by selling at higher prices, they will reap greater benefits. There are those who think that a large circulation increases the supply of capital and, by lowering the rate of interest, makes loans easier (...). Such enormous exaggeration has not yet appeared among us, although there are those who proclaim the advantages deriving from the expansion of the circulating medium'. Session of 12 July 1859, in *Annaes da Camara dos Deputados* (henceforth, *ACD*), Tome III, p. 13. The thesis will consider monetary policy capable of affecting real variables, at least in the short run.

⁵⁵ This was also the combination propounded by the *metalistas*, who equated adherence to the gold standard with sound economic policy. See Teixeira, "Determinantes", pp. 62-6. The main elements in the controversy between the *metalista* and *papelista* schools of monetary thought will be discussed in Chapter 6.

Exporters at large, import-competing traded goods producers and, more generally, *papelistas*, as seen in Figure 1.3, favoured the low/high combination. An undervalued *milréis*, coupled with a lax monetary policy, was the soft money scenario that interested them. Other things equal, a depreciated rate of exchange increased the domestic currency proceeds from the export of the main crops, the prices of which were determined internationally. In this context, and provided domestic production costs (which were defrayed in depreciating local currency) increased less than revenues, *fazendeiros* would count among *papelistas*.⁵⁷

As noted, the government not only preferred an appreciated currency, but also a stable one.⁵⁸ In fact, the losses stemming from exchange-rate (and price) movements were clearly identified by contemporaries. Speaking in the Council of State in 1864, Joaquim José Rodrigues Torres (Visconde de Itaboraí) inveighed against what he thought were the dire consequences for all economic agents of an overissue of inconvertible notes by the Bank of Brazil.

(...) it seems unquestionable that (this will result) in great depreciation and instability in the value of the circulating medium, and, with it, the reduction in the incomes of holders of the consolidated internal debt, and of all those who live on fixed wages; the diminution of the salaries and means of subsistence of the numerous working class; the disturbance in the relations between creditors and debtors; the absence of a base for calculations and predictions in commerce and industry; the increase in the State's commitments related to the payment of the foreign debt, as well as its current

⁵⁶ See S. Topik, "State Autonomy in Economic Policy: Brazil's experience, 1822-1930", *Journal of Interamerican Studies and World Affairs*, Vol. 26. No. 4, November 1994, pp. 449-476.

⁵⁷ The above discussion of the political economy of exchange-rate and monetary policy is open to a few qualifications. The first point concerns the relative sensitivity of tradable producers to exchange rate movements, which, in turn, depends on the price elasticity of demand for their products. In the Brazilian case, the coffee sector was characterised by quasi-monopoly power, coupled with a low price elasticity of demand for its product. This feature enabled coffee producers to weather phases of exchange-rate appreciation better than other exporters. Also, as pointed out above, foreign investors when bringing capital to Brazil, would initially benefit from a depreciated *milréis*. The income stream from those very investments, on the other hand, would be greater in foreign currency terms the more appreciated the value of the *milréis*. Finally, in a fixed-rate regime such as the gold standard, divisions might arise within a group of exporters if there is mounting pressure for a competitive devaluation of the currency. In this case, the policy decision will involve choosing between those with long-term contracts, that is, whose sale prices in foreign currency might have been set way beforehand - and who will tend to be against the instability that devaluation introduces - and other exporters who would gain immediate competitiveness as a result of a currency devaluation. See Frieden, "Exchange", pp. 85-6.

⁵⁸ By helping to secure better terms, a high *milréis* provided the best environment for the issue of loans, both domestically and overseas. On this point see M. D. Bordo and H. Rockoff, "The Gold Standard as a *Good Housekeeping Seal of Approval*", *Journal of Economic History*, Vol. 56, No. 2, June 1996, pp. 389-428.

purchases; and, finally, the difficulty that the depreciation and uncertainty over the value of the currency create for the importation of foreign capital.⁵⁹

The authorities repeatedly stressed the government's position in relation to the rate of exchange. Minister of Finance Francisco José Torres Homem (Visconde de Inhomirim) put it clearly in the 1859 annual report to Parliament:

The government is the first one to bear the consequences of a depreciating currency. On the side of tax collection it is the most important of creditors; likewise, it is the most important consumer from the point of view of expenditures. As a creditor it is subject to the same fortune as the others, suffering with them the violation of contracts, and receiving in payment amounts below those anticipated. As a consumer it is forced to disburse more in order to purchase the same amount of goods and satisfy the same number of necessities. To these evils should be added the more or less considerable losses incurred in transferring the funds needed to settle its overseas commitments.⁶⁰

Planters, on the other hand, would seldom admit openly their preference for a weak *milréis*. However, they insisted that trade (or balance of payments) deficits, not overissue, were at the root of exchange-rate depreciation.⁶¹ Curtailment of the process of expansion of the banking system, or of the money supply, was therefore seen as a counterproductive means of attempting to regulate the rate of exchange. Ultimately, in their view, this only served to penalise the agricultural sector, by increasing the cost of credit. Accordingly, *fazendeiros* demanded an expansion of the circulating medium to help bring down interest rates. This position, in turn, depended on two points, one theoretical, and the other a misconception. The first point, as noted above, concerned the non-neutrality of money, that is, the implicit belief that at least in the short run increases in the money supply could affect real variables, not just nominal ones. As to the second, it consisted of equating money and credit, meaning

⁵⁹ Session of 9 November 1864, in J. H. Rodrigues (ed.) *Atas do Conselho de Estado* (Brasília, Senado Federal, 1978, 14 vols.), Vol. V, p. 404. Henceforth this collection will be referred to as *ACE*.

⁶⁰ *Proposta e Relatório Apresentados à Assembléa Geral Legislativa Pelo Ministro e Secretario d'Estado dos Negócios da Fazenda - 1859*, p. 3 (henceforth, *RMF*). The *Relatório*, published annually, contained an overview of the main economic events in the preceding financial year, as well as the budget proposal for the current year, beginning in June. The budget had to be presented to the General Assembly for discussion in May, at the start of the legislative session. Until 1860, the date on the cover page of the *Relatório* referred not to the year in which it was actually presented to the Chambers, but rather the year covered by the report. Thus, in May 1850 the Minister would present to the Assembly the *RMF* for 1849. From 1861 onwards the date corresponded to the year in which the *Relatório* was published.

⁶¹ See, for example, the debates in the 1878 agricultural congress held in Rio, reprinted as *Anais do Congresso Agrícola do Rio de Janeiro, 1878* (Rio de Janeiro, Casa de Rui Barbosa, 1988).

that a monetary expansion automatically, and necessarily, translated into cheaper credit.⁶²

* * *

To sum-up, and as pointed out in the Introduction to the thesis, works on the monetary and banking history of the Empire have not devoted much attention to its political-economic aspects. Those that do, take different stances as regards State-society relations. In terms of Figure 1.3, at least, there appears to be agreement in the literature as to the preferred combination of exchange rate and monetary policy independence for the two groups under examination here. The imperial government preferred the high/low combination, while landowners were keen on the low/high scenario. However, although useful as an introduction to the political economy of monetary and exchange-rate policies, Figure 1.3 offers no indication as to the actual forces that influenced those policies in the Second Reign. In relation to Figure 1.2, it is restricted to stage I. After analysing at the theoretical level how changes in the structure of the international economy affect the preferences of domestic actors, it remains to be explained how the imperial government responded in practice to these preferences. Did it simply adopt policies which favoured landed interests, or was there a relative autonomy when deciding on the road to take in regard to money and banking? This is the subject of Parts II and III of the thesis. First, it is necessary to look at politics and the economy during the apogee of the Empire.

⁶² These points will be taken up in Chapter 7, when discussing the “developmental” role of banks.

Conclusions

Chapter 1 began with a discussion of three political models: those in the radical tradition, market-based models, and the new political economy perspective. It was shown that both Marxist-inspired and market-based models of the polity ultimately postulate the dependence of politics on class, or interest groups. The new political economy perspective, on the other hand, allowed for politics to be relatively autonomous, that is, to have its own incentives, independent of social classes. This approach is richer and especially relevant to political frameworks distinct from those of modern democracies.

It was then seen that in certain occasions in imperial Brazil reasons of State often prevailed over demands made by social groups, even if emanating from the land-owning oligarchy. What this suggests is that at times the interests of the ruling class and of the dominant class did not coincide. It was argued that this was made possible by two main factors. First, the complex system of elite training, which involved the development of a view of the “interests of the State”, sometimes at odds with class aspirations. Second, the difficulty in practising absentee ownership at a time when communications over the vast territory of the Empire were extremely poor. This fact greatly hampered the presence of heirs to the powerful landed aristocracy, particularly from the northern provinces, in the political and administrative centre of the Empire.

In Chapter 1 it was also argued that in the 1850-70 period the main area of intra-elite conflict was over monetary and banking policy. The reason for this was that institutional breakthroughs, such as the Land and Immigration Law, the abolition of the trans-Atlantic slave trade and the promulgation of the Commercial Code had opened up great investment opportunities. As a result, provision of cheap credit became a central demand of the productive classes. The coffee sector, which had been expanding since the 1830s, was a particularly lucrative venture at the time, still unhindered by labour shortage and declining productivity. Nevertheless, planters complained about the cost of credit and what they saw as its main cause - the shortage of currency. Given a choice of monetary policy and exchange-rate regime that best suited their interests, then, *fazendeiros* opted for a depreciated, and abundant, *milréis*. In short, for soft money. The government, on the other hand, had a different set of

preferences. Even though its foreign exchange commitments remained within a safe margin until the mid-1860s, the imperial government would be required to increase its *milréis*-equivalent service payments whenever the value of the currency slipped. Not only an appreciated, but also a stable rate of exchange was deemed necessary by the authorities, for it sent the proper signals to foreign creditors as to their commitment to sound monetary policies. Moreover, stability also made it easier to raise credit domestically.

In principle, the opposite stance maintained by the imperial government and *fazendeiros* as regards monetary and exchange-rate policy indicates that unless the State enjoyed a degree of autonomy from the dominant class its preferences would hardly be fulfilled. In other words, if the Marxist view of a State captured by powerful economic interests were true, soft-money policies would have been pursued. Therefore, if it could be shown that the imperial government succeeded in implementing a hard money policy, consisting of an appreciated *milréis* and monetary restraint, this would lend support to the existence of a relative autonomy of the imperial State. In practice, it would mean that the ruling class of bureaucrats and politicians in key organs - in particular the Council of State and the cabinet - managed to retain a degree of autonomy from class demands.

In Chapter 2, it was shown that the institutions that were in place throughout most of the Second Reign (1840-1889) had developed as a result of the struggles between centrifugal and centripetal forces that followed independence from Portugal, in 1822. The triumph, in the end, of the “monarchic solution” meant that the political system of the Empire would be characterised by centralisation. In this regard, the institution of the Moderating Power was the assurance that factional conflict amongst the two major political parties - Liberals and Conservatives - would not develop into open struggle, to the detriment of the territorial integrity of the Empire and its economic viability. It was also shown how an intricate system of dispensation of patronage reinforced the hold of the central government over the whole political system.

On the economic side, it was said that agriculture was the mainstay of the Empire during its apogee. Export-oriented agriculture, it was emphasised, constituted the dynamic centre of the Brazilian economy, although subsistence crops and the

production for the domestic market employed the majority of the workforce. Section 2.2.1 showed how a local capital market gradually developed to serve the export sector, and commercial activity in general. As a result, a host of institutions sprang up, such as joint-stock banks, private banks, commercial houses and factorage houses. At the centre of the system were factors (*comissários*), who advanced credit to planters, and helped commercialise export crops. Over the years, a few financial instruments were created, prominent among which were short-term promissory notes, or *vales*. Because of their acceptance, *vales* were often deemed as good as banknotes, and served to meet the growing demand for currency in the economy. Yet, with the development of the banking system, the issue of notes payable to bearer would take centre stage. Accordingly, the creation of money - and its impact on the rate of exchange and the rate of discount - would dominate policy debate. In what follows, the evolution of monetary and banking policies, and the underlying monetary controversies, will be examined in detail.

PART II - MONEY AND BANKING IN THE EMPIRE

Introduction

Part II analyses in detail the evolution of the monetary and banking policies that were pursued between 1850 and 1870. It is divided into two chapters. Chapter 3, covering the 1850-60 period, comprises four sections. Section 3.1 deals with the early years of the decade, when banks engaged in the issue of short-term promissory notes, known as *vales*. The government's desire to regulate the money supply led it to create a semi-official bank responsible for the issue of notes. The foundation of the "third" Bank of Brazil, which represented a momentary victory for the advocates of a monopolist bank of issue, is analysed in Section 3.2. The ongoing drain of currency from the centre-south to the provinces of the north led the *Conciliação* cabinet of 1857 to issue a host of decrees allowing new note-issuing banks to be created in the Empire. The return to plurality, in 1857, and the subsequent financial panic imported from overseas, are examined in Section 3.3. Finally, Section 3.4 looks at the orthodox reaction to the events of 1857-8, in the run-up to the 1860 Law of Impediments, which dramatically altered banking and corporate legislation.

Chapter 4, dealing with the 1860-70 period, is divided into three sections. Section 4.1 examines the essence of the Law of Impediments, in particular its effects on the note-issuing banks. The research strongly suggests that earlier appraisals of the Law exaggerated its impact on the subsequent monetary contraction. The 1864 Souto crisis, in turn, is taken up in Section 4.2. It investigates the extent to which this major commercial upheaval was a consequence of the conservative spirit of the 1860 Law. It will be argued that the unchecked operation of private banks is likely to have been a major cause behind the crisis. Section 4.2 also examines the evolution of monetary variables leading to the early days of the Paraguayan War. Section 4.3 analyses the reasons behind the enactment of Law 1349, of 12 September 1866. This law restored the monopoly of note issue into the hands of the Treasury, thus bringing to an end the experiment with banks of issue. The manner by which the Brazilian government financed the campaign against Paraguay is also examined in this section, which concludes with the fall of the Itaboraí cabinet, in September 1870.

Chapter 2 - Politics and the Economy in the Apogee of the Empire

The single most important feature that set nineteenth-century Brazil apart from the former colonies of Spain was the “monarchic solution” to its independence from the metropolis. Moreover, the replacement of Portuguese rule by an Empire provided the country with a highly centralised polity. The smooth transition from colony to nation in the early nineteenth century was characterised by the survival of two additional institutions, apart from the monarchy itself: slavery and the plantation system. Economically, independence was neutral.¹ Production for the domestic market - both of a subsistence nature and for commercialisation to food-importing regions - remained dominant, and employed the vast majority of the workforce. Yet, the most dynamic sector of agriculture was export-oriented. The plantation system, which had flourished during the colonial period, continued to prevail, and witnessed the gradual replacement of sugar by coffee as the country’s main export crop. It was in the provision of funds for the import/export activities that a local banking system developed.

2.1 - Politics

The Empire that followed independence would span most of the nineteenth century, until its eventual demise, in 1889. Just two rulers would have the chance to sit on the throne of the Brazilian Empire: Pedro I, from 1822 to 1831, and his eldest son, Pedro II, who ruled from 1840 until 1889. In between, the Regency period, when the country was first headed by a triumvirate appointed by the Chamber of Deputies and, then, a single, elected, regent.²

The first decade of Pedro II’s reign was characterised, on the political level, by a relentless tendency towards centralisation. This was a backlash against earlier

¹ See S. Haber and H. S. Klein, “The Economic Consequences of Brazilian Independence”, in S. Haber (ed.) *How Latin America Fell Behind: essays on the economic histories of Brazil and Mexico, 1800-1914* (Stanford, CA, Stanford University Press, 1997). For details of the transition from colony to Empire, see R. J. Barman, *Brazil: the forging of a nation, 1798-1852* (Stanford, CA, Stanford University Press, 1988).

² On the early imperial period, see S. B. de Holanda (ed.) *História Geral da Civilização Brasileira*, Tome II (“O Brasil Monárquico”), Vols. 1 and 2 (São Paulo, Difel, 1972); Barman, *Brazil*; Bethell and Carvalho, “1822-50”; and D. Bushnell and N. Macaulay, *The Emergence of Latin America in the Nineteenth Century* (New York and Oxford, Oxford University Press, 1994, 2nd ed.), Chapter 7.

experiments in political and administrative devolution, which almost cost the integrity of the Empire. In fact, in the early 1830s the country witnessed a wave of provincial rebellions. Their main focus was the protest against the rising cost of living (in part owing to increasing food prices brought about by the falling rate of exchange), and the spread of counterfeit coins, the so-called *xenxéns*.³ A second wave of rebellions in the late-1830s and throughout the 1840s was played out in the interior for the most part. These challenges were quite different from earlier, popular, revolts. This time, the land-owning class itself was displaying its dissatisfaction with the end of the liberal experiment in decentralised government. Once these uprisings were finally defeated, in 1849, it became clear to the rural oligarchies that safeguarding the monarchy provided the best guarantee of their own prosperity while ensuring the survival of the mainstay of the Brazilian economy, the institution of slavery. In other words, the monarchy had shown that it was capable of maintaining order in the country, as well as serving as a trusted arbitrator of disputes among different sectors of the oligarchy.⁴ Political and administrative centralisation were finally achieved in the late 1840s, marking the beginning of the apogee of the Empire.⁵

Centralisation implied exercising control over a vast territory. Given the poor communication system of the time, there arose the need to develop the means for central authority to be represented at the local level. Patronage was the best way to ensure this. It was the cement that bound together the different links of a long chain emanating from the monarch in Rio, and ultimately reaching the remotest areas of the interior. Indeed, a system had been created whereby many strategic posts - such as the local chief of police (*delegado*), National Guard officers, judges, and even high members of the clergy - were centrally appointed, through some important patron (*padrinho*).⁶ Judicial and police powers wielded locally by judges, police officers and

³ See Carvalho, *Teatro*, p.13. This was an indication of a problem that would beset most of the interior throughout the Empire, namely, the shortage of currency. This point will be addressed in Parts II and III of the thesis.

⁴ Carvalho, *Teatro*, p. 17.

⁵ ‘After 1840 or 1850 any presumed division between the state and men of wealth in the various provinces must be doubted; by that time most of the rural potentates throughout Brazil had come to recognize the value of central authority, not least because it bolstered their own.’ Cf. R. Graham, *Patronage and Politics in Nineteenth-Century Brazil* (Stanford, CA, Stanford University Press, 1989), p. 69.

⁶ The term is the Portuguese equivalent of godfather. In the case of the ruling families of the economic and political establishment, the *compadrio* (that is, the act of becoming one’s godfather or godmother)

members of the National Guard were instrumental in ensuring the election of the “right” people to the provincial assemblies and, most importantly, Parliament, where the infamous “unanimous chambers” (of Deputies) were commonplace.⁷ These local networks, as noted, spread to the Court, where politicians and civil servants did their utmost to ensure that the incumbent party remained in power.⁸ To that end, officials were appointed across the country, securing favourable political support at the local level and, ultimately, affording the central government control over the political machine.⁹

Elite cohesion was a distinct feature of the Empire. The top echelon of the elite, or the national political elite, comprised very few members, as noted by Carvalho: a total of 342 individuals, in the whole imperial period (1822-1889).¹⁰ Defined as to include cabinet ministers, councillors of state and senators, the national elite had one major unifying trait - their formal education.¹¹ In fact, of a total of 219 cabinet ministers in the 1822-89 period, only 19 had no higher education.¹² It should be stressed that this was no mere detail in a society boasting very few literate individuals as late as 1890, when fewer than 15% of the population was capable of

was most important in reinforcing links among planters and, ultimately, avert a dissipation of their wealth, by keeping future heirs within a broader family (*familia*). On the importance of this practice in the consolidation of the political establishment in the Brazilian Empire, see F. Colson, “The Destruction of a Revolution: polity, economy and society in Brazil, 1870-1891” (unpublished Ph.D. thesis, Princeton University, 1979), pp. 18 ff.

⁷ In seven out of the seventeen legislatures that spanned the Second Reign, electoral manipulation resulted in the lower Chamber being made up entirely of deputies from one of the major parties or, at most, a 7% representation for the minority party. In the case of the 1843/44 and 1869/72 legislatures, however, “unanimity” sprang from a decision of the Liberals to abstain from taking part in elections, in protest against the dissolution of the previous chamber. See Carvalho, *Teatro*, pp. 135-6.

⁸ ‘Local leaders needed appointment to positions of authority to extend their clientele and advance their position within the scale of power and status. At the same time, the Prime Minister in Rio de Janeiro counted on the influence of those men, even in the most remote village of the backlands, to bolster the power of the central government.’ Graham, *Patronage*, p. 69.

⁹ *Ibid.*, p. 55.

¹⁰ See Carvalho, “Political Elites”.

¹¹ For the elite as a whole, that is, not just the “national elite”, there were several institutions that helped to forge a common ethos, such as schools, social clubs and theatres. For an elaboration, see J. D. Needell, *A Tropical Belle Époque: elite culture and society in turn-of-the-century Rio de Janeiro* (Cambridge, Cambridge University Press, 1987). On the common goals that serve to bind elites together, see the Introduction in M. L. Conniff and F. Cann (eds.) *Modern Brazil: elites and masses in historical perspective* (Lincoln, Nebraska, University of Nebraska Press, 1989).

¹² Carvalho, “Political”, p. 385, Table I.

reading or writing.¹³ In view of the absence of institutions of higher education in Brazil prior to the arrival of the Portuguese court in 1808 - when two law and two medical schools were founded - the elite would send its sons to Europe, usually to the law school at Coimbra, Portugal. Not surprisingly, therefore, of the 180 Brazilians who graduated from Coimbra between 1800 and 1830, 149 (82.5%) came from the five wealthiest and most populous provinces.¹⁴ The practical result of this peculiar pattern of elite education - both in terms of its *locus* and content - was the ideological homogeneity it afforded. At the same stroke, Brazilian students from different provinces were able to socialise, share a common experience abroad, and were educated in the same principles of Roman law. The latter, as taught in Portugal, emphasised the virtues of central rule, and was ‘instrumental in infusing the future Brazilian leaders with a strong statist orientation, a firm belief in the reasons of the state and in its supremacy over church and barons’, that is, landowners.¹⁵ This would prove especially important in the turbulent 1830s and 1840s, when the *saquarema* group of, mostly, Coimbra-trained Conservative politicians designed the political framework that would facilitate the consolidation of the Empire.¹⁶

Also important in the general training of the cadres of this elite were their geographical circulation and a common occupation. Geographical circulation (at the provincial, regional and national levels), helped expose graduates (*bacharéis*) to various people, groups and situations. Furthermore, it was instrumental in familiarising them with the problems of different parts of the country, an invaluable asset for anyone aspiring to a political position at the national level.¹⁷ Occupation was similarly important in accounting for the cohesion and homogeneity of the elite. Thus, while up until 1850 a bureaucratic elite composed of magistrates, the military and civil servants, proved essential in maintaining Brazil’s territorial integrity, the

¹³ See Carvalho, *A Construção*, p. 65, Table 6. Note that this was a decrease on the rate found in 1872 - 20%.

¹⁴ Cf. E.-S. Pang and R. L. Seckinger, “The Mandarins of Imperial Brazil”, *Comparative Studies in Society and History*, Vol. 14, No. 2, March 1972, p. 219.

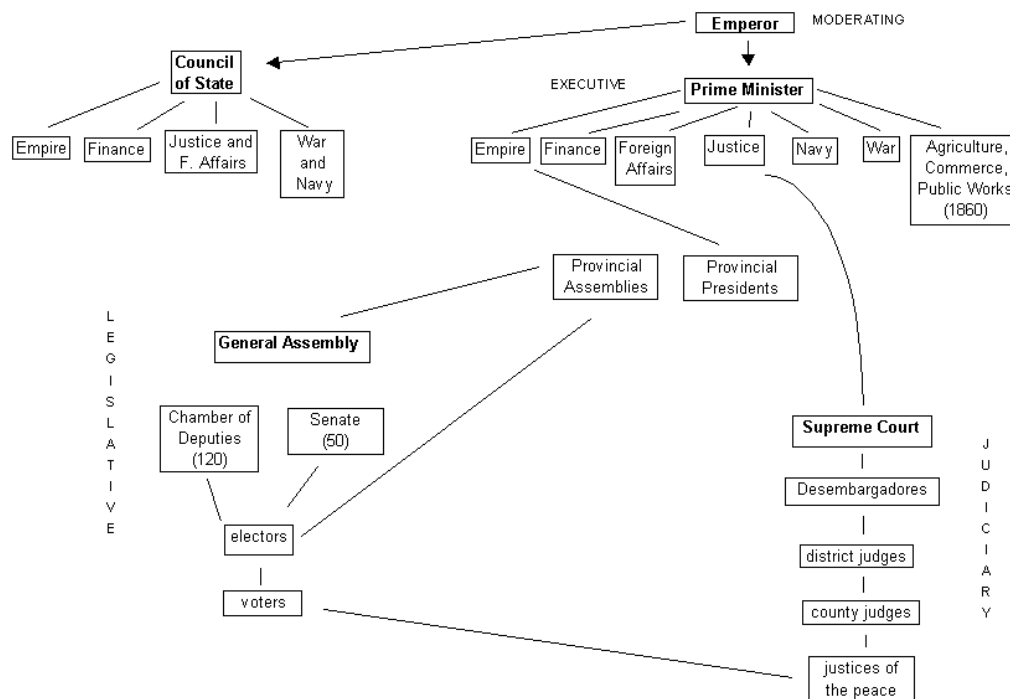
¹⁵ Cf. Carvalho, “Political Elites”, p. 387.

¹⁶ The leadership that lay behind the centralisation process of the 1840s, and who dominated party politics until the early 1860s, became known as the *saquaremas*. For a detailed account of their rise, see I. R. de Mattos, *O Tempo Saquarema: a formação do Estado imperial* (Rio de Janeiro, Access, 1994, 3rd edn.).

¹⁷ See Pang and Seckinger, “The Mandarins”, p. 225.

economic expansion that followed would foster the growth of liberal professionals. During the apogee of the Empire, lawyers, in particular, but also physicians, engineers, journalists, and teachers held prominent posts, indicating a shift in the relationship between State and society. In fact, while magistrates were civil servants, ‘in charge of applying the law and defending the interests of the order, (...) lawyers were instruments of individual interests and, as such, could speak either for the opposition or for the State’.¹⁸ As stressed by Carvalho, although not a sufficient condition for the maintenance of the Empire’s territorial integrity, the presence of an elite sharing a similar education, career pattern and occupational experience - in short, a common world view - proved to be effective to the maintenance of the country as a centralised monarchy.¹⁹ This select group of individuals would formally exercise its influence in the backbone of the imperial political structure, as outlined in Figure 2.1.

Figure 2.1 - Summary of the Political Powers in the Brazilian Empire



¹⁸ *Poder público*, in the original in Portuguese. Cf. Carvalho, *A Construção*, p. 78.

¹⁹ See Carvalho, “Political Elites”, p. 390.

The Brazilian Constitution recognised four distinct powers: the Legislative, Executive, Judiciary and Moderating.²⁰ In other words, it introduced an extra element in the classical division, namely, the Moderating Power. It was to be ‘the key to the whole political organization’ and was delegated to the Emperor so that he could ‘watch over the maintenance of the independence, equilibrium and harmony of the remaining powers’.²¹ In exercising it, the monarch had the power to:

- i) appoint senators;
- ii) convene extraordinary sessions of the General Assembly;
- iii) sanction decrees and resolutions of the General Assembly, in order for them to become law;
- iv) approve and suspend momentarily resolutions of the provincial assemblies;
- v) prorogue, dismiss or adjourn the General Assembly;
- vi) appoint and dismiss ministers of State;
- vii) suspend, under certain circumstances, magistrates;
- viii) pardon or reduce penalties imposed on convicted individuals;
- ix) grant amnesty in urgent cases.²²

This long list shows that far from being one power amongst the other three, the Moderating Power allowed the Emperor substantial influence over all branches of political life. This feature was further ensured by Art. 102 of the Constitution. This made the Emperor chief of the Executive power, which he exercised through his ministers. The Prime Minister, also known as the president of the Council of Ministers, was appointed by the monarch, and was normally a member of the Senate. He selected his cabinet members ‘with a careful eye to balancing competing political ambitions, regional strengths and parliamentary skills and contacts’.²³

The president of the Council of Ministers, after hearing the opinion of the cabinet, appointed provincial presidents for two-year terms, although most would rarely serve a full term, due to the job rotation that characterised political careers at

²⁰ “Constituição Política do Império do Brasil (de 25 de março de 1824)”, in *Constituições do Brasil (de 1824, 1891, 1934, 1946 e 1967 e suas alterações)* (Brasília, Senado Federal, 1986).

²¹ *Ibid.*, Art. 98.

²² *Ibid.*, Art. 101.

²³ R. Graham, “1850-1870”, in Bethell (org.), *Brazil*, p. 140. It is noteworthy that the Constitution did not make any reference to the cabinet.

the time. Provincial presidents, in turn, had under their supervision a host of officials who made up the local police apparatus, thus enabling the central government substantial control over local affairs. This led to constant conflicts between provincial assemblies, which represented regional oligarchies, and provincial presidents, ultimately potentates of the Executive.²⁴

The cabinet consisted of seven portfolios: Agriculture and Public Works (created in 1860), Empire (Interior), Finance, Foreign Affairs, Justice, Navy, and War. The Finance and Empire ministries held the most power and prestige, and often Prime Ministers would occupy the Finance portfolio concurrently. Formally, a new cabinet had to earn a vote of confidence from the Chamber of Deputies before it took power. If this was not forthcoming, the Prime Minister could ask the Emperor to dissolve the Chamber and call new elections, a right that Pedro II would exercise eleven times during his reign.²⁵ After hearing the Council of State the Emperor would have to opt between maintaining the newly appointed cabinet or forming a new one, capable of obtaining parliamentary approval.

The Legislative power was delegated to the General Assembly, with the sanction of the Emperor. Amongst its prerogatives was the final decision on the annual budget of the government, the granting of authorisation for the government to contract loans (both domestic and external), and “the determination of the weight, value, inscription, type and denomination of coins, as well as their standard weight and measurements”.²⁶ The Assembly was bicameral, comprising an upper House (the Senate) and the Chamber of Deputies. Deputies (*deputados gerais*), some 120, were indirectly elected.²⁷ The number of deputies returned by each province was

²⁴ See B. W. de C. Leite, “A Escalada Política no Segundo Reinado: a análise de algumas lideranças”, *História*, Vols. 5/6, 1986/7, pp. 47-60. Provincial assemblies convened for two months every year and legislated on issues unrelated to the “general interests of the nation”. Its resolutions had to be sent to the Executive, via the president of the province, who would then forward it to Parliament. If on that occasion the National Assembly was convened it would decide on the matter and, eventually, turn it into law. See “Constituição”, Title IV, Chapter V.

²⁵ During this period, seven parliaments served their full, four-year, terms and a total of 18 elections took place. For details, see B. de Javari, *Organizações e Programas Ministeriais* (Rio de Janeiro, Imprensa Nacional, 1960, 2nd edn.).

²⁶ Art. 15, Para. 17, in “Constituição”. This paragraph would prove very contentious, as analysed in Parts II and III of the thesis.

²⁷ The total number of deputies in the Empire varied over the years. The electoral system is examined below.

determined by population size. They served for four years, unless the Emperor dissolved the Chamber. Senators, unlike deputies, were appointed by the Emperor, on the advice of the Council of State, and served for life.²⁸ The 50 or so members of the upper House were picked from the three candidates who received the most votes in each province, a practice that aroused indignation among more radical politicians. In order to display his independence, or simply to suit his immediate needs, the monarch would sometimes choose the second or third on the list, compounding the attacks on his Moderating Power.²⁹ The Senate contained at least one member from each province of the Empire.

The opening session of the Assembly took place every year on 3 May, with the pronouncement by the Emperor of the Speech from the Throne, which contained the main policy objectives of the cabinet. The Assembly sat until late September. Both the Chamber of Deputies and the Senate had the power to propose, refuse and approve legislation. Proposals originating in the Executive were sent to the Chamber of Deputies to be examined by a committee, after which they could be converted into a bill. If, after three hearings, deputies approved the bill, it would be sent to the Senate, with occasional amendments. The Senate had the power to accept fully the bill as it arrived from the Chamber, propose amendments or refuse it in its entirety, after which the bill would return to the lower House. In case of legislation emanating from the Senate, the same procedures applied in the Chamber of Deputies. Once the discussions were over, and any of the two Houses approved bills which had originated in the other, legislation would be drafted in decree form and sent to the Emperor, who had one month to sanction it or not. If sanctioned, it became the law of the Empire.

In overseeing the law, the Empire counted on a Judiciary composed of various layers, from county judges to justices of the Supreme Court. In practice, distinctions between judicial and law enforcement activities were often blurred in nineteenth-

²⁸ 'It would nevertheless be a gross misjudgement to classify all the senators of the empire as a bunch of subservient mandarins of the House of Braganza. Although many were blindly loyal to the cause of imperialism, some proved to be ardent defenders of regional economic interests, asserting their independence protected by their life-tenure offices'. Cf. Pang, *In Pursuit*, p. 208.

²⁹ Often senators used the title of "senator of the nation", thus rejecting the idea that they were linked in any way to their original provinces. See K. M. Mattoso, *Bahia, Século XIX: uma província no Império* (Rio de Janeiro, Nova Fronteira, 1992), p. 281. Incidentally, it was possible to become senator for a province without originating in it.

century Brazil.³⁰ In this respect, a landmark event was the reform of the Procedural Code (Law of 3 December 1841), which gave the central government the power to appoint judges in the inferior courts (*juíz municipal*, or county judge).³¹ In addition, this reform also created a parallel hierarchy of appointed police officials, who would be responsible to provincial chiefs of police, hand-picked by the central government from among the professional magistrates.³² Ultimately, these reforms sought to undermine the role of the more independent justices of the peace (*juíz de paz*), who, being elected locally, tended to owe allegiances to the local notables, not to Rio de Janeiro. The importance of exercising control of the Judiciary lay on the latter's supervision of the electoral process. In fact, 'by a careful balancing of favours, threats or fraud, the partisan judge could normally get the local elites to turn out the vote for government candidates. Conflict was avoided by offering positive inducements to the elite, and reserving cruder tactics for the inarticulate and powerless voters'.³³

Up until the electoral reform of 1881, elections in Brazil were carried out through a two-tiered system with two classes of citizens - voters and electors. Voters at parish level selected electors, who then chose national deputies and senators.³⁴ Provincial assemblymen were elected through a similar process, and served for two years. Voters also elected justices of the peace and county councilmen, who served for four years.³⁵ Apart from women and slaves, the law excluded from the franchise vagrants, beggars, servants and males under 25 (except military officers and married men over the age of 21). Income qualifications were also present. In order to be a voter (in the first stage), an annual income of 100 *milréis* (£10) was required.

³⁰ Graham, "1850-1870", p. 141.

³¹ See T. Flory, *Judge and Jury in Imperial Brazil, 1808-1871: social control and political stability in the new state* (Austin, University of Texas Press, 1981), Chapter 10. Among the main duties of a county judge was substituting for his immediate superior, the district judge (*juíz de direito*) in his absence and executing the latter's orders, sentences and injunctions.

³² *Ibid.* Given that the Constitution forbade the dismissal of professional magistrates, judicial manipulation took the form of the power of transfer to remote districts.

³³ Cf. Flory, *Judge*, p. 188. Among the most feared intimidating tactics was the threat of conscription of the less fortunate members of a community.

³⁴ On elections, see Barman, *Brazil*; and, especially, Graham, *Patronage*, Chapter 4 ("The Theater of Elections").

³⁵ Flory, *Judge*, p. 102. 'After 1860 voters (still indirectly) elected Deputies whenever one died, resigned, chose to represent another district where he also had been elected, became a lifetime senator, or accepted a Cabinet position'. *Ibid.*

Electors, who participated in the second stage, were required to have an annual income of 200 *milréis* (£20). The result was a small electorate, easily manipulated by a system of patronage - or outright coercion - wielded by local bosses.³⁶ Hence votes were delivered to favourite candidates. In the end, deputies in Parliament were indebted to two groups of individuals at each end of the power structure: to local chiefs, whose friends and relatives were electors, and to the member of cabinet who had appointed that chief to a position such as *delegado*, commander of the National Guard or substitute county judge.³⁷

Apart from the four powers described above, the Brazilian Empire counted with a college of experienced politicians, who exercised substantial influence in the political arena - the Council of State. Its 24 members (12 regular and 12 alternate) were appointed for life by the Emperor, at the suggestion of the Prime Minister. Council members advised the monarch on the exercise of his Moderating Power, thus having a say in a host of important issues, although the Emperor was not required to follow the opinion of the majority. Reports on submissions to the four standing committees (*Seções*) into which the Council of State was divided (Empire, Justice and Foreign Affairs, War and Navy, and Finance) often served as the basis for executive decrees. Preliminary versions of parliamentary legislation sometimes emanated from the Council, which also exercised judicial review over the legality of laws and decrees, thus acting as a constitutional court.³⁸ The Council was an elite group *par excellence*: of the 72 members of this body in the period 1841-1889, no less than 47

³⁶ See Costa, *The Brazilian Empire*, p. 61. For Graham, this view somewhat exaggerates the impact of this *régime censitaire* (restriction of suffrage by property or income requirements) on the size of the electorate. Based on the study of parish electoral records for the period, he concludes that (in spite of some significant regional variations), 'for Brazil as a whole, 50.6% of all free males twenty-one years of age or older, regardless of age or literacy, appeared on the roles of registered voters'. Graham, *Patronage*, p. 108. Driven by the fear that freed slaves would eventually undermine the mechanisms of electoral control, reform of the 1841 electoral Law was included in the political agenda of the 1870s, culminating in the compromising Saraiva Law of 1881, which abolished the two-tier system, but kept income qualifications. In practice, it enfranchised all literate males over 21 and who had a net income of 200 *milréis*. These criteria reduced the number of those who could vote from 1,114,066 people registered as voters (and 240,000 as electors) to just 145,296 voters, or about one percent of the population. See Costa, "1870-1889", pp. 194-5. On electoral reform, see also S. B. de Holanda, *História Geral da Civilização Brasileira*, Tome II, Vol. 5, "Do Império à República" (São Paulo, Difel, 1964), pp. 195-228.

³⁷ Graham, *Patronage*, p. 180. Largely as a result of this pattern of patronage that was at the root of the political system of the Empire, factional divisions at the local level - which took the shape of disputes among rival groups of ranchers, mill-owners and planters for government favour and the powers of office-holding - often dominated class cleavages.

³⁸ See Graham, "1850-1870", p. 140.

had been provincial presidents and 53 exercised either the post of minister of state, senator or national deputy.³⁹ When appointed to cabinet posts, council members were disqualified from the decision-making process, that is, they kept their seats but were barred from voting.

The main political parties of the Empire were the Conservatives and Liberals. Themselves the direct offspring of the disputes that followed the abdication of Pedro I, Liberals tended to be identified with devolutionist, federalist, aspirations, while the Conservative cause was best mirrored in the political and administrative centralisation which marked the Second Reign. Bipartisanship would formally characterise the Second Reign until the mid-1860s, when the short-lived Progressive Party - encompassing dissident Conservatives and moderate Liberals - made its appearance. Itself the product of the *Conciliação* movement of the 1853-7 period, when Liberals and Conservatives momentarily shared the cabinet, the Progressive party would give birth to the Republican Party and the (new) Liberals, who were not prepared to challenge the monarchic system.

³⁹ Carvalho, *Teatro*, p. 108, Table XI. These data refer to the third Council of State. Earlier councils operated in the 1822-3 and 1823-34 periods.

Figure 2.2
Imperial Cabinets, 1848-71

Date Cabinet Installed	Party	Prime Minister
31 May 1848	Conservative	Francisco de Paula Sousa e Melo
11 May 1852	Conservative	Joaquim José Rodrigues Torres (Visc. de Itaboraí)
6 September 1853	<i>Conciliação</i>	Honório Hermeto Carneiro Leão (Marquês de Paraná)
4 May 1857	<i>Conciliação</i>	Pedro de Araújo Lima (Marquês de Olinda)
12 December 1858	Conservative	Antonio Paulino Limpo de Abreu (Visc. de Abaeté)
10 August 1859	Conservative	Angelo Muniz da Silva Ferraz
2 March 1861	Conservative	Luís Alves Lima e Silva (Duque de Caxias)
24 March 1862	Progressive	Zacarias de Góis e Vasconcelos
30 May 1862	Progressive	Pedro de Araújo Lima (Marquês de Olinda)
15 January 1864	Progressive	Zacarias de Góis e Vasconcelos
31 August 1864	Progressive	Francisco José Furtado
12 May 1865	Progressive	Pedro de Araújo Lima (Marquês de Olinda)
3 August 1866	Progressive	Zacarias de Góis e Vasconcelos
16 July 1868	Conservative	Joaquim José Rodrigues Torres (Visc. de Itaboraí)
29 September 1870	Conservative	José Antônio Pimenta Bueno (Visc. de São Vicente)
7 March 1871	Conservative	José Maria da Silva Paranhos (Visc. de Rio Branco)

Source: J. M. de Carvalho, *A Construção da Ordem: a elite política imperial* (Rio de Janeiro, Campus, 1980); and B. de Javari, *Organizações e Programas Ministeriais - regime parlamentar no império* (Rio de Janeiro, Arquivo Nacional, 1962, 2nd edn.)

During most of the imperial period, Conservatives and, to a lesser extent, Liberals would monopolise seats in the lower House and in the two major political bodies of the Empire, the Council of Ministers and the Council of State.⁴⁰ With the exceptions of the 1864/66 and 1867/68 legislatures (where the Progressive Party held the majority), Conservative deputies dominated the Chamber. Furthermore, the party was in power for most of the period, meaning a hold on the post of Prime Minister. Given the constant cabinet shifts, however, Liberal ministers were present more often than their Conservative counterparts.⁴¹

⁴⁰ This admittedly cursory review of the political parties, of course, fails to do justice to the subtleties that divided “urban” and “rural” Liberals and Republicans based in São Paulo from those operating from Rio. For an in-depth treatment, the reader is referred to Carvalho, *A Construção*, Chapter 8.

⁴¹ Attribution of party affiliation is sometimes made difficult by defections and, in the case of the *Conciliação* movement of the mid-1850s, there is a divergence as to the nature of the cabinets (if Conservative or Conciliation) and, even, as to the duration of the *Conciliação* itself, if meant to stand

Table 2.1
Political Representation in the Chamber of Deputies, 1850-1872

Legislature	Representation	Percentage of Seats	Dissolution
1850/52	Liberals Conservatives	.9 99.1	served for full term
1853/56	Liberals Conservatives	0 100	served for full term
1857/60	Liberals Conservatives	17 83	served for full term
1861/3	Liberals Conservatives	20 80	dissolved by dissident Conservative cabinet
1864/66 (*)	Historical Liberals Progressive Party Conservatives	39 60 1	served for full term
1867/68	Historical Liberals Progressive Party Conservatives	17 74 9	dissolved by Conservative cabinet
1869/72 (**)	Liberals Conservatives	0 100	dissolved by Conservative cabinet

Notes: (*) estimated division of seats.

(**)Liberals abstained in these elections in protest over the dissolution of the previous legislature.

Source: Adapted from Table XV, in J. M. de Carvalho, *Teatro das Sombras: a política imperial* (Rio de Janeiro, Vértice/Iuperj), pp. 153-4.

An examination of the geographical origin of cabinet members reveals that throughout the Second Reign a clear majority of both prime ministers and cabinet members came from Bahia,⁴² while there was an approximately even distribution of the remaining cabinet posts amongst the provinces of Rio de Janeiro, Minas Gerais and Pernambuco. In this respect, São Paulo, Pará and Rio Grande do Sul, the other main provinces economically-speaking, were under-represented.⁴³ Finally, as regards the social origin of cabinet members, Carvalho's research has indicated that

for the whole 1853-61 period (and its four cabinets) or just the Paraná cabinet of 1853-7. For a discussion, see Carvalho, *A Construção*, pp. 162-3, footnote 18. On the issue of stability of the imperial cabinets, see C. Sarmento, "Estabilidade Governamental e Rotatividade das Elites Políticas no Brasil Imperial", *Dados*, Vol. 29, No. 2, 1986, pp. 139-176.

⁴² This predominance of Bahian prime ministers, it has been argued, was not translated into policies directly beneficial to that province, since 'once in power, men would rapidly identify with the Nation State, and this was a pre-condition for their permanence at the head of political and administrative affairs'. Cf. Mattoso, *Bahia*, pp. 288-9. This point will be retaken in Chapter 5, when contrasting the views of the Council of State and of *deputados* on monetary and banking matters.

⁴³ By combining data on party affiliation and geographic origin, Carvalho concludes that i) Rio de Janeiro was predominantly Conservative; ii) Bahia and Pernambuco were more or less divided equally between both parties; and iii) Minas Gerais, São Paulo and Rio Grande do Sul and the other provinces were predominantly Liberal. See Carvalho, *A Construção*, p. 169.

throughout the imperial period the share of those claiming to be landowners, “capitalists” or businessmen remained constant at around 50%.⁴⁴ The remainder was made up of civil servants, professionals and members of the clergy.

2.2 - The Economy

The geographical area over which Pedro II would rule for almost five decades was similar to present-day Brazil, except for parts conquered from Paraguay in the 1860s, and those purchased or obtained via treaties from its neighbours to the west. In all, it covered slightly less than eight million square kilometres. Given some particularities of its geological make-up, especially the presence of a sharp escarpment a few miles west of the shoreline, occupation of this territory was mostly confined to coastal areas. From the beginning of Portuguese settlement, trading posts along the coast naturally evolved into the country’s main urban centres. Salvador (also known as Bahia) and Pernambuco in the Northeast were the main ports in which goods, including slaves, were commercialised. Mostly sugar, but also cotton, tobacco and hides dominated the export trade in these two cities. Belém, further to the North, served as the natural entrepôt of the huge Amazon region.

It was not until the mid-eighteenth century, during the gold and diamond boom that took place in the province of Minas Gerais, that the city of Rio de Janeiro emerged as the principal trading post in Brazil. The transfer of the administrative centre of the colony from Salvador in 1763 only acknowledged the gradual shift of the economic and demographic centre of gravity towards the Southeast. The arrival of the Portuguese royal family in Rio in 1808 consolidated the position of the city as the centre of the Portuguese world. This move coincided with the gradual spread of coffee in the hillsides around the city. From then on Rio would concentrate political, administrative and economic power.

The first official population census to be carried out in Brazil took place in 1872. Estimates of the country’s population for the earlier period reveal that in 1850

⁴⁴ *Ibid.*, pp. 85 ff. Carvalho stresses the difficulty in assigning a particular class origin to members of the imperial political elite, especially members of the National Assembly, due to important gaps in the available sources of information.

Brazil had approximately 7.2 million inhabitants, of which a third were slaves.⁴⁵ By 1870 total population had increased to 9.8 million, while the slave population had fallen to 1.5 million. Illiteracy was widespread. Less than one-fifth of the population could read or write according to the 1872 census.⁴⁶

The nineteenth century as a whole was a period of very modest growth. After a dismal performance in the first half of the century, when it is widely thought that GDP per capita actually fell in real terms, the coffee boom from the 1850s onwards allowed a measure of growth in the subsequent period.⁴⁷ Rough estimates by Goldsmith put aggregate real GDP growth in the 1850s at 2.9% p.a. (1.3% in per capita terms), and 3.4 % p.a. in the 1860s (1.8% per capita).⁴⁸

Brazil was primarily an agricultural society throughout the nineteenth century. Manufacturing activity, however, did develop in the main urban centres in the mid-nineteenth century, catering to local demand for soap, candles, hats, glass, and other wage goods.⁴⁹ Over the decades, the cotton textile industry gradually began to compete with imports, in particular in the manufacture of coarse fabrics.⁵⁰ An embryonic capital goods sector had also developed by the 1850s, consisting mostly of forges and other workshops manufacturing equipment for sugar mills and farm implements.⁵¹ Despite the expansion of this modest manufacturing base, the primary sector remained the mainstay of the Brazilian economy well into the twentieth century. Agriculture employed two-thirds of the active population in 1872, with

⁴⁵ See IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987, Vol. 3), Section 1. Native Brazilians (Indians) were not included.

⁴⁶ See Carvalho, *A Construção*, p. 65, Table 6.

⁴⁷ See N. Leff, *Underdevelopment and Development in Brazil* (London, George Allen and Unwin, 1982), especially Vol. I, Chapter 2.

⁴⁸ See R. W. Goldsmith, *Brasil, 1850-1984: desenvolvimento financeiro sob um século de inflação* (São Paulo, Harper & Row, 1986), p. 20. Estimates of GDP growth for the period should be approached with extreme caution.

⁴⁹ See W. Suzigan, *A Indústria Brasileira: origem e desenvolvimento* (São Paulo, Brasiliense, 1986).

⁵⁰ In 1850 there were eight active mills in Brazil, employing 424 workers. By 1870 the number of workers in the textile sector had increased to 768, employed in nine mills. See S. Haber, "Industrial Concentration and the Capital Markets: a comparative study of Brazil, Mexico and the United States, 1830-1930", *Journal of Economic History*, Vol. 51, No. 3, September 1991, pp. 559-80. Textile manufacturing was also carried out in cottage industries, as shown in D. C. Libby, "Proto-Industrialisation in a Slave Society: the case of Minas Gerais", *Journal of Latin American Studies*, Vol. 23, No. 1, February 1991, pp. 1-35.

⁵¹ See L. A. C. do Lago, F. L. de Almeida and B. M. F. de Lima, *A Indústria Brasileira de Bens de Capital: origens, situação recente, perspectivas* (Rio de Janeiro, IBRE/FGV, 1979), Chapter II.

production of maize, beans, manioc, rice, and jerked beef catering mostly to the growing domestic market. Farming practices in these sectors were often rudimentary, and could involve either free smallholders or slave labour. Production was usually located in the interior, leaving coastal areas to concentrate on export crops. Still, the commodity-export sector remained as the dynamic centre of Brazil's economy throughout most of the nineteenth century, and certainly before 1870. Moreover, even though the majority of the workforce would be employed in activities not linked to agricultural exports, it is widely accepted that productivity gains, if any, were confined to the commodity-exporting sector of the economy.⁵²

Nineteenth-century Brazil was an open economy, at least when compared with the country's experience in the twentieth century. It is estimated that the weight of the foreign sector in the overall economy - as expressed by the sum of imports and exports as a percentage of GDP - reached its peak in the 1850s, at approximately one-third. From then on this ratio declined continuously, reaching one-fourth in 1870.⁵³ For more than two centuries sugar occupied the leadership in Brazil's export schedule, but from 1831 onwards coffee took over as the country's main export item, and accounted for approximately 50% of the value of goods shipped overseas in the 1850s and 1860s. The growth in coffee exports notwithstanding, Brazil's trade balance would be in deficit throughout most of the 1850s. Between the 1850/1 and 1860/1 financial years, exports increased from £8.1 million to £13.2 million, while imports rose from £9.2 million to £13.3 million.⁵⁴ In the 1860s the trade balance would turn in Brazil's favour, with exports reaching £15.5 million in 1869/70, while imports amounted to £13.2 million.⁵⁵

Table 2.2
Brazil, Foreign Trade Flows: 1850/1 to 1869/70
(five-year averages in £ '000)

⁵² For an elaboration, see N. Leff, "Economic Development in Brazil, 1822-1913", in Haber (ed.) *How Latin America Fell Behind*.

⁵³ See Goldsmith, *Brasil*, p. 53.

⁵⁴ See Table A18, in the Statistical Appendix. Between 1833 and 1887 the financial year for statistical purposes ran from 1 July to 30 June.

⁵⁵ See Table A18, in the Statistical Appendix.

Financial Years	Exports	Imports	Trade Balance
1850/1 to 1854/5	8,836.4	10,072.6	-1,236.2
1855/6 to 1859/60	11,565.0	12,965.4	-1,400.4
1860/1 to 1864/5	14,029.4	12,980.2	1,049.2
1865/6 to 1869/70	15,857.2	13,393.0	2,464.2

Source: Elaborated from data in IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987), Table 11.1.

The increase in export earnings, and the achievement of trade surpluses throughout most of the 1860s, were accompanied by an expansion of the foreign currency commitments of the Brazilian government. The total outstanding balance of the foreign debt in 1850 was £6.2 million, having increased very modestly in the following years. Interest and amortisation payments on this debt amounted, on average, to £500,000 p.a. in the decade.⁵⁶ In the 1860s - and on account of loans contracted in 1863 and 1865, totalling more than £10 million - these payments more than doubled, to an average of £1.1 million p.a..⁵⁷

The exchange rate, expressed in pence per *milréis*, stood at close to its par value of 27d until the mid 1850s, with a slight tendency towards appreciation. However, and in great measure as a result of the 1857 financial panic, it dropped to near 25d in 1860. The downward trend was compounded by the financial instability of the 1860s - largely owing to the Paraguayan War (1864-70) - with the lowest quotation reaching 14d in 1868. At the end of the decade the exchange rate had recovered to slightly over 22d.⁵⁸

The literature contains a host of estimates of the rate of growth of the price level in the 1850-70 period, although they all suffer from either of two basic shortcomings. One group of estimates comprises cost of living indices with a limited commodity coverage and inadequate system of weighting, while the other relies on the debatable purchasing-power-parity hypothesis. In the absence of a series that is clearly superior to the others, Goldsmith has produced a composite index of the average of four different estimates of inflation in the 1850-70 period. The results

⁵⁶ Calculated from figures in IBGE, *Estatísticas Históricas*, Table 11.7, pp. 540-1.

⁵⁷ Ibid. It is not clear from the series in *Estatísticas Históricas* whether service payments on the foreign debt include interest guarantees provided by the imperial government on investments in railways.

show that the two periods with the fastest growth in the price index were the early 1850s and the second half of the 1860s, when prices rose on average 5.6% p.a. and 5.3% p.a., respectively.⁵⁹ In the first case, the economy was experiencing a phase of moderate average output growth, following the onset of the coffee boom in the Paraíba Valley region. This initial expansion soon gave way to a period of contraction that lasted from 1852 to 1854. However, the other major inflationary period, in the second half of the 1860s, was accompanied by almost uninterrupted output growth, largely due to the multiplier effects of the Paraguayan War.⁶⁰

The imperial government counted on a tax structure heavily biased towards the import/export trade. Between 1850 and 1870, taxes levied on imports would account, on average, for 60% of total tax collection. Taxes on exports brought in another 15% on average, the remainder being accounted for by a myriad of taxes on consumption and trade in general.⁶¹ The Brazilian government ran budget deficits in all but two of the financial years in the 1850-70 period.⁶² In the 1850s the budget deficit amounted to less than 4% of total revenues. In the 1860s, and especially in the second half of the decade, the deficit got out of control, as the country embarked on a long and costly war against Paraguay.

⁵⁸ See Table A7, in the Statistical Appendix.

⁵⁹ Goldsmith, *Brasil*, pp. 29-35.

⁶⁰ *Ibid.*, pp. 20-6.

⁶¹ See Table A11, in the Statistical Appendix.

⁶² See Table A10, in the Statistical Appendix.

Table 2.3
Revenue and Expenditure of the Imperial
Government, 1850/1 to 1869/70

(five-year averages in £ '000)

Financial Years	Revenue	Expenditure	Balance	Deficit/ Revenue (in %)
1850/1 to 1854/5	4,217.1	4,308.9	-91.8	2.2
1855/6 to 1859/60	5,029.8	5,216.6	-186.8	3.7
1860/1 to 1864/5	5,769.4	6,646.9	-877.5	15.2
1865/6 to 1869/70	6,557.1	12,390.7	-5,833.6	90.0

Source: Elaborated from data in IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987), Table 12.1.

Financing the budget deficit was done by means of various instruments. In the 1850s, when the situation was still manageable, deficits were covered mostly by the issue of short-term (up to one year) Treasury bills (*bilhetes do Tesouro*), usually paying 4% interest. Long-term bonds of the consolidated debt (*apólices*) were also issued. This class of paper normally paid 6% annual interest for investors. Nevertheless, total outstanding issue of *bilhetes* decreased between 1850 and 1859, from 4,700 *contos* to just 135 *contos*.⁶³ The volume of outstanding *apólices* - in other words the stock of consolidated imperial debt - increased very little in the 1850s, from 53.2 thousand *contos* in March 1851 to 57.8 thousand *contos* in December 1859.⁶⁴ By contrast, throughout the 1860s the government would make increasing use of domestic debt to finance its deficits. Additionally, it relied on the issue of three foreign loans between 1860 and 1865 (totalling £11 million) and, in 1867 and 1868, on the printing of vast amounts of notes (*notas*). Resort to seignorage was made possible by the concession of the monopoly of note issue to the Treasury, in 1866.⁶⁵

2.2.1 - Money and Banking

The financial system inherited from colonial times changed very little during the imperial period, and evolved basically as a result of the credit demands of the

⁶³ See Table A14, in the Statistical Appendix.

⁶⁴ See Table A16, in the Statistical Appendix.

commodity-exporting sector. At its centre were the factorage houses, trading in commodities in general, but which made their importance felt particularly in the coffee sector. Factors (*comissários*) provided producers with the first link in a financial and marketing chain ending in the importing countries.⁶⁶ Essentially, factors advanced credit and goods to planters throughout the year and, when the time came, arranged for the transportation of the harvest to the coast and its subsequent commercialisation. Once this had been achieved, outstanding balances would then be settled, taking into account the goods forwarded to planters over the year and the proceeds from the sale of the harvest. *Comissários* relied on commercial credit from manufacturers, exporters and domestic merchants in order to advance goods and money to their planter clients. In sum, 'factors operated at the confluence of production, marketing and finance in the plantation export economy'.⁶⁷

Apart from factorage houses, the capital market that developed to support this flow of goods and credit consisted of other institutions, such as commercial houses, private banks (*casas bancárias*) and joint-stock banks (*bancos*). Commercial houses, as already noted, often provided factors with goods payable in up to one year, a practise ultimately benefiting planters as well. Private banks proliferated in Brazil, particularly in the coastal cities. They were partnerships, often of a family nature, which took deposits and discounted paper, both private and official. Joint-stock banks - which were few in number and did not exist between 1829 and 1836 - operated along similar lines as *casas bancárias*, although usually on a larger scale. During certain periods banks also issued their own paper, which circulated alongside Treasury notes.

Throughout the imperial period, there were complaints of a shortage of money and one of its offshoots, the cost of credit. Planters, often through their political representatives in the Chamber of Deputies, stressed the need to expand the means of payment in order to lower interest rates paid to *comissários*.⁶⁸ The presence of a host of intermediaries in the credit chain, however, offered little room for a reduction in

⁶⁵ The question of deficit financing will be examined in more detail in Section 7.2.

⁶⁶ See J. E. Sweigart, *Coffee Factorage and the Emergence of a Brazilian Capital Market, 1850-1888* (New York, Garland, 1987).

⁶⁷ *Ibid.*, p. 5.

⁶⁸ These demands will be examined in Chapter 5.

the rate of discount charged on planters' drafts. In great measure, mortgage legislation was to blame. It offered wide protection to planters. In the event of default, foreclosure was only possible under adverse terms for creditors. Thus, the law made investors, especially commercial banks, very wary of lending long to the agricultural sector.⁶⁹ As a result, interest rates were kept at 2% to 4% above the market rate, which varied from 5% to 11% in Rio in the 1850s.⁷⁰

Virtually free from State supervision, the development of the banking system prior to the 1850 Commercial Code resulted in the creation by these institutions of some financial instruments, prominent among which were *vales*. *Vales* were favoured by banks and consisted of short-term promissory notes drawn by them on their cashier. They paid such low rates of interest (2% p.a.) that holders never bothered to redeem them, thus resulting in their being kept in circulation well beyond their formal maturity. Technically, they constituted liabilities of the banking sector and were part of the money supply. This was clearly acknowledged by contemporaries, for whom 'five-day obligations are equivalent in their effects to notes payable to bearer (...)'.⁷¹

For most of the third quarter of the nineteenth century, and given that deposits made up but a small fraction of banks' source of funds, permission to issue private paper (initially *vales*, then notes) was an obvious way to "manufacture money"⁷² and provide credit to the economy. As a result, issuing rights were a heated topic of debate throughout this period. Meanwhile, policymakers were primarily concerned with the macroeconomic dimension of the banking question.⁷³ Thus, the central variable in the discussions was the money supply, or the stock of the "circulating medium". Not only did it help determine the rate of interest, it was also widely believed to be the single major factor influencing the rate of exchange. As argued in Chapter 1, the price of foreign currency is crucial in an open economy. Exchange rate

⁶⁹ The problems associated with financing the agricultural sector are discussed in Section 7.1

⁷⁰ See Table A6, in the Statistical Appendix.

⁷¹ Cf. Consultation No. 359, 24 August 1854, in *Imperiaes Resoluções do Conselho de Estado na Seção de Fazenda, desde o anno em que começou a funcionar o mesmo conselho até o presente* (Rio de Janeiro, Typ. Nacional, 12 vols., various years), Vol. III, p. 319. Henceforth, *SFCE*.

⁷² The expression is from R. S. Sayers, *Modern Banking* (Oxford, Clarendon Press, 1951, 3rd edn.), p. 1. Research on the *paulista* banks confirmed that prior to 1875 deposits were a very modest source of banks' loanable funds. See Saes, *Crédito*, pp. 80 ff.

⁷³ See Hanley, "Capital", pp. 41-2.

volatility, by causing shifts in both the wealth and income of various sectors of the economy (including the government), ensured that the external value of the *milréis* occupied the attention of the major groups in the political arena.

Between 1851 and 1870 the money supply - taking the narrow definition (M1), equivalent to the sum of demand deposits and currency in the hands of the public - increased from 45,000 *contos* to 217,000 *contos*, or approximately 8.6% p.a.⁷⁴ If a broader aggregate is used - M2, which would also include interest-bearing deposits - the results would differ little, given the modest extent of the use of those accounts at the time. Two distinct sub-periods can be identified as far as the evolution of the money supply is concerned. The first, from 1850 to 1864, saw M1 growing at an average annual rate of 7.3%. In the second, 1864-1870, money supply expanded at 11.6% p.a. on average. Put another way, the nominal money supply roughly doubled between 1850 and 1864, and doubled again between 1864 and 1870. The first sub-period saw nominal GDP growth of approximately 6% p.a. between 1851 and 1861, falling to 3.7% between 1862-64.⁷⁵ The larger average growth in M1 in the 1864-70 period was largely due to the financing of the Paraguayan War, during which the economy grew at more than 9% p.a.⁷⁶

Operationally, the growth in the money supply can be decomposed according to its main determinants. Using the classical methodology developed by Friedman and Schwartz, and Cagan,⁷⁷ the identity expressing the supply of money (M) as a multiple of the monetary base (H) can be written as

$$M = \frac{H}{C/M + R/D - (C/M)(R/D)}$$

⁷⁴ See Table A1 in the Statistical Appendix for quarterly data on money supply. Unless otherwise stated figures are in nominal terms and refer to end of year. Growth rates were calculated from raw data presented in IBGE, *Estatísticas Históricas*, Section 10.

⁷⁵ See Goldsmith, *Brasil*, Table II-2, p. 25.

⁷⁶ Ibid.

⁷⁷ See Friedman and Schwartz, *A Monetary History*; and P. Cagan, *Determinants and Effects of Changes in the Stock of Money, 1875-1960* (New York, Columbia University Press, 1965).

where C = currency in the hands of the public;
 D = deposits of the public in the commercial banks; and
 R = commercial banks' reserves

Essentially, this identity shows how money supply (M) is jointly determined by the behaviour of the monetary authorities (through H), the banking system (by means of the reserve/deposits ratio, R/D) and by the preference of the public for liquidity (as captured by the C/M ratio). Other things being equal, the higher the monetary base, the higher the money supply. Equally, an increase in the prudence of the banking system - resulting in higher reserve ratios - causes a fall in the money supply, the same occurring should the public's preference for holding cash balances (as opposed to deposits) increase.

Peláez and Suzigan have estimated the relative contribution of each of the three variables (H , C/M and R/D) for the overall growth of the money stock between 1855 and 1869, a period broadly bounded by the beginning of the operations of the third Bank of Brazil and the end of the Paraguayan War.⁷⁸ Their estimates show that the issue of high-powered money accounted for the bulk (close to 90%) of monetary growth in the period, in either of its two definitions, $M1$ and $M2$. The offshoot, as already noted, was that capacity to issue banknotes was hotly disputed. Issuing rights, accordingly, were controlled closely by the Brazilian government.⁷⁹ This behaviour derived from the government's concerns about possible abuses resulting from a process of unchecked money creation, and the effects on the rate of exchange.

⁷⁸ See Peláez and Suzigan, *História Monetária*, p. 74.

⁷⁹ During certain periods in the 1850s and 1860s private issuing banks created monetary base. As such, government control over the money supply ultimately consisted in establishing a limit on banks' note issues as a proportion of their gold reserves. This system will be examined in detail in Parts II and III of the thesis.

Table 2.4
Brazil: Sources of Changes in the Money Stock, 1855-69
(in %)

Annual Average Rate of Growth as Contributed by				
	Total	H	C/M	R/D
M1	7.47 (100)	6.79 (91)	0.36 (5)	0.94 (13)
M2	6.87 (100)	6.79 (99)	-0.08 (-1)	-0.61 (-9)

Note: Figures in brackets do not add up to 100 due to rounding and errors in approximation.

Source: C. M. Peláez and W. Suzigan, *História Monetária do Brasil* (Brasília, Ed. da Universidade de Brasília, 1976, 2nd edn.), p. 74.

It is noteworthy that in the 1855-69 period banks and public displayed contrasting behaviours, while their joint contribution to the growth in the money supply was only marginal. The reserve/deposit ratio exhibited a declining trend throughout, reflecting a slackening of banks' prudence.⁸⁰ Meanwhile, the public's preference for cash, after falling continuously until the mid-1860s, increased again during the remainder of the decade. This was probably a result of greater uncertainty caused by the war with Paraguay, but might also have reflected public anxiety about a reduction in bank prudence. The public's apprehensions are confirmed by a concurrent drop in the rate of growth of deposit liabilities in the banking sector, which peaked at the outbreak of the conflict and remained stagnant for its duration.⁸¹ The slow modernisation of the Brazilian banking system, away from cash and towards the use of deposits accounts, had thus to await the end of the turbulent period of the war.

A final point concerns the estimates of the money supply used above, to be employed throughout most of the thesis. As noted by Goldsmith, the monetary series calculated by Peláez and Suzigan omit two important items from the money supply in the period, namely, coins and short-term liabilities issued by private banks.⁸² There are only very sparse data on the supply of coins in the Second Reign. Yet, if coins are taken into account, the traditional estimates of the money supply in 1850 should be increased in some 20,000 *contos*, or a hefty 35%. Still, by the beginning of the Paraguayan War the volume of coins in circulation had fallen by half, amounting to

⁸⁰ See Table A1, in the Statistical Appendix.

⁸¹ Ibid.

⁸² Goldsmith, *Brasil*, p. 43.

less than 10% of M1. After that, coins virtually disappeared from circulation.⁸³ Other forms of “money” are harder to pin down. Liabilities issued by private banks certainly performed similar functions as banknotes or Treasury paper, although they only circulated locally. However, there is no statistical record of the activities of *casas bancárias*, so that it is virtually impossible to estimate the extent of their issues.

Surprisingly, Goldsmith fails to notice that other forms of money (or quasi-money) are omitted from the Peláez and Suzigan series. Indeed, it could be argued that some types of drafts issued by private individuals, as well as Treasury bills (*bilhetes do Tesouro*) and deposits held at private banks should also be included. Although there are sparse estimates for deposits and some types of drafts (and a complete series for Treasury bills), questions remain as to their effective role as substitutes for money. Neither drafts, nor *bilhetes* - and, as a matter of fact, paper issued by both private and joint-stock banks - were legal tender. In practice, then, individuals were not required to accept them. Furthermore, none of these could be used in payment of taxes and debts to the government, something which further restricted their circulation. In light of these considerations, and given the greater reliability of the series estimated by Peláez and Suzigan, most of the analysis that follows will rely either on their estimates of the monetary aggregates, or on contemporary data on notes in circulation.

⁸³ On the metallic circulation in the period, see L. A. C. do Lago, “Balança Comercial, Balanço de Pagamentos e Meio Circulante no Brasil no Segundo Império: uma nota para uma revisão”, *RBE*, Vol. 36, No. 4, October/December 1982, pp. 489-508.

Chapter 3 - From Plurality of Issue to Monopoly and Back: 1850-60

3.1 - The *Vale*-Issuing Banks

In 1850 two opposing forces were acting on the financial sector. On the supply side, capital hitherto employed in the trans-Atlantic slave trade was suddenly made idle by Brazil's final acceptance of British demands to end this commerce.¹ Simultaneously, pressure was exercised on the demand side by planters eager for cheap credit, as the coffee economy expanded westwards, in the direction of the fertile plateaux of São Paulo. To cope with the new demands that arose from the coffee sector, as well as commercial activities in general, the Empire counted with a financial system consisting of just three joint-stock banks: the Banco Comercial da Bahia, the Banco Comercial do Rio de Janeiro and the Banco Comercial do Maranhão. All of them issued *vales*,² as well as accepting deposits and offering loans. Apart from these banking corporations, commercial houses, discount houses, and private (partnership) banks operated in the major commercial centres.

Every year, at harvest time, part of the circulating medium in Rio - consisting of Treasury notes and coins - was exported to the provinces, where they helped ease the shortage of money. This, in turn, led to the emergence of proposals in 1850 for the creation of a national bank. This establishment would be entrusted with the retirement of the Treasury notes in circulation and be responsible for the money supply, ensuring the necessary liquidity in an expanding market. In his 1849 report to the Assembly, the then Minister of Finance (Joaquim José Rodrigues Torres, Visconde de Itaboraí) displayed sympathy for the idea of an enlargement of the banking system.³ The aim was to create deposit and discount banks in the provinces,

¹ According to a businessman testifying before the commission set up to investigate the causes of the 1857 commercial crisis, approximately 15 to 20 thousand *contos* (£2 million) were freed from the slave trade in 1851 and 1852. See *Comissão de 1859*, p. 104. On the trans-Atlantic slave trade, see Bethell, *The Abolition*.

² As noted in Chapter 2, *vales* were short-term promissory notes which circulated locally, performing a similar role to banknotes.

³ See *RMF* 1849, pp. 36-7. A native of the province of Rio de Janeiro, Itaboraí was one of the three leading Conservative representatives of that province in Parliament. He formed, alongside Eusébio de Queirós and Paulino José Soares de Sousa (Visconde de Uruguai), the "Saquarema trinity", which would exercise considerable political influence in the Empire between 1840 and 1870. Itaboraí was a Mathematics graduate from the University of Coimbra, and held the Navy and Finance portfolios on many occasions. It was in the latter capacity that he gained his reputation for austerity and technical ability, making him, arguably, the most respected authority in financial matters during the period. It is

a move that, it was hoped, would ‘fertilise industry and enrich the country’.⁴ However, Itaboraí was quick to point out that he did not see ‘any usefulness in banks of issue’ (emphasis added). He doubted whether the creation of such banks was compatible with what would be the main objective of the government in the coming years: to regulate monetary expansion.⁵ On 31 May 1850, Law 552 came into effect. Article 3 stated that in ‘no circumstance, and under no pretence whatsoever, shall the amount of circulating paper in the Empire increase, even if temporarily’. This provision was never observed, but it illustrates vividly the intentions of policymakers at the time. Instead of increasing the volume of Treasury notes in circulation or granting to a private establishment the right to issue legal tender notes, the government appeared to be approaching very cautiously the whole question of issuing rights.⁶

At the beginning of the 1850 legislative session a bill was presented to the Senate by Holanda Cavalcanti, a former Minister of Finance, proposing the creation of provincial issuing (or circulating) banks. This was an attempt to meet a growing regional demand for credit and to reduce the movement of currency from Rio to the interior at harvest time. Under the bill, each of the main provinces (and the city of Rio de Janeiro) would have a bank with permission to issue notes up to the amount of its capital fund, and backed by its shares. These notes would circulate only in the provinces where they had been issued and would be accepted in payment of taxes and debts. In all, Cavalcanti’s plan provided for a potential note issue in the order of 20.7

said that whenever cabinet re-shuffles occurred, the first thing financiers in London would ask was if Itaboraí had been appointed Prime Minister or Minister of Finance, given his reputation as a firm conductor of economic policy. See A. Tavares de Lyra, *Instituições Políticas do Império* (Brasília, Senado Federal, Ed. da Universidade de Brasília, 1978), pp. 287-8.

⁴ See *RMF* 1849, p. 36.

⁵ *Ibid.* ‘What would be the use of withdrawing from circulation, at the cost of great sacrifice, five or six thousand *contos* in paper if the vacuum thus created were to be filled by an equal amount of bank notes, which also represent paper money?’ *Ibid.*, p. 37. Itaboraí was referring to Law 401 (11 September 1846), which established the new gold parity between the *milréis* and sterling, at 27d (Art. 1). Article 2 authorised the government to withdraw from circulation whatever amount of paper money was necessary to keep the rate of exchange at that level. This point will be examined in Chapter 6.

⁶ Decree 575, of 10 January 1849, regulated the functioning of corporations. It determined in Articles 9 and 10 that no joint-stock bank would be allowed to operate before one-fourth of its capital had been subscribed. The decree also gave the government powers of inspection and the right to close banks that failed to comply with legislation. For details, see Cavalcanti, *O Meio*, Vol. 2, p. 165.

thousand *contos*, an amount equal to about half the money stock at the time.⁷ His bill was endorsed by the Finance Committee of the Senate and approved in the first round of discussion on the floor. After long delay, subsequent discussion of the bill would resume only at the start of the 1853 legislative year, when it met an alternative project originating in the Executive. This project proposed the monopoly of note issue, to be granted to a semi-official institution based in Rio. Faced with this new proposal, which appeared to sabotage his own bill, Cavalcanti withdrew his project for the creation of provincial banks.

The author of the new project, Itaboraí, had returned to the Ministry of Finance in January 1851 and gone on to become Prime Minister, in May 1852. His project for the creation of a ‘solidly constituted bank, to help in the expansion of the operations of commerce and industry’ was included in that year’s Speech from the Throne, delivered by the Emperor at the opening of the legislative session, on 3 May 1853.⁸ Although clearly emanating from the Executive, the Itaboraí proposal was originally meant as an amendment to the Holanda Cavalcanti project. However, with the withdrawal of the latter, Itaboraí’s project ended up being “adopted” by five senators. Thus it became *de jure* a project of the upper House of the Legislative, where it began to be discussed in the session of 13 May.⁹ The bill consisted of six articles, as follows:

Art. 1: The Bank will have a capital of 30,000 *contos*, which can be increased after deliberation by the general assembly of shareholders and subject to government approval. It will last thirty years from the date of its installation;

Art. 2: The notes of the Bank will be redeemable in currency (metal or paper money) and will enjoy the exclusive privilege of being accepted in public agencies at the Court and province of Rio de Janeiro, as well as in the others where offices exist;

Art. 3: (the Bank) will not be allowed to issue notes of less than 20\$ in the Court and province of Rio de Janeiro; and of less than 10\$ in the other provinces of the Empire;

Art. 4: The president of the Bank will be appointed by the Emperor. (He will) preside over the general assembly of shareholders, will be entitled to follow the work of every commission, and to suspend any deliberation contrary to the law or to the Bank’s statutes;

Art. 5: The Bank will be required to retire from circulation government paper at a rate of 2,000:000 annually, the retirement having to commence within two years of its installation.

⁷ Ibid., pp. 167-73.

⁸ See *Fallas do Throno Desde o Anno de 1823 Até o Anno de 1872, acompanhada dos respectivos votos de graças da camara temporaria e de diferentes informações e esclarecimentos colligidos na Secretaria da Camara dos Senhores Deputados* (Rio de Janeiro, Typ. Nacional, 1872), p. 448.

⁹ This confirms the opposition’s claims that the Senate bill was no more than ‘a government project in disguise’. See session of 17 June 1853, in *ACD*, Tome II, p. 232.

The first 10,000:000 employed in the retirement of paper money will be offered by the Bank (to the government) as a loan, interest-free, for the duration of its privilege.

At the end of the period marked in Art. 1, the government will pay the said 10,000:000 in cash or bonds of the consolidated debt (*apólices*) at par, and interest of 6%.

As soon as the amount of paper retired reaches 10,000:000 the government will repay the Bank, quarterly, the excess of the said sum;

Art. 6: If, for the greater security of its operations, the Bank deem it necessary to contract a credit, which does not exceed the amount that the government owes it, in a foreign country, the government will be able to provide Brazil's guarantee for it (...);

It seems, therefore, prudent that the maximum issue of the Bank be limited to twice the amount in its reserve fund, leaving it to the government the right to grant an extension of this limit if the circumstances so require.¹⁰

On 17 May the first criticisms were directed at Art. 2 of the project, in particular the provision concerning the redemption of the notes of the Bank for either gold or paper money.¹¹ Itaboraí's defence came two days later, when he stressed the sheer impossibility of demanding redemption exclusively in gold, given the costs this would involve for the acquisition of metallic reserves on such a scale. Additionally, Itaboraí maintained that permission to redeem Bank notes into Treasury paper stemmed precisely from the existence of the latter. In the absence of Treasury notes in circulation, redemption would have been done solely into gold.¹² After a few more sessions of debate the project was finally approved in the Senate without any modification, on 6 June 1853.

In the Chamber of Deputies, where the project arrived on 17 June, Itaboraí was charged with changing his mind too quickly on the need for banks of issue. After all, as noted, he had already publicly proclaimed his reservations in regard to this type of establishment.¹³ His about-face had been explained earlier to the Assembly.

The public wealth and, with it, the sum of transactions, has increased (since 1850); the industrial spirit has begun to develop in a pronounced way; and, finally, the insufficiency in paper money is shown by the presence of 16 to 20 thousand *contos* in coins, with which the mass of the circulating medium has been augmented.¹⁴

¹⁰ *RMF* 1852, p. 15.

¹¹ See the summary of the parliamentary debates in C. Pacheco, *História do Banco do Brasil* (Banco do Brasil, 1973, 4 vols.), Vol. II, pp. 94-110.

¹² Cited in debate held in the Chamber of Deputies on 7 July 1859, in *ACD*, Tome III, p. 54.

¹³ *RMF* 1849, p. 36.

¹⁴ *RMF* 1853, p. 14.

Circumstances had in fact changed between 1850 and 1853, but not in the direction which Itaboraí would have thought “ideal”. On the positive side, there had indeed been a marked improvement in the accounts of the imperial government, which displayed a surplus of 4,700 *contos* in the 1852/3 financial year.¹⁵ This contrasted with a deficit of nearly 7,000 *contos* in the year before. Still, on the monetary front, there had been no reduction in the amount of Treasury notes in circulation, a necessary step, as stated by Itaboraí in his 1850 report, before the private issue of banknotes could be considered.¹⁶ Meanwhile, the existing *vale*-issuing banks operating in the Empire increased their combined circulation sharply.¹⁷

Table 3.1
***Vale*-Issuing Banks and Their Main Accounts, 1850-53**
(in *contos*)

year	no. of banks	capital	issues	deposits	loans
1850	3	4,870	1,147	9,448	14,079
1851	4	9,390	1,290	14,631	19,139
1852	5	12,337	4,526	24,998	16,392
1853	5	16,524	5,310	19,954	35,043

Note: Figures do not include the Banco Comercial do Pará, for which no data were available.

Source: Table A3, in the Statistical Appendix.

Despite this increase in *vale* circulation, all was not well in the Rio market. The main commercial centre of the Empire experienced a “monetary pressure” in the first half of 1853.¹⁸ According to the testimony given by one of the many merchants heard by the committee set up to investigate the causes of the 1857 crisis, the origins of the pressure in 1853 could be ascribed to three factors.¹⁹ Firstly, capital released by the cessation of the trans-Atlantic slave trade had been “recycled” by many banks, who lent liberally (and irresponsibly, according to some) for periods of up to one year,

¹⁵ See Table A9, in the Statistical Appendix.

¹⁶ Cavalcanti, *O Meio*, Vol. 2, p. 173.

¹⁷ In 1851, the “second” Bank of Brazil, founded by the Barão de Mauá, joined the Comercial in the Rio market. The following year, the Banco de Pernambuco started operations.

¹⁸ See PRO, Foreign Office, 13/303, Jerningham to the Earl of Clarendon, Rio de Janeiro, No. 34, 11 June 1853.

¹⁹ See *Comissão de 1859*, Annex A, pp. 102-3.

exposing their portfolios to considerable strain. Second, the fact that *vales* were not accepted in public offices made redemption for Treasury notes and specie necessary for the payment of taxes and debts to the government. Additionally, currency (Treasury notes and coins) had to be shipped to the provinces, where they were accepted, in payment of slaves and other goods. *Vales*, in turn, only circulated locally. Finally, in the early 1850s the exchange rate in Recife and Salvador - the main commercial centres of the North - was often higher than in Rio, making it profitable to ship Treasury notes and gold to those markets, for the purchase of bills of exchange.²⁰

There are clear indications that contemporaries experienced a shortage of money in the Rio market in the first half of 1853. This was evidenced by the rise in discount rates,²¹ in spite of (or, as some would argue, as a result of) the actions of the two *vale*-issuing banks based in the capital city. The first of these, the Banco Comercial do Rio de Janeiro (BCRJ), started its operations in 1838, although its statutes would only be officially approved in June 1842. On that occasion, the government expressly denied the BCRJ the possibility of ever becoming an issuer of notes, as proposed in Article 2 of its statutes. In its first decade in operation the BCRJ annually discounted an average of 4,800 *contos* in commercial bills, while its outstanding issue of *vales* averaged slightly over 200 *contos*.

In the early 1850s, as the coffee economy around Rio de Janeiro expanded its operations, the “second” Bank of Brazil opened its doors.²² This was the first bank to be created under the new rules laid down by the 1850 Commercial Code. Organised as a limited company, its statutes were approved by the imperial government on 2 July 1851, with one major modification. Instead of being able to issue 5-day *vales* to

²⁰ Ibid., p. 104.

²¹ See Table A6, in the Statistical Appendix.

²² Mauá’s Bank of Brazil had been the third institution to bear that name, after the original 1808 bank, and a failed attempt to incorporate a national establishment in 1833. Yet, it was the second bank actually to operate under that name. More on this in Chapter 6.

an amount equivalent to one-half the bank's liquid holdings, that limit was reduced to one-third.²³

Table 3.2
Issuing Banks in Rio de Janeiro: *vales* outstanding
and bills discounted, 1840-54
(in *contos*)

	average 1840-49	1850	1851	1852	1853	1854
BCRJ						
outstanding issue of <i>vales</i>	213	5	2	257	1,574	n.a.
bills discounted	4,801	6,657	8,417	10,997	10,629	n.a.
Bank of Brazil (Mauá)						
outstanding issue of <i>vales</i>	-	-	98	1,594	1,937	1,880
bills discounted	-	-	3,903	6,926	9,033	9,364

Notes: Figures are as of 31 December. Mauá's Bank of Brazil began operations in 1851.
n.a. = data not available.

Source: Compiled from data in A. Cavalcanti, *O Meio Circulante Nacional* (Rio de Janeiro, Imprensa Nacional, 1893, 2 vols.), Vol. 2, pp. 151-60.

The figures in Table 3.2 show that prior to the arrival of the second Bank of Brazil on the scene, the BCRJ relied to a very modest extent on the use of its own *vales* in discounting commercial paper. In fact, the main source of profits for the bank derived from receiving funds on interest-paying deposits (*dinheiro a prêmio*) of 4% - 4 1/2 % p.a. and re-lending them at much higher rates. Nevertheless, from 1852 onwards there appears to have been a shift in strategy. The Banco Comercial increased both its issues of *vales* and the volume of discounts, in competition with the new entrant in the Rio market, Mauá's Bank of Brazil. In the space of just two years the combined volume of discounted bills increased by approximately 80%, while *vales* issued by both banks jumped from just 100 *contos* to more than 3,500 *contos*. Competition between the Comercial and the Bank of Brazil led them both to overlook the quality of the paper being discounted, and to lower rates of discount to an unprecedented level of 4% in late 1851.²⁴

²³ See Pacheco, *Banco do Brasil*, Vol. II, pp. 72-83; and R. J. Barman, "Business and Government in Imperial Brazil: the experience of Viscount Mauá", *Journal of Latin American Studies*, Vol. 13, Part 2, November 1981, pp. 239-64.

²⁴ *Ibid.*, pp. 245-6. Dividends paid out to shareholders of the Comercial fell from a high of 13.6% in 1850 to an average of less than 9% in the following three years. See Cavalcanti, *O Meio*, Vol. 2, p. 152. Figures for Mauá's Bank of Brazil are incomplete and do not allow a comparison to be made.

The inevitable adjustment hit the Rio market with an unprecedented liquidity crisis. The discount rate rose from 4-5 percent to 10-11 percent and, worse yet, both banks were so over-committed that they ceased to discount even the best paper. As their liquid assets shrank, so by their statutes the banks were forced to withdraw their credit notes from circulation, thus further shrinking the money supply.²⁵

Essentially, as both banks increased their loans, their issue of *vales* also expanded. However, as Treasury notes were being exported to the northern provinces, bearers of *vales* found it increasingly difficult to redeem them at their respective issuers, who reacted by raising their rates of discount. At the height of this monetary pressure, in July 1853, the government was prompted to offer credit of up to 4,000 *contos* in interest-bearing Treasury bills (*bilhetes*) to the two Rio banks. Furthermore, it considered giving their *vales cours forcé* in Rio.²⁶ In the end, only Mauá's Bank of Brazil would take the offer of credit, and only to a modest extent.²⁷ In light of this episode, the government saw the need to take definitive steps towards solving the underlying problem of providing adequate liquidity to a growing economy, while maintaining a stable monetary circulation. An institution that it could monitor closely seemed the best option. Thus the "third" Bank of Brazil was born.

3.2 - Monopoly Achieved: the "third" Bank of Brazil

The circumstances surrounding the creation of the third Bank of Brazil reveal the interplay of opposing forces in the monetary controversies of the nineteenth century. As already noted, in 1850 and amid a growing shortage of money in the economy,²⁸ those in favour of plurality of note issue backed the Holanda Cavalcanti proposal creating several provincial banks of issue. In a sense, this was the "economic" version of the political (and military) disputes which beset the Empire from its inception in 1822, and which pitted centrifugal forces in the provinces against the

²⁵ Barman, "Business", p. 245.

²⁶ See session of 13 June 1853, in *ACD*, Tome II, pp. 182-4.

²⁷ See B. Ribeiro and M. M. Guimarães, *História dos Bancos e do Desenvolvimento Financeiro do Brasil* (São Paulo, Pró-Service, 1969), p. 76.

²⁸ The amount of Treasury notes in circulation decreased by almost 10% between 1845 and 1850, from 50.4 thousand *contos* to 46.9 thousand *contos*. The increase in *vale* issue in the same period (from 600 to 1,100 *contos*) did not make up for the reduction in government legal tender in the economy. See Peláez and Suzigan, *História Monetária*, p. 79, Table IV.2.

powers of centralisation.²⁹ The latter, victorious at last after the defeat of the *Praieira* revolt in 1849, would again triumph in the new “battlefield” of banking policy.³⁰

Although in favour of the creation of a national bank operating with discounts, deposits and note issue, Itaboraí staunchly opposed the setting-up of a state-run institution, lest it run counter to (the government’s) position as an ‘impartial protector of all interests in society’.³¹ His “counter-project” to the Holanda Cavalcanti bill, while shunning the creation of a state-run bank, nevertheless ensured a considerable degree of government control over the operation of a Rio-based establishment. Thus, to political centralisation would be added monetary centralisation, in the hands of a bank bestowed with many privileges, and where both the president and vice-president would be appointed by the Emperor.

After a third round of discussions in the Chamber of Deputies, the Itaboraí project, outlined above, was finally approved without any modification. On 5 July, Law 683 was sanctioned by the Emperor, ‘authorising the Government to grant the incorporation and approve the statutes of a bank of deposits, discounts and issue, based in the city of Rio de Janeiro’.³² The new Bank of Brazil was created with a capital of 30,000 *contos* (£3.5 million), divided into 150,000 shares of 200 *milréis* each. It came into being as the result of the amalgamation of the existing Bank of Brazil - which had evolved into the country’s main bank - and the BCRJ. As the major partners in the merger, shareholders of the second Bank of Brazil were entitled to 50,000 shares of the new bank, while those of the Banco Comercial kept 30,000 shares. The remaining 70,000 shares were reserved for the bank’s provincial branches (40,000), and for subscription by the general public in Rio de Janeiro (30,000 shares). Under these circumstances, it was only natural for Mauá and his group to expect to control the Bank and, therefore, to be able to set policy. To their disappointment, the Emperor appointed João Duarte Lisboa Serra, a member of the

²⁹ This process was reviewed in Chapter 2.

³⁰ This point will be taken up again later in the thesis.

³¹ *RMF* 1852, p. 14. This sense of fairness would permeate discussions in the Finance Standing Committee of the Council of State, as will be seen in Chapter 5.

³² *Legislação Sobre Papel-Moeda* (Rio de Janeiro, Imprensa Nacional, 1923), pp. 35-7. Shortly before the act that created the third Bank of Brazil was passed, the government approved the statutes of a new bank in the city of Rio de Janeiro, the Banco Rural & Hipotecário. With a capital of 8,000 *contos*, divided into 20,000 shares of 400\$000 each, it had its application to engage in the issue of *vales* denied by the Council of State. More on this in Chapter 5.

Chamber of Deputies, president of the Bank. Mauá, along with six other shareholders of the former Bank of Brazil, did manage to secure seats in the 15-member board of the new bank.³³ Yet, the majority of seats were in the hands of representatives from the former Banco Comercial, which had the royal family as clients. Feeling defeated and realising he would be unable to control the new bank, Mauá went on to found a new (*vale*-issuing) bank - the Mauá, MacGregor.³⁴

The statutes of the Bank of Brazil, approved by Decree 1223 (of 31 August 1853), comprised 79 articles, of which the following stand out:

Art. 11: The Bank is entitled to:

- para 1: Discount bills of exchange and commercial bills, guaranteed by two known signatures;
- para 2: Buy and sell, under commission, precious metals, bonds of the consolidated debt, and any other securities;
- para 3: Receive deposits in current account;
- para 4: Receive interest-bearing deposits (*dinheiro a prêmio*), for periods of no less than 60 days;
- para 5: Buy and sell precious metals on its own account;
- para 6: Make loans against precious metals, bonds of the consolidated debt, stocks, and private drafts representing legitimate commercial transactions;
- para 9: Issue notes, payable to bearer on demand;

Art. 12: Notes of the Bank will have the exclusive privilege of being accepted in public offices, as follows: in the city and province of Rio de Janeiro, those issued in the head office; in the provinces, those issued by the respective Bank branch;

Art. 16: The issues referred to in Art. 11 are to be limited by the following rules:

- para 1: Except for the rules set out in Art. 18, total issues of the Bank shall not exceed twice its reserve fund, that is, two times the amount that the Bank will effectively have in its vaults, represented by currency, or 22-carat gold bars. Exception is made to *dinheiro a prêmio* and money deposited in current accounts, which are not part of the reserve fund;
- para 2: Except for the rules set out in Art. 19, total issues shall not exceed the volume of discounts made in accordance with Art. 11, para 1, and those made against precious metals and private drafts representing legitimate commercial transactions;

Art. 17: If at any point in time it is agreed that the rules set out in the preceding para do not allow for the prompt redemption of the notes of the Bank, the government, after hearing the opinion of the Council of State, may decree that total issues shall not exceed the sum of drafts discounted in accordance with Art. 11, para 1;

Art. 18: The Bank may increase its issue by a sum equivalent to the paper money that it will have effectively withdrawn from circulation, on account of the 10,000 *contos* referred to in Art. 56; but in such a way as to never exceed three times the amount of its reserve fund, nor the limit set out in Art. 16, para 2;

Art. 19: Apart from the limit set out in Art. 16, para 2, or the limit eventually imposed in accordance with Art. 17, the Bank shall be allowed to make an additional issue, by redeeming notes into currency

³³ See Guimarães, “Bancos”, pp. 128 ff.

³⁴ See Barman, “Business”, pp. 246-7. On the tribulations of the Barão in his relations with the imperial government throughout his long business career, see J. Caldeira, *Mauá: empresário do Império* (São Paulo, Cia. das Letras, 1995).

or gold, as long as it maintains in its vaults not only the reserve corresponding to that limit, but also the currency or gold that it receives on account of the additional issue;

Art. 39: The president and vice-president of the Bank will be appointed by the Emperor;

Art. 56: The Bank is required to withdraw from circulation the paper currently serving as *numéraire*, at the rate of 2,000 *contos* per year; the operation shall begin, at the latest, two years after the installation of the Bank, as follows:

para 1: The first 10,000 *contos* employed in the withdrawal of the paper money shall be provided by the Bank in loan to the government, which shall not pay interest as long as the privilege of the said bank lasts. At the end of it, the government shall repay the Bank the 10,000 *contos*, either in currency or in 6% bonds of the consolidated debt, at par;

para 2: As soon as the sum withdrawn from circulation exceeds 10,000 *contos*, the government shall pay the Bank the amount in excess of this sum, in quarterly instalments;

Art. 57: Paper money withdrawn by the Bank shall be sent at the end of each semester to the Caixa de Amortização³⁵, after being rendered useless;

Art. 59: If, owing to the shortage of paper money, the Bank is incapable of carrying out the operation mandated by Art. 56, the board of directors shall request from the government the necessary measures to remove this difficulty;

Art. 60: If, for the safer conduct of its operations, the Bank should deem necessary the contraction of a loan abroad, which shall not exceed the amount owed it, in accordance with Art. 56, para 1, the government may provide it with the necessary guarantees;

Art. 61: Every time the Bank's capital fund is increased, the government may demand that one-third of this increase be used towards the withdrawal of paper money, through the means set out in Art. 56;

Art. 62: Notes of the Bank will be exempt from payment of stamp duty.

As the above list shows, the Bank was entitled to receive deposits, discount bills, and trade in precious metals and government bonds. But, crucially, it had the right to issue notes redeemable in “currency”, which at the time comprised gold and Treasury notes.³⁶ Notes issued by the new Bank of Brazil, unlike *vales*, were accepted in payment of taxes and debts owed to the government. Yet, they were not legal tender (*curso forçado*), that is, no one was required to accept them in private transactions. Furthermore, their circulation was restricted to the region where they had been issued. That is, in and around the city of Rio de Janeiro, in the case of notes from the head office, and in the respective provinces where its branches were allowed to be set up and issue notes.

The privileges granted the Bank were manifold, leading to repeated accusations of favouritism. To begin with, not only were its notes accepted in the

³⁵ The Caixa de Amortização was originally created to manage the consolidated imperial debt. Over the years it was also entrusted with the storage, preparation and signing of new government notes, as well as the replacement and custody of those withdrawn from circulation.

³⁶ As already noted, the reason for this awkward disposition referred to the scarcity of gold in the country, which precluded the adoption of a fully gold-backed issue. This point will be examined in detail in Chapter 6.

public offices of the provinces where the Bank operated, but Article 16, para 1, of its statutes allowed it to redeem them for either currency or gold, at its own discretion. Noteholders were unable, thus, to demand redemption in gold. The idea was that given a rate of exchange at (or very near) the par value of 27d to the *milréis*, gold and currency notes were one and the same. Yet, in practice the Bank would seldom give gold in exchange for notes, regardless of the rate of exchange. In addition, whenever there was pressure on its reserve fund (*fundo disponível*), the Bank could seek permission from the government to suspend convertibility.³⁷ The very fact of having a monopoly of note issue was an additional privilege for the Bank. Article 16, paragraph 1, of its statutes also established a maximum ratio of 2:1 between note issue and the reserve fund. This limit could only be relaxed after obtaining government approval (pending deliberation of the Council of State). Should the Bank feel that its operations were being compromised by the amount of gold or Treasury notes in its fund, it could seek the government's guarantee to obtain foreign loans (up to an amount equivalent to the Treasury notes withdrawn from circulation) to reinforce it. Alternatively, note issue could not exceed total discounts and loans.

The monopoly of note issue awarded to the new bank would come with strings attached. As already noted, Itaboraí, formerly an opponent of any sort of bank of issue, admitted that circumstances had changed of late. His change of mind, however, was only partial. First, just a single bank would be given government authorisation to issue notes and, even then, under strict rules which, in many instances, were to the advantage of the government itself. For instance, among the Bank's main duties was the yearly withdrawal of 2,000 *contos*' worth of Treasury notes from circulation. The first 10,000 *contos* would act as an interest-free loan to the government while the Bank's permission to operate lasted (in principle, for 30 years). The Bank would be reimbursed (with interest) for the remaining Treasury notes withdrawn from circulation which, it was hoped, would ultimately lead to a full, gold-backed, circulating medium consisting exclusively of Bank of Brazil notes. Lastly, Article 56 of its statutes suggests that the government expected it to act as a regulator of the currency, although this point was far from clear-cut. For some, Article 2 of the 1846

³⁷ Alternatively, the Bank would unilaterally decide to leave gold. This will be seen when discussing the reaction to the 1857 commercial crisis, in Chapter 7.

Law (which introduced the new 27d gold parity) actually entrusted the government with the task of maintaining monetary stability.³⁸

Either way, there was no disputing the semi-official nature of the Bank, which afforded the government a degree of influence over its activities. In particular, by limiting the issue of notes by the Bank, the government imposed a check on excessive discounting. Government control was made explicit by the fact that both its president and vice-president were to be appointed by the Emperor personally (Article 39).³⁹ Official discretion over the affairs of the Bank was further ensured by the provisions of Article 50, regarding the powers of the president of the institution. Amongst the latter's responsibilities, according to paragraph 3 of the said article, was to 'preside over and serve the decisions of the board of directors and the general assembly of shareholders'. However, he could 'suspend decisions judged to be contrary to the statutes, and refer the issue on to the government, which would ultimately decide if (these) should be carried out'.⁴⁰ The final say over Bank decisions, therefore, remained with the government, even though it was not a shareholder. This was simply the corollary of its appointing the two top officials in the institution.

As noted earlier, the road taken by Mauá after his bank was merged into the new Bank of Brazil was the creation, in July 1854, of the Mauá, MacGregor Bank. This bank had a capital of 20,000 *contos* (two-thirds of that of the new Bank of Brazil), which was subscribed by former shareholders of the defunct bank, and foreign merchants. Given that a traditional partnership would have demanded unlimited financial liability from each of the partners and, hence, hinder his efforts in raising large sums of capital, Mauá opted, instead, to organise his new venture as a limited partnership (*sociedade em comandita*). Taking advantage of a lacuna in the Commercial Code, he divided the firm's capital into freely transferable shares. This

³⁸ Law 401, 11 September 1846. The attribution of responsibility for maintaining the stability of the currency will be discussed in Part III.

³⁹ The dangers potentially arising from this provision, news of which had already been circulating before the Bank was established, did not go unnoticed to the British *Chargé d'Affaires* to the Court of Brazil. 'The Imperial Government will have the national bank more or less under their control; and if at some future period any Brazilian Minister find it convenient to abuse this power, and use it for their own ends and purposes, to the detriment of the community in general, I fear some danger may be apprehended not only for the commercial prosperity, but even perhaps for the peace and universal welfare of this Empire.' PRO, Foreign Office, 13/303, Jerningham to the Earl of Clarendon, Rio de Janeiro, No. 52, 8 July 1853.

⁴⁰ Law 1223, 31 August 1853.

gave the appearance of a corporation but, crucially, evaded the governmental intrusion that such a form of organisation would have entailed.⁴¹ Mauá's scheme found huge opposition both in Parliament and in the Executive, which contested the legality of his arrangements for the bank.⁴² A decree issued in December 1854 forbade the division of the capital of *sociedades em comandita* into shares, and ordered the Commercial Court to cancel the registration of the partnership deeds of firms with such a share capital.

No sooner had Mauá clashed with the government he found himself again in the midst of another dispute. This time the matter involved the issue of *vales* by the Mauá Bank in the Rio market. In the *Relatório da Fazenda* of 1854 Minister Honório Hermeto Carneiro Leão (Marquês de Paraná)⁴³ pointed out the dangers arising from the Mauá, MacGregor Bank issuing *vales* to the bearer with 5 to 10-day maturities. In practice, *vales* circulated as if they were notes, in breach of the monopoly enjoyed by the Bank of Brazil. Clearly, the government was not willing to tolerate unauthorised issues of money. The Rural & Hipotecário, for instance, was limited to issue *vales* of no less than 30 days, payable to a particular individual, and only transferable through endorsement. The government (rightly) considered *vales* issued by the Mauá, MacGregor as close substitutes to money and, as such, illegal, given that this was not amongst the operations stated in that bank's statutes.⁴⁴ The *vales* were promptly withdrawn from circulation by the Mauá Bank.⁴⁵

⁴¹ Barman, "Business", pp. 251-7. On 1 October, the Mauá Bank started operations in Rio. Throughout its duration, until the crisis of 1875, it would comprise fourteen branches, half of which were overseas (in Uruguay, Argentina and Great Britain).

⁴² The newly-created Bank of Brazil was also dissatisfied with the idea of limited partnership banks 'compet(ing) in circulation, without the burden that the Law placed on corporations in general, and on this Bank in particular'. See Banco do Brasil, "Actas das Reuniões da Directoria", session No. 80, 22 August 1854, AD 001/11-A. These minutes of the meetings of the board of directors of the Bank of Brazil will henceforth be referred to as "Actas".

⁴³ Born in 1801 in Minas Gerais, during his career Carneiro Leão would occupy on different occasions the ministries of Justice, Foreign Affairs, and Finance, as well as the presidency of the important provinces of Pernambuco and Rio de Janeiro. Originally a Liberal, he switched to the Conservative Party during the reaction (*regresso*) movement of the mid-1830s. A magistrate, he soon emerged as one of the country's most respected political leaders, renowned for his moderation. See Tavares de Lyra, *Instituições*, pp. 272-3.

⁴⁴ See *RMF* 1854, pp. 9-10.

⁴⁵ At times the central government would go to great lengths to stop banking institutions from issuing notes or *vales* without official permission, as mandated by Art. 295 of the Commercial Code. A typical case involved a corporation set up in Salvador, which in March 1856 started issuing *vales* of 50\$000 denomination, payable to bearer on demand. Shortly afterwards, the Chief of Police, acting on orders

Meanwhile, the peculiar status of the Bank of Brazil, that is, its semi-official nature, began to cause tension between its public facet and the interest of its many private shareholders. The withdrawal of Treasury notes from circulation - and, as some considered to be amongst its duties, the maintenance of a stable (and preferably appreciating) rate of exchange - would be judged against the desire to increase its discounting activities and, hence, note issues. Thus, in September 1854, barely four months after the start of its operations, the Bank of Brazil sent the first of a series of memoranda to the government requesting alterations to its statutes. The most important concerned the relaxation of the limits on the types of paper it was allowed to discount. It requested permission to discount not only commercial bills and bills of exchange with two known signatures (Art. 11, para 1), but also paper from banking corporations and public firms of renowned financial soundness.⁴⁶ After hearing the Finance Standing Committee of the Council of State, the government refused to grant permission to the Bank to lend against shares of joint-stock banks or public firms. The Committee agreed that at the time there were many such firms operating with very little surveillance, which increased the risk of them “contaminating” the Bank’s portfolio.⁴⁷

Six months later, on 26 March 1855, the Bank again turned to the government for permission to increase the leverage of its reserve fund, allowing it to raise its note issue from a ratio of 2:1 to 3:1.⁴⁸ The seasonal drain of both coins and paper money to the northern provinces - for the purchase of crops and in payment for the importation of slaves by *fazendeiros* in the Centre-South - was still causing problems for the Bank’s operations in Rio.⁴⁹ To try to remedy this problem, the Bank pressed

from the President of the province of Bahia, confiscated all *vales* printed by that establishment. See *RMF* 1855, p. 9.

⁴⁶ See Cavalcanti, *O Meio*, Vol. 2, p. 206.

⁴⁷ See Resolution No. 375, 16 December 1854, in *SFCE*, vol. III, pp. 352-55. It is worth noting that amongst the three councillors to sign the resolution was Itaboraí, the architect of the third Bank of Brazil who, from the outset, showed clear independence of opinion regarding the operations of his brainchild. This will be seen clearly in Chapter 5.

⁴⁸ *RMF* 1855, p. 9; and Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas do Banco do Brasil pelo Presidente do Banco* -1855, p. 4. Hereafter, Banco do Brasil, *Relatorio*.

⁴⁹ Banco do Brasil, *Relatorio dos Fiscoes do Banco do Brasil Apresentado á Assembléa Geral dos Accionistas* (Rio de Janeiro, Typ. de Pinheiro & Co., 1857), p. 8 (hereafter, Banco do Brasil, *Relatorio dos Fiscoes*). By then, according to the internally-appointed Bank inspectors, virtually all Treasury notes in Rio had either been exported to the interior or had found their way into the Bank’s vaults. *Ibid.*, p. 7.

ahead with its programme of setting-up provincial branches (*caixas filiais*), with their own locally circulating notes.⁵⁰

Sensitive to the Bank's arguments concerning the need to expand its issues but, at the same time, conscious of the potentially dangerous precedent it was setting, the government sanctioned an increase in the leverage to up to three times the amount of the reserve fund, but for one year only.⁵¹ This measure was not enough to stave off the monetary pressure, and the resulting loss of reserves, that were being felt in 1856. In a sense, Itaboraí, president of the Bank of Brazil since April 1855, had already anticipated this result. In the annual report to shareholders he remarked that the installation of the *caixas filiais* would not solve the problem of the drain of currency from Rio, while there remained a deficit in transactions with the North.⁵²

The dilemma in which the Bank found itself - that is, the need to balance its private interests with the services it was expected to provide to the economy as a whole - was perceived by its stockholders. It was thus expressed in the annual report for 1856.

The drain on the reserve fund entails either a restriction of discounts, or sacrifices that the establishment makes by importing precious metals. The Board of Directors, unwilling to accept the first remedy, which would cause great harm to the country, prefers the second, which brings some loss to shareholders, reducing the dividends to which they are entitled (...), convinced that they understand that the purpose of the

⁵⁰ Partly due to the sheer difficulties of communication at the time, the *caixas* enjoyed considerable autonomy from the head office. Not only did they issue notes in their respective regions, but they also had their own statutes and board of directors, appointed by the head office. The provincial offices of the Bank of Brazil were created by Decree 1490, 20 December 1854 (Ouro Preto), and Decree 1580, 21 March 1855 (Salvador, Recife, São Luís, Belém, Porto Alegre and São Paulo). The latter decree transformed the earlier banks established in those provincial capitals into *caixas filiais* of the Bank of Brazil. The São Paulo and Porto Alegre offices of the Bank were formerly branches of the "second" (Mauá) Bank of Brazil. Given the delay in procuring notes for the *caixas* - which ended up being imported from Britain, and still had to be signed by the respective directors - they would not start their operations until the early months of 1856. See Pacheco, *Banco do Brasil*, Vol. II, p. 178.

⁵¹ Decree 1581, 2 April 1855. The government's apprehensions turned out to be well-founded, for two months before the authorisation to increase its note issue expired, the Bank applied for, and obtained, the right to maintain the 3:1 ratio, which was also extended to its seven offices in the provinces. Decree 1721, 5 February 1856.

⁵² Banco do Brasil, *Relatorio* 1856, p. 4. For all purposes, Itaboraí was providing a confirmation of Furtado's claim about the nature of the Brazilian economy at the time, which, far from being a truly national market, was organised as an "archipelago". 'It seems beyond doubt that as long as we (in Rio) cannot pay with our products those (...) which we consume from the North, or as long as the discount rate is lower in this market than in those of the said Provinces, the migration of precious metals and Government paper will go on unabated to those points in the Empire'. Ibid.

Bank of Brazil is not solely to afford advantage to its shareholders, but also to serve to a great extent the general interests of commerce and industry.⁵³

In that same year the Bank of Brazil would start the process of withdrawing government paper money from circulation, at a rate of 2,000 *contos* p.a. In May 1857, Minister of Finance João Maurício Wanderley (Barão de Cotegipe)⁵⁴ remarked on the delicate position under which the Bank had been operating:

It is a fact that is present in the balance sheets of the Bank of Brazil that since June 1855, and up until late last March, this establishment has been importing approximately 20 thousand *contos* in gold and that, nevertheless (...), its reserve fund has increased since then by just 4,000:000\$; from which it can be seen that there has been, and still is, a permanent export of coins from this to other markets in the Empire, and perhaps overseas.⁵⁵

Even so, instead of pushing for an expansion of the Bank's issuing activities or, even, the creation of other institutions that could provide the market with the credit it demanded, Cotegipe opted for leaving things as they stood.

It is clear that the country's circumstances do not yet allow the Bank to increase its operations, as a bank of issue, up to the amount of capital already paid-in. Thus, creation of other Establishments of the same nature, either in this Court, or in the places where the Bank already has an office, would bring no advantage to the public, even if they were submitted to the same conditions imposed on the Bank of Brazil, and were directed with the same circumspection as repeatedly demonstrated by the administration of that establishment.⁵⁶

Not everyone was impressed by the Bank's "circumspection". A commission appointed by its own board of directors to investigate the state of the Bank's *fundo disponível* concluded that 'having encountered facility in the use of its issues (the

⁵³ Banco do Brasil, *Relatorio dos Fiscaes* 1856, p. 8. Early in that year the government assented to a request to allow the substitution of Bank of Brazil notes of 50\$000 denomination for those of the Treasury deposited in its provincial offices (*tesourarias provinciais*) and the Amortisation Office (Caixa de Amortização). See Banco do Brasil, "Actas", session No. 209, 7 January 1856, AD 002/11-A.

⁵⁴ A landowner from the province of Bahia, Cotegipe graduated from the Law school in Olinda. Later, he moved to Rio, to take his seat in the Chamber of Deputies, where he would represent his native province. Minister of Finance on two occasions (August 1856-May 1857 and June 1875-January 1878), Cotegipe never stood out as a particular expert in financial matters. His most notable achievement in that capacity was the promulgation of a new (import) tariff schedule in March 1857. See J. A. Pinto do Carmo, *Ministros da Fazenda, 1822-1930* (Rio de Janeiro, Irmãos Ponzetti, 1944), pp. 149-54.

⁵⁵ See *RMF* 1856, p. 17.

⁵⁶ *Ibid.*

Bank) lent its credit beyond what was suitable to the maintenance of its reserve fund'.⁵⁷ In light of this, the commission recommended that the Bank of Brazil gradually increase its rate of discount and, at the same time, start accepting interest-bearing deposits as a source of loanable funds.⁵⁸

Less than three months after Cotegipe's declaration of faith in prudence in monetary and banking matters, government policy took a dramatic turn. The Executive approved incorporation of the first of six new banks of issue. Plurality of note issue⁵⁹ was thus officially instituted, bringing to an end the monopoly enjoyed by the Bank of Brazil since 1854.

3.3 - Plurality by Decree: the new banks of issue and the 1857 Crisis

To some extent, the roots of the changes in the banking regime were political. In the previous years Liberals had been voicing their disgruntlement over the current electoral system, which allowed few chances of representation in the Chamber of Deputies for the party in opposition. The situation was made worse by the vote rigging carried-out by whoever happened to be in power. This state of affairs prompted calls for reforms in the electoral process, a cause that was embraced by the Marquês de Paraná, an old-time Conservative valued for his moderation. Since September 1853 Paraná had lead a cabinet composed for the most part of moderate Conservatives, too young to have taken part in the political conflicts of the previous decades.⁶⁰

⁵⁷ See "Parecer da Comissão Nomeada pela Directoria do Banco do Brasil em Sessão de 22 de Abril de 1857 para Propor os Meios Mais Adequados para a Conservação do Fundo Disponível". Museu Imperial de Petrópolis, Arquivo da Casa Imperial, bundle 124, document 6202.

⁵⁸ Ibid. The Bank implemented both recommendations soon afterwards. The discount rate was raised from 8% to 9% on 5 May, and the rate of interest on *dinheiro a prêmio* set at 7% on 9 June.

⁵⁹ In effect, after 1857 *vales* issued by private banks (but not joint-stock banks), businesses and individuals would still be circulating, with major implications, as will be seen below.

⁶⁰ Symptomatically, the hallmark of his administration, he explained, would be conciliation, imprinting that 'spirit of moderation that is synonymous with conservative opinions'. This new approach, which eschewed earlier confrontation, but without the ministers having 'to abandon their principles', would herald a the period that came to be known as the *Conciliação*. Paraná concurrently held the Finance portfolio during the better part of the first *Conciliação* cabinet, and through a strict fiscal policy, managed to achieve a substantial budget surplus in the 1856-7 financial year. See Table A10, in the Statistical Appendix.

Paraná was directly responsible for the electoral law of 1855, which introduced the so-called one-deputy electoral circles. The new system bypassed the previous influence of regional political chiefs in the voting process, thus bringing the National Assembly in direct contact with the local bosses. As a result, the gates were open for a measure of opposition representation in the Chamber of Deputies. Accordingly, in the first elections to be held under this new system, the Liberals were able to take 17% of the seats in the lower House, thus reversing the previous 100% Conservative-dominated “unanimous Chamber”. Upon the death of Paraná, in September 1856, the Emperor appointed his chief military commander, Luís Alves Lima e Silva (Caxias), to preside over the cabinet. An arch-Conservative, Caxias felt that the results of the parliamentary elections, by ushering in a small, but vocal, Liberal minority, represented a risk to his leadership. Accordingly, he resigned, making way for the moderate Conservative, Pedro Araújo Lima (Marquês de Olinda), to come to office, in May 1857. The thirteenth cabinet of the Empire, it would maintain the conciliatory note of the Paraná government and, in acknowledgement of the recent electoral results, appointed two Liberals to the six-member cabinet. At the helm in the Ministry of Finance was Bernardo de Souza Franco,⁶¹ a Liberal senator from the northern province of Pará.⁶²

In mid-1857, as the coffee sector started to experience a shortage of labour, wages and the price level also increased, leading to demands for an expansion of the money supply.⁶³ The accompanying requests for authorisation to incorporate new

⁶¹ The son of a local trader, Souza Franco graduated in Law from Olinda. He began his political career as a provincial deputy in 1838 and by 1850 had arrived in Rio as the sole Liberal member of the Chamber of Deputies. He had previously served as Minister of Finance for just over one month in the Conservative cabinet of May 1848. In that same year he would publish his influential monograph *Os Bancos do Brasil*, after which he would establish himself as a noted expert in financial matters and chief advocate of plurality of banks of issue. See Tavares de Lyra, *Instituições*, pp. 239-40. The Souza Franco book was reprinted as *Os Bancos do Brasil* (Brasília, Ed. da Universidade de Brasília, 1984).

⁶² The other portfolio given to the Liberals was the Ministry of War, to be headed by Jerônimo Francisco Coelho. According to Nabuco, in appointing Souza Franco to head the Finance portfolio in 1857, Olinda was choosing a “colleague”, albeit of a different party. Most important from the point of view of subsequent events, the choice, still according to Nabuco, had been a conscious one. Olinda, who earlier had strongly criticised Paraná’s *Conciliação* initiative, opted for appointing a known Liberal to a key post in the cabinet, something which his predecessor had not attempted. And, surely, Souza Franco’s heterodox views on banking policy could not have been lost on the old Conservative chief when he chose him for the post. For details on the whole *Conciliação* period, see J. Nabuco, *Um Estadista do Império* (Rio de Janeiro, Topbooks, 1997, 5th ed.), pp. 163-74; and F. Iglésias, “Vida Política, 1848/1868”, in Holanda (ed.) *História Geral*.

⁶³ *RMF* 1858, p. 4.

banks of issue were met with sympathetic ears by Minister of Finance Souza Franco. From late August he gave permission for the establishment of six new banks of issue (out of a total of 50 requests), thus breaking the monopoly hitherto held by the Bank of Brazil.⁶⁴ The rules governing the issue of notes were similar for all six banks, and broadly in line with those that applied to the Bank of Brazil.⁶⁵ They could issue notes to bearer, redeemable on sight in gold or Treasury notes, to an amount equal to their respective paid-in capital. Notes were to be backed by consolidated government debt (*apólices*), and shares of railways and other companies benefiting from government profit guarantees.

Crucially, creation of the new banks of issue was not done by means of a law, as had been the case in 1853 with the third Bank of Brazil. Instead, it was an act of the Executive, taken during the parliamentary recess. In doing so, Souza Franco was moving into a legal “grey area”. In fact, banking legislation fell into the broader rules governing incorporation, as laid down in the 1850 Commercial Code. Article 295 of the said legislation determined that corporations could only start operations after obtaining authorisation from the government and, when these operations entailed a special privilege, pending legislative approval.⁶⁶ Clearly, the issue of banknotes was a privilege and recognised as such when the third Bank of Brazil was incorporated. Moreover, Art. 15, para 17, of the imperial Constitution delegated to the General Assembly the task of ‘determining the weight, value, inscription, type and denomination of coins (...)’.⁶⁷ This further suggested the need for legislative sanction when allowing banks of issue to be established. None of this deterred Souza Franco from his objective of meeting, even if only partially, the demands for an expansion of the volume of credit. In the section on “Banks and the Circulating Medium” in the

⁶⁴ See Soares, *Esboço*, p. 50. The six new banks eventually given the go-ahead, and the dates of the decrees approving their statutes and authorising their incorporation are as follows: the Banco Comercial & Agrícola (in the Court, on 31 August 1857), the Banco Comercial do Rio Grande do Sul (based in Porto Alegre, on 24 October 1857), the new Banco de Pernambuco (in Recife, on 11 November 1857), the Banco do Maranhão (in São Luís, on 25 November 1857), the Banco da Bahia (in Salvador, on 3 April 1858) and the Banco Rural & Hipotecário (which had been operating in Rio for some time, and to whom the right to issue notes was being granted), on 27 February 1858.

⁶⁵ These rules are examined in more detail in Chapter 6.

⁶⁶ Law 556, 25 July 1850.

⁶⁷ See *Constituições do Brasil*, p. 19. The question of responsibility for authorising the issue of currency will be discussed in Part III of the thesis.

Relatório da Fazenda of 1857, the Minister justified the decision to allow the incorporation of the new banks on the grounds that

In general, and especially in the places where the Bank of Brazil or its branches operated, the new establishments were aimed at bringing the advantages of credit to industry, or to the classes of society to which the other (banks) could not extend their discounts, because of the special nature of their organisation, and at supplying funds to Commerce, and circulating medium to the market ...⁶⁸

This passage from Souza Franco's report is most illuminating, in that he advocates the establishment of new banks of issue precisely in the towns where the Bank of Brazil was already operating. Implicitly, he is suggesting that the Bank was not fulfilling its role of providing adequate liquidity and credit to the market.⁶⁹ Unsurprisingly, the Bank attacked Souza Franco's decision to allow the creation of new banks. It considered this unfair competition, and a breach of the (implicit) monopoly granted when it was set up four years earlier.⁷⁰

Be that as it may, misfortune had it that the bold policy shift promoted by Souza Franco coincided with a major crisis at the international level. It was triggered by the dramatic drop in some commodity prices, following bumper cereal and wool production in the United States and Eastern Europe, after the end of the Crimean War. The failure of the Ohio Life Insurance and Trust Company, in August 1857, led to a panic in the American market, requiring the shipment of gold from Britain. In order to stem the drain on its reserves and ensure the functioning of the gold standard, the Bank of England increased its discount rate to 10%, causing a re-diversion of capital to London, and the spread of panic to continental markets.⁷¹ News of the crisis in the United States arrived in Rio on 13 November, soon followed by packets from Europe bringing accounts of interest rate rises in London. This came barely three months after the first of the governmental decrees was promulgated and, it must be stressed, before any of the

⁶⁸ See *RMF* 1857, p. 6.

⁶⁹ *Ibid.* Two years later, Minister of Finance Ferraz would still be referring to the problems caused by the shortage of currency in activities such as the cattle trade in the province of São Pedro do Sul. Yet, the fact that notes from other provinces could not circulate locally did not deter *gaúcho* traders from making use of them at discounts of three to four percent of their face value. See *RMF* 1859, p. 69.

⁷⁰ See Banco do Brasil, *Relatorio dos Fiscoes* 1858, p. 2.

⁷¹ See J. Foreman-Peck, *A History of the World Economy: international relations since 1850* (London, Harvester Wheatsheaf, 1983); and C. Kindleberger, *Manias, Panics and Crashes: a history of financial crises* (London, Macmillan, 1996, 3rd edn.).

new banks started issuing notes.⁷² Foreign trade was badly hurt in Rio and in some of the major ports in the provinces, as creditors in Hamburg demanded immediate settlement of commercial debts.⁷³ At the same time, the practice of purchasing goods on consignment was suspended, as orders placed in Europe were required to be accompanied by the corresponding payments in hard currency.⁷⁴ Business in Rio came to a virtual standstill.

At first, the Bank of Brazil suffered a run for redemption of its notes in gold. The Bank obliged, in an attempt to calm the market. Yet, it was aware of the limits to its efforts. The difficult balancing act that it was forced to perform was clearly perceived by its directors. At the same time that the Bank had an interest in (and felt a duty to) meeting demands from the market, on the other it had to maintain the level of its reserves. As tension increased, businesses brought an increasing amount of bills to be discounted at the Bank.⁷⁵ From an average of 42,000 *contos* in September–November, the Bank’s portfolio increased to just under 52,000 *contos* in December.⁷⁶

⁷² There is the possibility, of course, that the simple news of the imminence of new banks entering the market could have provoked a run for sterling and corresponding depreciation of the *milréis*, even before the banks actually started their operations. Nevertheless, quotations in the Rio Bolsa show a stable *milréis*, at above par, until early December, when news of the crisis finally reached the city and provoked a run for sterling. Exchange-rate quotations are in Junta de Corretores de Fundos Públicos da Cidade do Rio de Janeiro, “Livro de Registro Oficial de Cotações de Títulos e Valores”, various issues, Arquivo Nacional, P8 13203. By way of comparison, the exchange rate in Rio dropped in early June 1853, at news of the government proposal allowing the BCRJ and Mauá’s Bank of Brazil a special increase of their combined issue to 6,000 *contos* (up 65% the total outstanding amount of *vales* from both banks at the time). See *Comissão de 1859*, p. 103.

⁷³ The hide trade in Rio Grande do Sul was severely hit upon receiving news of the crisis overseas. See Parliamentary Papers 1861, LXIII, *Report by the Hon. H. P. Vereker, British Consul at Rio Grande do Sul, on the Trade of that Port during the year 1858*, p. 5.

⁷⁴ See Levy and Andrade, “El Sector”. ‘From 1858 onwards it was no longer possible to continue to sustain large trade deficits through financing by private merchants in London. From this period, if Brazil wanted to continue to import, it had to sell staples to such a value that it could not only pay for her demand for imports, but also for the service deficit in the balance of payments’. Cf. L. C. T. D. Prado, “Commercial Capital, Domestic Market and Manufacturing in Imperial Brazil: the failure of economic development in the XIXth century” (unpublished Ph.D. thesis, University of London, 1991), pp. 250-1.

⁷⁵ ‘If the board of Directors of the Bank, on the one hand, was under the rigorous obligation to protect its reserve fund, on the other it was most willing to help out commerce, which (...) is wrestling with great difficulty as a result of the sudden withdrawal of the capital which used to aid it, and of the complete stagnation of exports. However, these two terms are so inter-linked when it comes to a bank of issue that the Board of Directors should see to both simultaneously and, therefore, raise the discount rate, satisfy the needs of foreign trade, and serve domestic trade liberally’. Cf. Banco do Brasil, *Relatorio* 1858, p. 6.

⁷⁶ This increase should not be considered a seasonal phenomenon, as in previous years there had been little change in the Bank’s portfolio at the end of the year.

Table 3.3
Bank of Brazil, Head Office: selected indicators, June 1857-June 1858
(in *contos*)

Month/Year	<i>Fundo Disponível</i>	Notes in Circulation	Value of Portfolio
June 1857	13,125.7	32,804.9	40,193.7
July	13,049.8	33,366.8	38,895.4
August	13,467.1	32,983.5	38,404.6
September	12,872.1	29,312.9	39,009.9
October	12,848.2	30,208.4	41,426.4
November	11,322.7	30,522.3	46,424.5
December	10,859.3	33,175.0	51,836.6
January 1858	11,105.8	31,084.8	49,538.5
February	10,994.1	28,858.1	47,668.3
March	9,978.8	27,131.6	46,210.5
April	8,877.3	24,545.9	43,843.4
May	8,829.6	23,418.4	42,965.2
June	8,753.0	25,607.0	45,780.0

Source: Table A4, in the Statistical Appendix.

In his 1858 report, the president of the Bank of Brazil stated that in late December 1857-early January 1858 the Bank was following what became known as “Bagehot’s rule” in the case of financial distress. This meant lending liberally - and dearly. Its (inter-bank) rates of discount were increased from 8% to 10% on 15 December, and to 11% on the 23rd.⁷⁷ For other businesses, the rates, when discounts were available, were as high as 15%.

Table 3.4
Bank of Brazil: rates of discount charged, 1856-62
(in %)

Date	Rate of Discount	Date	Rate of Discount
June 1856	8	15 December 1857	10
27 November 1856	9	23 December 1857	11
12 January 1857	8	27 January 1858	10
6 May 1857	9	10 February 1858	9
13 August 1857	8	8 January 1862	10

Note: Rates correspond to bills with two known signatures and, therefore, should be regarded as a minimum (“prime”) rate.

⁷⁷ One of the major sources of demands for loans from the Bank of Brazil at the time was the house of A. J. Alves Souto & Co., which suffered a run during the whole month of December, but managed to survive.

Sources: Banco do Brasil, *Relatorio Apresentado à Assembléa Geral dos Accionistas*, various issues; and *Relatorio da Comissão Encarregada pelo Governo Imperial por Aviso do Primeiro de Outubro e 28 de Dezembro de 1864, de Proceder a um Inquerito Sobre as Causas Principaes e Accidentaes da Crise do Mez de Setembro de 1864* (Rio de Janeiro, Typographia Nacional, 1865).

As the drain on its reserve fund continued, the Bank felt that its potential note issues - and, hence, the volume of discounts it was able to carry out - was being compromised. As a result, on 27 November the Bank unilaterally decided to suspend convertibility of its notes into gold.⁷⁸ Shortly afterwards, the government let it be known that it was willing to help the Bank reinforce its reserve fund by means of a guarantee on a loan of the equivalent of 3,000 *contos* (£340,000), to be arranged in London.⁷⁹ On 1 December, the first of a series of memoranda was exchanged between Bank and government. The Bank indicated that 3,000 *contos* were insufficient to restore calm to the market, and that until it could gauge the actual extent of demand for bills of exchange, some £600,000 would be needed.⁸⁰ The second Bank memorandum, in turn, called attention to the extent of the drain in its reserve fund and the effect this was having on its ability to pursue regular discounting activities. The Bank then asked the government to be allowed to increase the limit of its note issue from three to four times the reserve. Three days later the government replied in the affirmative to these requests, although the wording of its two memoranda was vague. Briefly, the government stated that it was conscious of the need to maintain both internal (i.e., discounts) and external (exchange rate) stability and would do its utmost to help the Bank. Nevertheless, Souza Franco did not

⁷⁸ Session No. 332, extraordinary meeting of the Board of Directors. A similar proposal put forward by the Discount Commission of the Bank for the appreciation of the Board of Directors, on 11 November, had been rejected. See Banco do Brasil, “Actas”, 1857-8, AD 003/11-A. This fact was overlooked by Cavalcanti, who maintained that suspension took place on the 11th, in which he was followed by Peláez and Suzigan. See Cavalcanti, *O Meio*, Vol. 2, p. 213; and Peláez and Suzigan, *História Monetária*, p. 88.

⁷⁹ These 3,000 *contos* represented the amount of Treasury notes that the Bank had already withdrawn from circulation, and which, according to Article 60 of its statutes, served as a ceiling to the guarantees that the government could provide on such occasions.

⁸⁰ For the full texts of the memoranda exchanged between the Bank of Brazil and the Minister of Finance, and between the latter and the Mauá, MacGregor Bank, see the Annex in *RMF* 1857, pp. 1-13.

commit himself to a specific amount for the guarantees.⁸¹ Soon afterwards, an operation to prop up the rate of exchange began.

The strategy consisted of selling drafts on London (guaranteed by the Treasury) at a relatively appreciated rate of exchange. The first draft, totalling £100,000, was made on the Union Bank of London, on account of a credit which that bank had offered to the Bank of Brazil earlier in the year. One month into the operation, the exchange rate continued to fall. Since the arrival of news of the panic overseas, the *milréis* had dropped by about 15%, being quoted at 23½d and 24d on 31 December. On 9 January, Souza Franco sent a new memorandum to José Pedro Dias de Carvalho, acting president of the Bank, enquiring about his plans to sustain the rate of exchange. On the same day, Dias de Carvalho replied that the Bank was willing to continue selling drafts on London, so long as the government would furnish it with the necessary Treasury notes to compensate for the loss of gold from its reserve fund. The government obliged, putting 1,000 *contos* at the disposal of the Bank, which went on to sell £200,000 worth of drafts in the market, at the rate of 25d. With this operation the government sought to force the rate of exchange up by increasing the supply of sterling.

By late January 1858, when the packets brought news of a worsening of the crisis in Europe, the Bank found difficulty in finding bills of exchange locally for purchase. This ultimately forced it to dip into its own reserves, leading to further losses of gold. In light of this, and in an effort to safeguard the fund, it once again took unilateral action. This time by deciding to shift its efforts from defence of the rate of exchange to concentrating on providing discount facilities to the domestic market.⁸² In a reversal of the previous trend, its discount rate for the best private paper was lowered from 11% to 10% on 27 January, and then to 9% on 10 February (see Table 3.4). This “washing of hands” of what many considered the duty to defend the rate of exchange was later justified by the directors of the Bank on the grounds

⁸¹ See “Reserved Memorandum” from Souza Franco to José Pedro Dias de Carvalho (acting president of the Bank of Brazil), 4 December 1857, *ibid.*, p. 6.

⁸² As noted by a contemporary, it was generally in the weeks between 15 June and 15 July, and 15 December and 15 January that the money market was at its tightest, as a result of the resources needed by the government to pay interest on its bonds (*apólices*), and by banks and other corporations, for payment of dividends. Testimony offered by an unnamed foreign businessman, in *Comissão de 1859*, Annex A, p. 38.

that it was a commitment impossible of being honoured from the moment that the new banks of issue were allowed to operate:

The removal of the means to satisfy an obligation contracted at a time when those very means were made available should liberate the obligee. The Bank of Brazil, unable, thus, to comply with the mission to which it was committed when it was the sole (bank) with issuing powers, should have the right to demand exemption from its duties, confining itself to being a mere bank of deposit and discount with the faculty to issue (notes) in competition with the other (banks), only to make profits that will reward its shareholders' capital.⁸³

Even if the Bank of Brazil had attempted to take a different path, and reduce its note issue (and, hence, money supply), it would never be certain of the end result, given the actions of the other banks of issue.

The only ostensible result, thus, of the efforts undertaken by the Board of Directors of the Bank of Brazil to re-establish the value of the circulating medium, and therefore meet the most important commitment which it had undertaken with the State, is the reduction in the profits of its shareholders, while helping to bolster those of the other issuing banks.⁸⁴

This “free rider” problem that the Bank of Brazil feared did, in fact, manifest itself in the second half of 1858. While the issues of its head office contracted substantially and those of the *caixas filiais* remained at the level of 20,000 *contos*, other banks increased their own note circulation. From April, the Banco Comercial & Agrícola started issuing operations, partially compensating the reduction in the note circulation of the head office of the Bank of Brazil. The banks in the provinces of Pernambuco and Bahia, with issues of more than 1,000 *contos* each, also helped to maintain the total amount of notes close to 50,000 *contos* in 1858. Clearly, any attempt by the Bank of Brazil to support the exchange by contracting its own issues voluntarily would have been thwarted by the actions of its competitors.

Table 3.5
Total Notes Outstanding, by Issuing Bank: January-December 1858
(in *contos*)

B. of Brazil (head office) (a)	B. of Brazil (<i>caixas</i>) (b)	Total B B (a) + (b)	Banco Com. & Agrícola	Banco da Prov. de PE	Banco da Prov. do MA	Banco da Prov. da BA	Total
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⁸³ Banco do Brasil, “Actas”, session No. 446, 30 March 1859, AD 004/11-A.

⁸⁴ Cf. Banco do Brasil, *Relatorio dos Fiscaes* 1858, p. 2.

Jan 1858	31,084.8	21,201.6	52,286.4	-	-	-	-	52,286.4
Feb	28,858.1	21,346.7	50,204.8	-	-	-	-	50,204.8
Mar	27,131.6	21,621.8	48,753.4	-	-	-	-	48,753.4
Apr	24,545.9	21,354.2	45,900.1	1,850.0	-	-	-	47,750.1
May	23,418.4	20,975.3	44,393.7	3,574.3	248.3	90.0	-	48,306.3
Jun	25,607.0	20,332.0	45,929.0	4,324.1	484.9	145.0	-	50,883.0
Jul	23,620.0	20,436.3	44,056.3	4,850.0	484.9	240.0	-	49,631.2
Aug	20,874.0	20,281.6	41,155.6	4,850.0	484.9	240.0	-	49,631.2
Sep	18,848.7	19,373.2	38,221.9	5,437.0	984.9	360.0	-	45,003.8
Oct	19,349.2	18,971.9	38,321.1	5,350.0	1,000.0	360.0	-	45,031.1
Nov	19,661.9	19,146.7	38,808.6	5,390.2	1,125.0	360.0	825.0	46,508.8
Dec	22,125.5	19,811.3	41,936.8	5,390.2	1,460.0	430.0	1,287.5	50,504.5

Notes: Figures for the Comercial & Agrícola refer to head office only.

Source: *Relatorio da Comissão de Inquerito Nomeada por Aviso do Ministerio da Fazenda, de 10 de Outubro de 1859* (Rio de Janeiro, undated).

If, as regards the reduction of its issues in Rio being offset by competition from the Comercial & Agrícola, the directors of the Bank of Brazil were partly right, their complaints in relation to diminishing profits were not warranted. Instead, they appear to have been directed at pressuring the government into reconsidering the question of plurality of issue altogether. In the financial year ending in June 1858 the Bank displayed record profits, as discounting operations expanded, despite competition from other banks. It is also worth noting that while the amount of bills discounted doubled between 1854/5 and 1857/8, net profits increased three-fold, in part as a result of higher rates of interest charged towards the end of the period.

Table 3.6
Bank of Brazil: selected indicators, 1854-8
(in *contos*)

Financial Year	Bills Discounted (a)	Payments (b)	Portfolio Balances (a) - (b)	Interest Earned on Bills Discounted	Net Profits
1854/5	99,258.6	75,138.5	24,120.1	1,567.2	1,332.8
1855/6	120,442.9	91,007.5	29,435.4	2,054.8	1,868.8
1856/7	128,453.0	117,694.7	40,193.7	2,330.2	2,285.4
1857/8	208,250.6	162,470.6	45,780.0	3,506.4	3,852.3

Notes: Figures refer to head office only, except interest earnings and profits, which include the *caixas filiais*. "Bills discounted" include portfolio balances from previous financial year.

Sources: Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas*, various issues; and *Relatorio da Comissão de Inquerito Nomeada por Aviso do Ministerio da Fazenda, de 10 de Outubro de 1859* (undated).

However serious the "free rider" problem might have been, the initial handling of the crisis by the Bank of Brazil was heavily criticised by the Finance Standing

Committee of the Council of State (Seção de Fazenda do Conselho de Estado). It met at the request of the Emperor on 26 March 1858 to examine the ‘causes for the fall in the rate of exchange and the measures that the government should take to remedy this situation’.⁸⁵ The decision to lower the discount rate in the early months of 1858 was seen by the Committee as a mistake, which simply added to the Bank’s woes concerning the reduction of its reserve fund. The Committee took the view that the Bank failed to react to the first news of the crisis in the United States and Europe with the necessary speed and commitment.⁸⁶ In particular, Committee members argued that discount rates should have been raised even earlier in 1857, in order to stem the drain on the reserve fund.⁸⁷ In other words, had the Bank kept discount rates at a high level, there would be less demand for redemption of its notes. Consequently, less pressure on the reserve fund, and no need to abandon convertibility. Furthermore, in their opinion the Bank’s early decision to suspend convertibility was to blame for the subsequent devaluation of the currency.⁸⁸ All in all, they reasoned, the exchange rate could have been kept near par.⁸⁹

The Committee also attacked ongoing efforts at raising the rate of exchange through operations on London, which it deemed as having only ‘ephemeral results’.⁹⁰ In a way, this hardly veiled indictment of both government and Bank of Brazil policies during the crisis can be imputed to Itaboraí’s personal antipathy for Souza Franco’s liberal ideas on monetary and banking matters. Itaboraí had resigned the post of president of the Bank of Brazil in June 1857, in protest over Souza Franco’s

⁸⁵ *SFCE*, Vol. IV, pp. 258-264. From its par value in the eve of the crisis, the *milréis* dropped continuously, having reached a low of 22³/₄ on 4 March 1858. Quotations from Junta dos Corretores de Fundos Públicos da Cidade do Rio de Janeiro, “Livro”, 1857-8.

⁸⁶ The Committee was formed by Itaboraí, the Marquês de Abrantes and the Visconde de Abaeté. Itaboraí would retain his seat in the Council of State (and its Seção de Fazenda) almost uninterruptedly, from 1853 until his death, in January 1872. From this position, as well as in the Senate, the Bank of Brazil, and the Ministry of Finance (which he would head again from July 1868 to September 1870), he was able to establish himself as Brazil’s leading financial expert of the time, helping to shape both policy and debate on monetary and banking issues. More on this in Chapter 5.

⁸⁷ Itaboraí would repeat these arguments in a speech in the Senate on 17 April 1858. See *Annaes do Senado do Império* (henceforth, *ASI*), Tome I, pp. 85-6.

⁸⁸ *SFCE*, Vol. IV, p. 261.

⁸⁹ This assessment, of course, involved giving priority to external (exchange rate) stability, to the detriment of internal balance. The Bank of Brazil thought differently, as it was not willing to cause further difficulties to the market by raising the rate of discount.

⁹⁰ *SFCE*, Vol. IV, p. 261.

plans (subsequently approved by Parliament) to transfer to the Bank the surplus deposits in the provincial treasuries and the Caixa de Amortização.⁹¹ In this case, Itaboraí's conservative views on money dominated any possible consideration of the obvious benefits such a move would bring to the Bank, by allowing it to re-loan these funds at a much higher rate.⁹² Following his stepping down from the presidency of the Bank, Itaboraí would go on to exercise opposition in the imperial Senate to Souza Franco's liberal policies. That is, until he returned to the command of the Bank, in December 1858.

Meanwhile, the decline in the value of the *milréis* would persist - the exchange rate reached 22¾ on 4 March 1858. On 10 March, as the deadline for the handing-in of the semi-annual instalment of 1,000 *contos* in Treasury notes to the Caixa de Amortização drew near, the directors of the Bank decided to bring 700 *contos* from the offices in Bahia and Pernambuco to reinforce the reserve fund at the head office.⁹³ Two days later, the Bank again turned to the government, calling its attention to the problems caused by the export of the silver coins still in circulation and used as small change. The Bank believed this could only be stopped if additional efforts were employed to force up the rate of exchange. It would be willing to draw on London at

⁹¹ PRO, Foreign Office, 13/352, Scarlett to the Earl of Clarendon, Rio de Janeiro, No. 73, 13 July 1857. Speaking in the Senate on 17 May 1858, Itaboraí apologised to his colleagues for not having resigned immediately after the cabinet of May 1857 came to power and, with it, Souza Franco, 'with whose economic ideas (I) could not agree'. *ASI*, Tome I, p. 82. During the same session Itaboraí and Souza Franco exchanged ironies about this point.

Itaboraí: 'I do not intend to impute all blame (for the mismanagement of the 1857 crisis) on the Bank. More appropriately, it should be ascribed to the Minister of Finance'.

Souza Franco: 'I impute it to Your Excellency's influence, for to this day you govern the Bank more than myself'.

Itaboraí: 'I will leave this aside to be judged by the public and the directors of the Bank'.

Souza Franco: 'Your Excellency is heard (there) more frequently than me.' *Ibid.*, p. 85.

On the following day, they resumed the exchanges.

Souza Franco: 'No matter what Your Excellency may say, at present you govern the Bank more than me'.

Itaboraí: 'Then, why is it that I censure its acts?'

Souza Franco: 'The father, even when he is his child's best friend, also slaps him when he deserves it. And I believe that it is the excessive love which the senator has for his child that makes him so severe'. *ASI*, Tome I, p. 103.

⁹² Article 2 of the contract celebrated between the government and the Bank of Brazil on 29 August 1857 determined that the government deposits earn a rate of interest equivalent to three percentage points below the going rate of discount practised by the Bank. Additionally, Art. 5 required the Bank and its provincial offices to charge this rate of interest when discounting Treasury bills (*bilhetes*). See "Contracto com o Banco do Brasil para o deposito dos saldos disponiveis", in Banco do Brasil, *Relatorio* 1858, pp. 45-6.

⁹³ See Pacheco, *Banco do Brasil*, Vol. IV, p. 224.

the rate of 25d, provided that the Treasury gave the usual guarantees and exempted the Bank from any obligation concerning a timetable for the shipment of bills to London. In its own words, it was requesting permission to ‘(...) draw freely on the next packet-boat, so as to satisfy any reasonable need (...) and at such a rate of exchange as to meet the objectives of the Law of 11 September 1846, and in harmony with the interests of the Bank and the market’.⁹⁴

Souza Franco’s reply came on the same day, 12 March. He made it clear that he found the Bank’s proposal too vague, for no specific figure was attached to the amount of guarantees sought from the government. Moreover, and as a sign that he was losing patience with what he perceived as foot-dragging on the part of the Bank, Souza Franco affirmed that the government had decided to undertake the defence of the rate of exchange directly through the Treasury, without the Bank’s help. In other words, the capacity of the Bank of Brazil to act as a “proto-central bank”, working as a lender of last resort and overseer of the well functioning of the monetary market, was put in doubt by the government.⁹⁵ Nevertheless, Souza Franco kept the door open. He was willing to extend the same guarantees as before should the Bank publicly announce that it would be drawing up to £400,000 at a rate not lower than 25½ by the March packet and up to £200,000 (at a rate of at least 26d) by the April packet. The Minister demanded a prompt reply from the Bank to what turned out to be his last offer.⁹⁶

At this point, versions differ greatly. The *Relatório da Fazenda* of 1857 simply states that the Bank of Brazil refused this last offer from the government, dated 12 March. As a result, the Minister of Finance immediately turned elsewhere for help.⁹⁷ By contrast, the Bank’s version of the events, as presented in its 1858 report, is as follows. Upon receiving Souza Franco’s memorandum (No. 11) dated 12 March, the president summoned an extraordinary meeting of the Board of Directors,

⁹⁴ Annex in *RMF* 1857, p. 12.

⁹⁵ Responsibility for defending the exchange rate was still a matter of dispute. For the Bank of Brazil, ‘it (seemed) that in spite of the creation of (the Bank), it (was) the government’s duty to comply with the letter of the Law of 11 September 1846, and undertake the credit operations necessary to maintain the equilibrium of the exchange rate’. Cf. memorandum No. 10, in *RMF* 1857, p. 12. More on the “proto-central bank” question in Chapter 7.

⁹⁶ *RMF* 1857, p. 12.

⁹⁷ *Ibid.*, p. 9.

to convene at 12 noon of that same day. Failing to obtain the necessary quorum to deliberate on the issue, the Bank immediately sent notice of that mishap to the Minister (memo No. 13), to which Souza Franco promptly replied, urging Dias de Carvalho to call a meeting of the directors for the following day (memo No. 14). The report goes on to add that in the meantime, and shortly after the messenger had been sent over to the Ministry of Finance, a few more directors turned up at the Bank, and agreed to a reply to Souza Franco's offer, which restated the Bank's initial position. Namely, the Bank was willing to help the government but, unfortunately, it was unable to offer drafts for sale by the next packet, for fear of seeing a further loss of gold from its reserve fund in a few month's time. However, should the government bear the responsibility of providing the funds (in bills of exchange or gold) to honour these drafts, the Bank would be ready to act (memo No. 12). In the Bank's account of the episode, 'the correspondence between the government and the Bank of Brazil on this subject came to an end with this memorandum, because the government did not deign to reply whether or not it accepted the services put at its disposal by the Board of Directors'.⁹⁸

According to one author, however, at 2:00 p.m., soon after the messenger arrived at Souza Franco's office with news of the Bank's position, the Minister had Mauá summoned.⁹⁹ On the very same day, the Barão, through the Mauá, MacGregor Bank, announced he would be selling 90-day bills of exchange at the rate of 25½d on the packet boat about to depart, a rate which was followed by other institutions. The total planned amount put at the service of his scheme to prop up the exchange rate would be as follows: £400,000 in March, £200,000 in April, £150,000 in May and, finally, £60,000 in June. This declining scale of drafts attests to Mauá's confidence in the success of measures to re-establish the value of the *milréis*. In practice, Mauá would sell bills of exchange from the Brazilian office of his bank, drawn on its

⁹⁸ See Banco do Brasil, *Relatorio* 1858. Apparently the directors of the bank were confident that the government would accept their counter-offer, as suggested by their decision to authorise the vice-president to prepare the operation with the sale of bills on London, pending confirmation from Souza Franco. See Banco do Brasil, "Actas", session No. 365, 12 March 1857, AD 003/11-A.

⁹⁹ See Caldeira, *Mauá*, p. 338. The copies of the memoranda exchanged between the Minister of Finance and the Bank of Brazil in those crucial months, which are reproduced in the 1858 annual reports of both institutions, do not lend support to the Bank's version of the events of 12 March. Its reluctance to cooperate was stressed by Cavalcanti (*O Meio*) and by the British *Chargé d'Affaires* in Rio, who blamed this attitude on (the Bank's) 'feeble Direction'. See PRO, Foreign Office, 13/362, Scarlett to the Earl of Malmesbury, Rio de Janeiro, No. 38, 14 May 1858.

London branch, and guaranteed (up to £750,000) by the Treasury's reserves in that city. After being bought in Rio, the bills still had to be shipped to London, to be presented in 90 days. The bills would then be paid for in London with the Treasury's money and then sent back to Brazil, where the final settlement between the Mauá Bank and the Treasury would occur. In all, the process would take some 150 days.¹⁰⁰

Fundamentally, the Barão was placing a bet against the market, by selling large amounts of the commodity perceived as most valuable at the time (sterling), in exchange for the discredited domestic currency. His reasoning for embarking on such an operation was as follows. The extent of the devaluation of the *milréis* since the outbreak of the commercial crisis, he estimated, was not warranted by any indicator of the "fundamentals" of the Brazilian economy, to use a modern term. The balance of payments was momentarily in deficit, largely as a result of a drop in the international demand for commodities exported by Brazil, specially coffee, the price of which, however, was hardly affected.¹⁰¹ Mauá thought he knew by what amount the balance of payments was in the red and, also, what the supply of bills of exchange would be in the near future. If his estimates were right, there was room for (in this case stabilising) speculation on his part. Also, given the existence of a mass of other speculators ready to bet against him (and ultimately the domestic currency), the opportunity to make a fortune - and prove them wrong in the process - was all too real.

At first sight, the odds were heavily against Mauá. The market was desperately trying to get hold of sterling at a time when the supply of bills of exchange was at a seasonal low, and, therefore, the direction of the rate of exchange was unequivocally downwards. Nevertheless, as noted, Mauá reckoned that this was strictly a transitional phenomenon caused by the sudden retraction in the international market for Brazilian goods, and the exceptional drying-up of commercial credit which followed the panic in Europe. As soon as the next crops came to the market and Brazilian exports recovered their trend (which, at the time, was definitely upward), he

¹⁰⁰ See Caldeira, *Mauá*, p. 346. Anticipating that the amount put by the Treasury at his disposal would not be enough to sustain (and appreciate) the rate of exchange, the Barão gave instructions to his London office to procure more resources. Finally, he went as far as putting his own (substantial) private fortune at the service of the operation, if need be. *Ibid.*

¹⁰¹ See Table A20, in the Statistical Appendix.

thought, the increased supply of sterling would lead the *milréis* to recover ground lost in recent months.¹⁰²

In June 1858, as the time to settle accounts with the Treasury drew near, the players would finally have to show their hands. Winners and losers would soon be known. In England, business had returned to normal, and interest rates were lowered to 2.5%. In the meantime, the Brazilian market was about to become awash with sterling, as the government finalised details in London of a loan of approximately £1.4 million, directed towards the “nationalisation” and extension of the D. Pedro II railway.¹⁰³ When news of this deal reached Rio, in June, the rate of exchange - which had been quoted at 25½ since the beginning of Mauá’s rescue operation in mid-March - rose to 27d (18 June), only to fall back to 25½d five days later.¹⁰⁴ The pressure for appreciation of the currency, however, had made itself felt. In early July the government withdrew its guarantees on the drafts on London. Meanwhile, holders of bills of exchange became increasingly nervous at the prospect of having to sell sterling at a lower price than they had paid earlier, in order to meet pressing expenses in local currency. As August approached, so did the peak period in coffee shipments from the interior in Rio.¹⁰⁵ Accordingly, demand for the hitherto shunned *milréis* increased, adding pressure for the appreciation of the exchange rate, and allowing Mauá to settle his debts with the Treasury, with considerable gain for his bank.

In mid-August, judging that the worst was over, the government demanded that the Bank of Brazil resume the exchange of its notes for gold, on demand. On 25 August, convertibility was restored at the Bank of Brazil and the rate of exchange reached near par, at 26⁵/₈d. The crisis was officially over, but it would leave a lasting legacy on both policy and debate on monetary matters in Brazil. There were 90

¹⁰² The harvest would begin in June, when the Mauá, MacGregor Bank sold the last drafts on London. See M. B. Levy, “História dos Bancos Comerciais no Brasil (estudo preliminar)” (Rio de Janeiro, IBMEC, 1972, mimeo), pp. 23-4.

¹⁰³ This was the first loan organised by the house of Rothschild and Sons, who in 1855 had replaced Goldsmidt, Thompson and King as financial agents of the imperial Treasury in London. See V. F. Bouças, *Finanças do Brasil*, Vol. XIX (“Dívida Externa”, 1824-1945”) (Rio de Janeiro, Ministério da Fazenda, 1955), Chapter IV.

¹⁰⁴ See Table A8, in the Statistical Appendix.

¹⁰⁵ Coffee shipments to Rio occurred throughout the year, but peaked between August and November. See Sweigart, *Coffee Factorage*, p. 111.

bankruptcies across the country and in Rio alone losses amounted to 20,000 *contos* (£1.7 million).

3.4 - The Orthodox Backlash

Even before the denouement, the conduct of the whole affair by the government was met with a barrage of criticisms in the Chamber. Soon after the opening of the new legislative year, on 17 May, a deputy from the province of Rio de Janeiro, Jerônimo José Teixeira Junior (Visconde de Cruzeiro), accused Souza Franco of sending confused signals to the market. According to Teixeira Jr., this had paved the way for wanton speculation, in the form of requests for the setting-up of new banks.¹⁰⁶ Alleging that official criteria for authorising the establishment of banks was contradictory, he filed a requisition for the government to provide the Assembly with the necessary clarifications, including copies of the records of meetings of the Finance Standing Committee of the Council of State, convened to examine the matter.¹⁰⁷ This requisition would occupy most of the discussions in the following two months of debates in the Chamber of Deputies.

The sessions that followed were marked by allegations of favouritism towards the Mauá, MacGregor Bank and endless (and often empty) discussions about Teixeira Junior's requisition.¹⁰⁸ Events began to take a turn for the worst for the government in late June when Francisco Sales Torres Homem (Visconde de Inhomirim) and Itaboraí directed their assaults on the liberal banking policies of the Olinda administration, from the Chamber of Deputies and Senate, respectively. Torres Homem targeted Souza Franco, as the man who personified bad economic thinking and reckless policy. His speeches were long, acrimonious and usually contradictory,

¹⁰⁶ See *ACD* 1858, Tome I, pp. 32-6. An adversary of the *Conciliação* initiative, ironically, Teixeira Jr. would later marry a daughter of the Marquês de Paraná, chief architect of the attempt at reconciliation between Conservatives and Liberals. See Tavares de Lyra, *Instituições*, p. 174.

¹⁰⁷ See *ACD* 1858, Tome I, pp. 32-6.

¹⁰⁸ Speaking in the Chamber of Deputies, on 29 May, Mauá took the opportunity to reveal that before embarking on the operation to raise the rate of exchange he personally made three last-minute efforts to convince the Bank of Brazil into accepting Souza Franco's last offer, to no avail. *Ibid.*, p. 150.

but that did not stop Torres Homem from establishing himself as an undisputed authority in financial matters, on a par with the likes of Souza Franco and Itaboraí.¹⁰⁹

Part of the attacks on Souza Franco on these occasions derived from the conviction that by creating new banks of issue by decree the government was acting in an area that was a preserve of the Legislative.¹¹⁰ The other fundamental criticism of the banks established by decree referred to their alleged overissue of notes, thus worsening the effects of a crisis which, everyone agreed, had been “imported”. This other strand of criticism originated with adversaries of a monopoly of note issue and, of course, counted with the sympathy of the Bank of Brazil.¹¹¹

In the end, the campaign waged by Torres Homem and Itaboraí against Souza Franco and his policies bore fruit. Following the allegation that the Minister of Finance had failed to hear the Chamber in the crucial subject of the new banks of issue, the Emperor put pressure on the Olinda cabinet, which finally resigned on 12 December 1858. The *Conciliação* era had come to an end. According to a noted Brazilian historian, the Emperor himself was a firm believer in the virtues of orthodox monetary and banking principles and, in this sense, Torres Homem’s assault on Souza Franco was, if not at the behest of His Majesty, at least directed towards currying favour with him.¹¹² If so, the strategy paid-off nicely. Torres Homem was appointed to the Finance portfolio in the new Conservative cabinet headed by the Visconde de Abaeté, the monarch’s third choice, after both Eusébio de Queirós and Paulino José Soares de Sousa declined the offer to form a new government. Soon after becoming

¹⁰⁹ See Caldeira, *Mauá*, pp. 353-5. Born in the city of Rio de Janeiro in 1812, Francisco de Sales Torres Homem graduated from the medical school and became a journalist under the protection of the highly respected man of the press, Evaristo da Veiga. During a stay in Europe, he came in contact with the literature on Political Economy, a topic in which he would later stand out in the Brazilian political scene, more for his raging speeches than for technical command. Originally a fervent Liberal, author of a pamphlet (*Libelo do Povo*) which attacked the Moderating Power like no one before, Torres Homem would switch sides and join the Conservatives in the mid-1850s, going on to become one of the leading politicians in his new party. Tavares de Lyra, *Instituições*, pp. 266-7.

¹¹⁰ This point will be analysed in more detail in Chapter 6.

¹¹¹ See Banco do Brasil, *Relatorio dos Fiscoes* 1858, Annex, p. 2. For Cavalcanti, however, opposition to the banks created by decree arose out of ‘subservience to the Bank of Brazil, a misunderstanding as to the (alleged) perils of plurality of issue or, as seems more likely, partisan reaction’. See A. Cavalcanti, *Resenha Financeira do Ex-Império do Brasil em 1889* (Rio de Janeiro, Imprensa Nacional, 1890), p. 128. Later events lend credence to the interpretation of a political motivation behind many of the attacks on the banks of issue or, more specifically, on Souza Franco.

¹¹² In a private letter to a friend, the Emperor clearly stated that ‘(he was) against the economic ideas of Souza Franco’. Pedro Calmon, cited in Caldeira, *Mauá*, p. 354.

Minister of Finance, Torres Homem invited Itaboraí back to the presidency of the Bank of Brazil.

One of the first measures implemented by Abaeté was to revoke, on 30 April, the permission granted to the Bank of Brazil to issue notes up to three times its reserve fund. After all, it was argued, since February 1856 the Bank had been making use of a relaxation of the original 2:1 ratio, granted in order to compensate for the drain of specie and Treasury notes from its vaults. Abuse of this facility, in the eyes of the government, left it with little choice but to curtail the amount of notes in circulation, including those of the Bank.¹¹³ Paradoxically, while attempting to exercise control over the money supply by reining in the issue of Bank of Brazil notes, the government was pursuing a parallel strategy by which liquidity in the economy might increase. Although in the end none of them would actually be incorporated, by means of Decrees 2383 and 2400, of 2 April 1859, Torres Homem gave permission for the establishment of 17 new deposit and discount banks, with a total capital of 400,000 *contos*.¹¹⁴

Two months after authorising the incorporation of 17 new banks of issue, and in a drive to impose a complete U-turn on the previous liberal banking policy, Torres Homem presented a bill in the Chamber of Deputies. If approved, it would impose severe limits on the issuing rights of the existing banks. His project, introduced on 15 June 1859, consisted of a single, eight-clause article.¹¹⁵

Art. 1: The Bank of Brazil and its branches, as well as the banks created by decree of the Executive, are required to redeem their notes in gold, on demand.

para1: Redemption in gold, as determined in this article, shall take place within three years of the publication of the present Law;

¹¹³ Rather surprisingly, this did not seem to upset the inspectors of the Bank of Brazil. As stated in their 1859 annual report, the drop in the volume of Bank notes in circulation should not be imputed to the new limit set by the government, but rather to the competition which had come about with plurality of issue. See Banco do Brasil, *Relatorio dos Fiscoes* 1859, p. 5.

¹¹⁴ See L. de C. Carreira, *História Financeira e Orçamentária do Império do Brasil* (Brasília, Senado Federal/Casa de Rui Barbosa, 1980, 2 vols.), Vol. II, p. 756. In this respect, the government was addressing, even if unwittingly, the problem posed by the drain of Treasury notes to the provinces where there were no banking institutions, as reported in Banco do Brasil, *Relatorio dos Fiscoes* 1859, p. 2. This blatant contradiction on the part of Torres Homem - who, while opposed to banks of issue, saw no harm in chartering deposit and discount banks - will be explored in Chapter 6.

¹¹⁵ See Cavalcanti, *O Meio*, Vol. 2, p. 235. On the occasion, Torres Homem was criticised for presenting the project in his capacity as a national deputy, not as Minister of Finance. As such, the project did not need to be accompanied by any supporting documentation and explanations as to its merits. See session of 30 June 1859, in *ACD*, Tome II, p. 232.

para 2: Issues of the said banks, while their notes are not yet convertible into gold, cannot exceed the maximum amount outstanding in the recent months of February, March, April and May;

para 3: Banks which exceed this limit shall be required to reduce their issues within five months from the date of publication of this Law in the respective province, under threat of losing the right to issue notes, and to operate for another year as banks of discount and deposits without renewed authorisation from the government. Banks which do not comply with the first paragraph of this Article shall be subject to the same penalty;

para 4: The government will appoint an inspector to each bank (...) and will determine his fees, to be paid by the bank. It will be up to this inspector to oversee the operations of the establishment and ensure that it follows religiously the letter of its statutes and of the present Law;

para 5: During the period in which the issues of the Bank of Brazil are limited by the arrangements in paragraph 2 of this Law, it will be dismissed from the obligation to retire two thousand *contos* of government paper annually, as determined on 5 July 1853;

para 6: The head office of the Bank of Brazil and its branches are allowed to receive in payments the notes of the other banks of issue created in the places where they operate;

para 7: It is exclusively the competence of the Legislative to authorise the incorporation of new banks of issue or to extend the operations of those already in place, pending legislation governing the general rules that the Executive will be required to follow in the exercise of this right;

para 8: The government will issue a decree with the requisite regulations for the execution of this Law.

This was a slightly modified version of the project that the Emperor had earlier forwarded to the Council of State, where it had had a mixed reception.¹¹⁶ Most of those in the twelve-member Council who actually made their votes clear stood against it. There were those, like Olinda, who adopted a legalistic approach to the question and remarked that the removal of a privilege from a party (in this case, the Bank of Brazil) could not be done without its consent. Others opposed the project on technical grounds.¹¹⁷ Though in a minority, backers of the project crucially included the “Saquarema trinity”, the very core of the old-time Conservatives, Itaboraí, Paulino José Soares de Sousa (Visconde de Uruguai), and Eusébio de Queirós. Uruguai’s positioning in this case is particularly revealing. Himself a lawyer and *fazendeiro* from the province of Rio de Janeiro, in defence of the project he highlighted the growing difficulties of the agricultural sector, particularly an ageing slave population. Nevertheless, he pondered that ‘if to the hardships that result from such a situation is added a great mass of depreciated paper-money, the circumstances will get even

¹¹⁶ Session of 6 June 1859, in *ACE*, Vol. V, pp. 95-104.

¹¹⁷ That was Jequitinhonha’s position. *Ibid.*, p. 100. One of the longest exposés came from General João Paulo dos Santos Barreto, who offered a passionate defence of free trade, including in the realm of banking. He nevertheless admitted his ignorance about the subject under discussion, adding that most of the information he had obtained came from his son-in-law, a stockbroker in Rio! *Ibid.*, pp. 103-4. See, also, J. M. de Carvalho, “O Brasil no Conselho de Estado: imagem e modelo”, *Dados*, Vol. 25, No. 3, 1982, pp. 379-406.

worse'.¹¹⁸ In the end, the Emperor decided to go ahead with the proposal, in spite of considerable opposition in the Council, further suggesting the monarch's sympathies towards hard money.

Upon arriving in the Legislative, the Torres Homem project followed the usual course, that is, it was first examined by the relevant commission. After deliberation, the joint commission of Justice, Finance and Commerce of the Chamber of Deputies issued a report, on 22 June. The report emphasised the following aspects to be observed in the government proposal: its objective, its instruments, and its legality.¹¹⁹ For the authors of the report, it was clear that the aim of the Torres Homem project was to 'fortify the value of the currency', thus preventing shifts in income distribution brought about by exchange-rate oscillations and inflation.¹²⁰ The means to achieve this objective was the institution of convertibility within three years and, in the meantime, the imposition of strict limits on the issuing activities of banks. This involved a re-interpretation of Art. 1, para 6 of Law 683 of 5 July 1853, which allowed the Bank to redeem its notes in currency (metal or paper money). The authors of the report recognised the need 'to impose on the banks the obligation to redeem their notes in gold on demand as the most efficacious means to preserve the value of the currency'.¹²¹ However, they disagreed with para 2 and, instead, proposed that issues of the Bank of Brazil be limited to twice its *fundo disponível* (as determined by its statutes), but with the proviso that the authority to grant permission to the Bank to alter this limit be transferred from the Executive to the Legislative. Finally, as to the legality of the project, and in line with the previous point, they were of the opinion that it required a clear statement of the Legislative's ascendancy on

¹¹⁸ *ACE*, Vol. V, p. 101. This statement lends support to the idea that members of the Council of State more often than not professed a vision of the State in their meetings, rather than taking the opportunity to put forth parochial interests. In this case, Uruguai sided with hard money when clearly soft money would have helped alleviate at least part of the problems in the coffee sector. The resolutions of the Finance Standing Committee of the Council of State will be analysed in detail in Chapter 5.

¹¹⁹ Cavalcanti, *O Meio*, Vol. 2, pp. 236-8.

¹²⁰ Interestingly, the report clearly acknowledged the dual aspect of inflation on the government budget. If, on the one hand, rising prices reduced government expenditure in real terms, it also corroded the real value of its tax revenues. *Ibid.*

¹²¹ *Ibid.*, p. 237.

matters related to money and banking, in an attempt to clear-up the confusion which surrounded this crucial question.¹²²

Some deputies did not share the opinions of the majority of the members of the joint commission. Two of them, Manoel de Souza Dantas and Francisco de Paula Santos, issued a minority report, in which they expressed their disagreement with both the original Torres Homem proposal and the views of the rest of the commission. Their main point concerned the legality of the bill that, in their view, represented a clear breach of the rights of shareholders of the banks concerned (the Bank of Brazil and those created by decree in 1857). For these deputies, any fundamental change in the contracts signed between the government and those institutions required consent from the latter and, therefore, could not come about unilaterally at the initiative of the government. The authors disagreed particularly with proposed limits on rights of issue and the convertibility requirements (paras 2 and 3). For them, not only was this a unilateral change in the rules of the game but also a contradictory imposition. For, at the same time that the government required that the institutions concerned ensure the redemption of their notes into gold, they were forced to accept inconvertible Treasury notes in payment of their loans.

To the Minister's great surprise, his project was attacked from other quarters as well.¹²³ Journalists and businessmen alike condemned what they saw as too radical a change of course which, it was argued, would bring not only the closure of the banks created by decree, but also great hardship for the economy in general.¹²⁴ In the end, the Torres Homem bill passed in the Chamber by a very small margin, in spite of the considerable Conservative majority in that House.¹²⁵ Having presented the whole

¹²² Ibid.

¹²³ In a sample of the monetarist tone of most early twentieth-century authors, it was remarked that the Torres Homem project 'soon met the greatest and rudest opposition from the advocates of inflation and a depreciated currency, who have always been numerous in Brazil'. Cf. Ortigão, *A Moeda*, p. 59.

¹²⁴ In a striking "Keynesian" insight into the matter, a contemporary remarked that 'the provisions of the (Torres Homem) project, however much they lacked the capacity to increase the value of our circulating medium directly, should bring about this desired result in an indirect way, through general impoverishment, the ruin of public and private fortune, and the retreat of industry and commerce'. Cf. H. A. Milet, *O Meio Circulante e a Questão Bancária* (Recife, Typ. do Jornal de Recife, 1875, 2nd edn.), p. 37.

¹²⁵ In the first of three voting sessions required by the statutes of the Chamber of Deputies the project received 61 votes in favour and 51 against. See Andrada, *Bancos de Emissão*, p. 116. The Conservatives at the time held 92 seats in the Lower House. As regards the discussion of the project in the Assembly, a contemporary noted that '(...) the support which sixty deputies and some of the most

issue as a matter of confidence in the 1858 cabinet, Abaeté sought to convince the Emperor to dissolve the Assembly. Instead, Pedro II dismissed the cabinet.¹²⁶

3.4.1 - The Inquiry Into the 1857 Crisis

Victory for the opponents of banking reform was short-lived. The new Prime Minister, Ferraz, who also held the Finance portfolio, began his term by determining that all banking establishments and corporations in the Empire be required to present every month to the government an account of their operations.¹²⁷ A second decree, dated 30 September 1859, further extended the supervision exercised by the Executive over businesses. Finally, on 10 November Ferraz commissioned an investigation into the 1857 crisis, to be headed by three distinguished civil servants.

The final report of the commission set up by Ferraz remains the single most important source of both statistical and anecdotal evidence about banking and monetary affairs in the period. In the five months that the enquiry lasted the authors interviewed 28 businessmen and experts on trade and finance. On 30 April 1860, the report was published, offering a general abstract of all testimonies, and excerpts from each of the interviews, as well as an impressive set of statistical data.

The ten questions that were asked of the interviewees, and a summary of replies, are given below.

1. Q: How are operations in foreign exchange conducted in the Rio market?

distinguished characters in the Senate have lent to the ideas of Mr. Torres Homem, in spite of the immediate harm which they bring (...), serves to show that the project will be rejected as inopportune and in breach of the rights of the existing banks, rather than for its ineffectiveness and for being contrary to the principles of political economy (...). Cf. Milet, *O Meio Circulante*, p. 31.

¹²⁶ Rio's main financial paper commented that 'the expected reaction' (to the Torres Homem project) took place in the Chamber. 'Interests hurt by the bill reacted with the strongest possible force. Liberal opinion maintained its opposition in the name of the principles of its school, of the faith in contracts, and acquired rights. Many Conservative deputies who supported the Olinda cabinet were convinced that they should reject the bill, as being ill-suited to cure the current evils. The financial question was linked to the question of conciliation and centralisation (...), as well as the dispute between the cabinet that had ceased to exist in December 1859 and its opponents'. *Jornal do Commercio*, 7 January 1861.

¹²⁷ Ângelo Muniz da Silva Ferraz (later Barão de Uruguaiana) was born in Valença, Bahia, in 1812. At the age of 22 he graduated from the Law school in Olinda, and in 1842 was elected to the Chamber of Deputies, where he gained notoriety for his opposition to the *conciliação* initiative of the Marquês de Paraná. When appointed Prime Minister, in 1859, Ferraz brought with him a reputation as a skilled administrator, having been very successful, as an inspector, in reforming the Customs service between 1848 and 1853. See Pinto do Carmo, *Ministros*, pp. 169-174.

A: The operations in foreign exchange are made by means of bills drawn for their most part against products that are exported. Those transactions in the exchange market with objectives distinct from the above, given their small share of the total, have exerted little influence on the rate of exchange.

2. Q: What determines, in general, the rate of exchange in this market?

A: Two elements act on the rate of exchange: the relative monetary value of the currencies being exchanged and the comparative amount of money that must be shipped between the countries concerned.

3. Q: What are the causes behind the depreciation of the rate of exchange, especially in 1857 and 1858?

A: In the years between the failure of the first Bank of Brazil and 1847 the large and frequent depreciations were, mostly, the result of issues of money in excess of the volume of transactions in the economy, as well as the poor state of government finances.

4. Q: What was the nature of the Crisis of 1857? What were its effects?

A: The immediate impacts of the international crisis were far less important than those which resulted from purely internal factors, the product of speculation and abuses in commercial activity. Preliminary estimates put the losses directly imputable to the international crisis at between 1,500 and 3,000 *contos*, and the number of import/export businesses that failed at between four and twelve. Total losses, though, are estimated at between twenty thousand and thirty thousand *contos* in Rio de Janeiro alone. The effects of the crisis were hardly felt in Bahia and Pernambuco.

5. Q: Can the depreciation of the exchange rate be attributed to an oversupply of banknotes?

A: Most of the depreciation of the exchange rate must be blamed on the excessive issue of banknotes, which still remains to this day. This depreciation in fact occurred with the aid of other causes that acted upon the economic circumstances of the time, given the direct and indirect effects of the 1857 crisis (...)

6. Q: Can competition between banks lead to overissue?

A: Yes. Competition between banks of issue can raise the amount of notes beyond what the markets demand. Also, the circulation of any one bank, instead of replacing that of another, actually increases the overall supply of fiduciary notes, harming its regularity and guarantees (...)

7. Q: Can the notes of the Bank of Brazil be considered as real paper money, on a par with government notes?

A: No, they are different. Contrary to Bank of Brazil notes, government paper is not redeemable on demand.

8. Q: Have the *vales* issued by the Banco Comercial and others (...) behaved as banknotes before and after their maturity?

A: Yes. Although the circuit in which *vales* are accepted is narrow, (...) it must be concluded that short-term *vales* and bills are equivalent in their effects to notes payable to bearer redeemable on demand, having the power in certain circumstances to replace coins and paper money.

9. Q: Are there any associations which operate as banks without government approval?

A: In the province of Bahia alone the Commission identified in October 1859 eleven institutions (*caixas econômicas*, *caixas comerciais* etc.) operating without government authorisation.¹²⁸ Many others in similar circumstances were operating in Rio.

¹²⁸ *Caixas econômicas*, or saving banks, operated by making depositors shareholders in the enterprise. In the case of those created in the province of Bahia, capital was invested mostly in urban mortgages and stocks. Interest received from these operations, net of administrative charges, was distributed semi-annually among shareholders (or depositors), in proportion to their capital. See *Parecer sobre Caixas Econômicas e Montes de Socorro* (Rio de Janeiro, Typ. Nacional, 1882).

10. Q: Who issues bills payable to bearer with maturities of less than ten days?

A: The Commission unearthed countless cases of private individuals and companies that issued *vales* and other paper to bearer and redeemable on demand. For example, the Nictheroy & Inhomirim, Omnibus and Gondolas Co. issued its own private coins, given to passengers as small change. Also, a Mr. Manoel Pereira de Souza Barros had *vales* printed in denominations of 50 to 10\$000 to give in payment to his slaves for the produce from their plots.

Despite the diverse opinions presented at the enquiry, a general monetarist note characterised the above summary of the findings of the Commission. It concluded that the origins of the crisis lay in Europe and the United States, but that the extent of its consequences in Brazil was due to the end of the monopoly of note issue enjoyed by the Bank of Brazil, and the excessive monetary expansion that ensued. Furthermore, and crucial in their view, the abandonment of convertibility of the notes of the Bank further compounded the problems. In concluding their report on this note, the commissioners were echoing the current credo, which equated sound monetary policy with the “smooth” operation of the gold standard. To the Minister who had commissioned the report, the Emperor himself and many contemporaries, these findings sounded like the vindication of everything *metalistas*¹²⁹ had always stood for.

Yet, not everyone heard by the commission expressed this view. Actually, several of the persons interviewed expressed opinions which, if not diametrically opposed to the final conclusions, at least diverged to such an extent as to merit inclusion in the commissioners’ final considerations. For example, Comendador José Ferreira Pinto, testifying on 31 December 1859, highlighted the indirect effects of monetary growth on the exchange rate, operating through an expansion in economic activity and the accompanying increase in the value of imports.¹³⁰ The imbalance between imports and exports, he insisted, was the main ‘engine of the rate of exchange’, which was also influenced by the remittances on account of interest and amortisation of the foreign debt.¹³¹ Balance-of-payments influences upon the

¹²⁹ *Metalistas* would come to designate advocates of convertibility and, more generally, of hard money, i.e., monetary restraint and a high exchange. Conversely, their ideological foes, *papelistas*, sided with expansionist monetary policies, a slipping exchange and, at times, fiduciary paper. The differences between *metalistas* and *papelistas* will be explored in Chapter 6.

¹³⁰ *Comissão de 1859*, Annex A, p. 11.

¹³¹ *Ibid.* The trade deficit for the 1857/58 financial year stood at £3.8 million, up £2.5 million from the year before, while service of the foreign debt remained constant at 3.5 thousand *contos* (approx. £390,000). Data on foreign trade are from IBGE, *Estatísticas Históricas*, Table 11.1, p. 522. Figures

exchange rate were also stressed by the next interviewee, Visconde de Ipanema, for whom ‘as a rule the fall of the exchange rate in our market is caused by crop shortages. (This was) especially (true) in 1857 and 1858 with coffee, as well as the extraordinary remittances which importing houses had to make to Europe’.¹³² An unidentified foreign businessman based in Rio, in turn, remarked that

The compared movement of imports and exports is what regulates, in general, the course of the exchange. The rate of discount, the nature and value of the circulating medium are two causes that also act irresistibly on the course of the exchange. From this point of view, the operations of the Bank of Brazil exercise a positive influence; and in many different countries in Europe the decisive influence of the banks of issue on the course of the exchange has been proven.¹³³

In the end, it was Mauá who provided the most eloquent defence of monetary heterodoxy. In one of the longest and most circumstantial testimonies offered to the Commission, he began by stating that ‘as a principle, (he would) never deny the disastrous consequences that inconvertible paper money could have on the rate of exchange, for that would run counter to common sense (...)’.¹³⁴ Yet, he was quick to point out that in order to assert that the decline of the exchange rate which began in late 1857 was due to an overissue of notes and to the circulation of inconvertible paper money in excess of the needs of transactions, two things would have to be proved. First, that convertibility of notes into gold had been carried out before the onset of the crisis and, second, that the money supply in the Empire at the time was in fact superior to the needs of the market. The answer to both points, Mauá insisted, was clearly “no”. In fact, as already noted, the Bank of Brazil seldom gave gold in

(in *contos*) for foreign debt payments can be found in *Balanços da Receita e Despesa do Imperio* (Rio de Janeiro, Typ. Nacional). On the evolution of Brazil’s foreign debt, see M. de P. Abreu, “A Dívida Pública Externa do Brasil, 1824-1931”, *Estudos Econômicos*, Vol. 15, No. 2, May/August 1985, pp. 167-189.

¹³² *Comissão de 1859*, Annex A, p. 12. Coffee exports indeed suffered a drop between 1856 and 1858, from a high of £5.9 million to little over £5 million. This loss in revenues was due exclusively to a fall in the quantities exported, prices having increased slightly during the Crimean crisis. A similar point was later made by an insightful contemporary, who identified the record trade deficit in the period (£3.8 million in the 1857/8 financial year) as the main factor behind the depreciation of the *milréis*. According to him, this deficit had been caused by a drop in the demand for Brazilian exports, reduced production due to a cholera epidemic among slaves, and a substantial increase in manufacturing imports following a misguided tariff review. See Milet, *O Meio Circulante*, pp. 41 ff. For data on the coffee trade, see Table A20, in the Statistical Appendix.

¹³³ *Comissão de 1859*, Annex A, p. 44. In short, he admitted that the rate of exchange was determined by both monetary and balance of trade influences. Others rightly noted the influence exerted by political crises. See the testimony offered by a John Hasenclever, *ibid.*, p. 3

¹³⁴ *Ibid.*, p. 95.

exchange for its notes before it officially announced it would confine convertibility to Treasury paper. In practice, therefore, the economy was technically under a peculiar type of gold standard regime, where Bank of Brazil notes could be redeemed for inconvertible government paper.¹³⁵ As to the alleged overabundance of notes in circulation, Mauá pointed to the high interest rates in 1855 as an indication that the market was demanding more money than was on offer, not the reverse.¹³⁶ In that respect and, again, in opposition to general opinion, he directed his criticisms at the gradual retirement of Treasury notes. This operation, by causing a reduction in the reserve funds of the issuing banks, would end up forcing additional cuts in note issues.¹³⁷

As noted, few of these less “mainstream” views were taken into account by the commissioners, who opted instead for a monetarist interpretation of the events leading up to the 1857 Crisis. In possession of their conclusions, Ferraz felt confident to ventilate in the *Relatório da Fazenda* of 1859 (published in May 1860) the policies that he envisioned in order to restore the money supply to a “healthy” state.¹³⁸ His long exposition began with a digression about the recent events in the monetary market and the policies pursued by both the government and the Bank of Brazil. He then went on to stress the excessive liberty enjoyed by banks and corporations in the Empire. This involved, amongst other things, the issue of private notes by individuals or businesses, as well as the existence of banks operating exclusively under provincial authorisation, in open breach of legislation. More generally, he inveighed against the lack of official scrutiny of the conduct of many businesses, where unscrupulous individuals would often take advantage of uninformed investors. These considerations laid the ground for the subsequent approval of the infamous “Law of

¹³⁵ More on this in Part III of the thesis.

¹³⁶ *Comissão de 1859*, Annex A, pp. 95-6. There is, of course, the possibility that high interest rates and a large supply of money coexist, given imperfections in the capital market. The latter was clearly a problem at the time, as discussed in Chapter 7.

¹³⁷ *Ibid.*, p. 97. More on this point in Chapter 7.

¹³⁸ See “Dos Bancos e do Meio Circulante”, in *RMF* 1859, pp. 65-82.

Impediments” (*Lei dos Entraves*),¹³⁹ which would regulate banking and corporate activity in the years to come.

* * *

To sum-up, in 1850 Brazil’s banking system was showing signs of being incapable of meeting the demands of the economy. After many years in which a single joint-stock bank operated in the Court (the Banco Comercial do Rio de Janeiro), the Barão de Mauá founded a *vale*-issuing establishment. Intense competition between both banks, however, led to a monetary pressure in Rio, in 1853. In response to it, and with a view to create an institution which it felt could aid in regulating the money supply, the government created a semi-official, note-issuing, bank - the third Bank of Brazil.

The 1853 Law that created the Bank bears witness to the temporary victory of the advocates of a monopoly of note issue over pluralists. The arrangement devised to that effect involved a set of privileges and obligations for the new institution, which made it an attractive investment to private shareholders, while at the same time affording the government important benefits. These took the shape of an interest-free loan, and the capacity to regulate indirectly liquidity in the economy, via the imposition of limits on banks’ reserve ratios.

The creation of the third Bank of Brazil was not sufficient to satisfy the demands for additional monetary expansion that came from the provinces. In response to this, new banks of issue were chartered in 1857, during Souza Franco’s tenure at the Ministry of Finance, during the *Conciliação* period. The outbreak of the international financial crisis at about the same time lay bare the lack of preparedness of the Brazilian banking system for such an event. The initial co-operation between the Bank and the government, directed at artificially sustaining the rate of exchange, was a failure, and sent mixed signals to the economy. The firmer commitment displayed by the Mauá, MacGregor Bank, however, enabled the *milréis* to close near par by mid-1858, after its initial depreciation.

¹³⁹ Law 1083, 22 August 1860. The expression is attributed to a French author (J. Garnier) who, writing in 1860, first referred to it as the *Loi d’ Entraves*. See Cavalcanti, *O Meio*, Vol. 2, p. 265.

The inquiry into the 1857 crisis set the stage for the opponents of plurality of issue and inconvertible paper money to attack Souza Franco's management of the episode. The dismissal of the *Conciliação* cabinet paved the way for the advocates of hard money to inveigh against the banks of issue and, especially, what they considered the privileges enjoyed by the Bank of Brazil. In spite of the initial opposition mustered against the Torres Homem bill for the reform of banking legislation, the *metalista* spirit triumphed in the end, with the passing of the 1860 Law of Impediments (Law 1083).

Chapter 4 - From the “Law of Impediments” to Restoration of Monopoly: 1860-70

4.1 - *Metalistas* Win the Day: the 1860 Law

As seen in Chapter 3, the cabinet that replaced the *Conciliação* proceeded to reverse the liberal banking policies promoted by Souza Franco. The new Minister of Finance, Torres Homem, presented a bill to the Chamber directed at reducing the existing issue of banknotes, and restoring convertibility. His decision to file the project in his capacity as a national deputy, rather than as an initiative of the new cabinet, proved to be fatal. Deputies, many of them from the Conservative majority, felt that the Legislative had been sidelined in its duty to examine measures emanating from the Executive. On 15 June 1859, the Chamber held a vote on a petition requiring that the bill be sent to the Civil Justice Committee. Having been filed by Martinho Campos, a Liberal deputy from Rio de Janeiro, it won by 36 votes to 33. The Conservative majority, taken aback by the result, accused the opposition of procrastination.¹ Deputy Fernandes da Cunha (Bahia) replied by stating that the Torres Homem project was nothing but a ‘party law’.² Parliamentary opposition to the banking project ultimately led to the downfall of the Abaeté cabinet. Ferraz was called in to form a new government

Meanwhile, the Torres Homem project was being amended in the Senate. As well as the article concerning banks of issue, the new version of the project included measures dealing with joint-stock companies, savings banks, and the coining of a new family of copper coins. Deputy Martinho Campos maintained his opposition to the project. He argued that it was no more than an attempt to alter the Commercial Code, disguised as an amendment to the Torres Homem bill.³ Yet, overall, reaction in the Chamber this time was less hostile. Deputies who had voted against the Torres Homem proposal now claimed to be happy to support the amended bill, which had

¹ See session of 15 June 1859, in *ACD*, Tome II, p. 136.

² Session of 25 July 1859, in *ACD*, Tome V, Appendix, p. 79. The Minister had already acknowledged this point himself three weeks earlier, when he had presented the whole question as one of confidence in the cabinet. Session of 6 July 1859, in *ACD*, Tome III, p. 45.

³ Session of 6 August 1860, in *ACD*, Tome III, p. 66.

become more “palatable”.⁴ The new project did away with the demand that convertibility of banknotes be resumed within three years. Also, while the original bill unilaterally determined reductions in outstanding note issues, the new version provided for an agreement between banks and the government as to the rate of withdrawal, thus respecting banks’ rights. In the end, the project was approved by a comfortable margin of 51 votes (70 votes to 21), to become the Law of Impediments.⁵

Law 1083 was promulgated on 22 August 1860. It contained ‘measures concerning banks of issue, the circulating medium and various corporations and partnerships’.⁶ In an attempt to reaffirm provisions from the 1850 Commercial Code, the Law determined that joint-stock companies would be heavily fined, if found to be operating without official authorisation (Art. 2).⁷ The Law of Impediments also regulated the operations of *caixas econômicas* and philanthropic pension societies (*monte-pios*), as well as providing for the replacement of copper coins in circulation. The main items in Law 1083 relating to the operation of the banks of issue were as follows:

⁴ See the speech by deputy Gomes de Souza, *ibid.*, p. 70.

⁵ Pinto Aguiar, *Ensaio de História e Economia* (Salvador, Livraria Progresso Editora, 1960). The striking contrast with the results of the vote on the Torres Homem project can be ascribed to the changes introduced by Ferraz in the original bill. Also, the fact that the Ferraz cabinet was avowedly “parliamentarian” - all its members were either senators or national deputies - may have helped. An additional reason might have been the wish of some deputies to become “cosy” with the government before soon-to-be-held parliamentary elections. As such, politicians’ survival instinct may have got in the way of deeper, “philosophical”, considerations.

⁶ In the Speech from the Throne in 1860, the Emperor had already made known the wish of the cabinet to review ‘legislation on associations and corporations, both civil and commercial’. See *Fallas do Throno*, p. 519. The 1860 legislation has sparked much controversy in the literature. Some historians allege that it served to advance British interests in Brazil, since it ‘guaranteed the unification of the internal and external monetary standard’, in other words, it supposedly forced Brazil back into the gold standard and, in this way, helped British firms. The following measures would be evidence of this intention to advance British interests in Brazil: (i) the enacting of obstacles to the creation of new joint-stock companies; (ii) the opening-up to foreigners of the Brazilian coastal trade; (iii) the policy of high exchange rates; (iv) the government having become a client of the British commercial banks (that first set up operations in 1862); and, finally, (v) the (official) guarantee of minimum returns on invested capital, especially on railways. See Granziera, *A Guerra*, p. 75. It is not clear why, on balance, items (i) to (v) above, if actually helping British interests, would in this way hinder the overall development of the Brazilian economy in the process. Likewise, elsewhere it was said that ‘the conservative legislation (of 1860) coincided with the interests of British capital in operating in a more stable environment’. Cf. Levy and Andrade, “El Sector”, p. 75. Again, however much this might have been the case, it begs the question of why would not greater stability be in the interests of domestic firms, and the Brazilian government as well.

⁷ In the end, it is possible that, by clamping down on unauthorised businesses, the government was attempting to attract more investors, who felt their interests in joint-stock companies to be more secure.

Art 1: None of the banks created by decree of the Executive shall be allowed to issue, in the shape of notes on demand, an amount in excess of their average issue in the first half of the current year, until they are in a position to redeem their notes in gold (...).

Whilst the Bank of Brazil is unable to pay its respective notes in gold, the government will only grant it permission to increase its issues beyond twice the amount of the reserve fund (...) when such a concession does not result in a right to issue notes in excess of the average outstanding issues from the day of its installation until March of this year (...)

para 1: If the current issue of any bank exceeds the limits imposed at the beginning of this Article, it will be required to reduce such issue to those limits, in a period determined by the government, but never within more than six months;

para 2: If within six months of the publication of this law the Bank of Brazil is still incapable of redeeming its notes in gold, it shall not be allowed to retain in circulation more than twenty-five percent of its issues represented by notes of denominations of less than 50\$000 in the Court and 25\$000 in the provinces;

para 3: If at the end of one year, from the date of publication of this Law, the banks are not yet in a position to exchange their notes into gold, the government will have them reduce (...) the amount of notes in circulation, at a rate yet to be decided (...);

para 4: Issuing banks created by decree will be allowed to replace securities currently used in their guarantees for metallic currency, and as soon as their notes are convertible into gold, on demand, they will be entitled to issue up to twice the amount of gold in their vaults, within the limits set out in their respective statutes (...);

para 5: Any issuing bank incapable of redeeming its notes for currency - or, in the cases predicted in the previous paragraph, for gold - and on demand, will be declared bankrupt; in the meantime bearers of its notes will be entitled to interest payments (...);

para 7: Each and every one of the banks created by decree of the Executive will have an inspector appointed by the government, in charge of overlooking all the operations of the bank and the decisions of its board and the general meeting of shareholders, suspending the execution of those (decisions) which run counter to the statutes or to the present Law, and immediately reporting to the government, so that it can decide if the decisions can be implemented or not (...)

para 10: No bank, except those currently operating as a result of a decree of the Executive, corporation, partnership of any kind, trader or individual in any position, will be allowed to issue, without permission from the Legislative power, notes, bills, *vales*, paper or bond of any kind payable to bearer (...), liable to the payment of a fine of four times its value, to be borne fully by both issuer and bearer.⁸

Article 1 of the Law of Impediments retained the spirit of the earlier Torres Homem project that had caused so much controversy in the Assembly. For example, on the

⁸ A comparison with a summary of the main provisions of the 1844 Joint-Stock Bank Act - which imposed several restrictions on the formation and operation of new joint-stock banks in Britain - reveals the similarity of the Law of Impediments with comparable legislation elsewhere at the time. This helps to diffuse the idea that Brazilian authorities were somehow more orthodox in this respect than their average contemporaries. 'The minimum nominal capital was to be £100,000, no share was to be of lower denomination than £100, and no company thus formed could begin business until all the shares had been subscribed and at least one-half of their nominal amount paid-up. It was required that the deed of partnership should be in a form approved by the Privy Council and that it should contain, among other clauses, provisions forbidding the company to purchase or lend upon the security of its own shares, requiring a statement of assets and liabilities to be published once a month, and arranging for the annual accounts to be examined by auditors elected by shareholders.' Cf. W. F. Crick and W. E. Wadsworth, *A Hundred Years of Joint-Stock Banking* (London, Hodder and Stoughton, 1936, p. 26), quoted in M. Collins, *Money and Banking in the United Kingdom: a history* (London, Croom Helm, 1988), p. 73.

question of the limits imposed on banks' outstanding issues, the new law considered an average of the first semester of 1860, instead of the average obtained in the February-May 1859 period, in the Torres Homem version. Paragraph 7, imposing a government-appointed inspector to the banks of issue, also mirrored the 1859 project. Similarly, the Law retained the objective set out in paragraph 7 of the earlier project, which aimed at clearing up the controversial question of primacy in approving legislation governing banks of issue. This was an attempt to avoid a repetition of the episodes of 1857, when the Executive power alone legislated on the creation of new establishments. Finally, paragraph 5 of the Law of Impediments introduced the threat of bankruptcy for issuing banks that failed to ensure note redemption, a provision long-established in the United States.

Details of the limits to note issue for the existing banks were given in Decree 2685, 10 November 1860. Its main points were:

Art. 1: The issue of notes, bills or paper payable to bearer by the banks of issue created by decree of the Executive Power currently in operation, and their branches and offices, while their redemption is not yet realised in metallic currency, cannot exceed the values assigned in Table 1.

Table 1

Bank	Maximum Issue (in <i>contos</i>)
Comercial & Agrícola: head office	6,337.9
Vassouras branch	600.0
Campos branch	300.0
Rural & Hipotecário	1,992.3
Pernambuco	1,486.0
Maranhão	513.3
Bahia	2,832.8
Rio Grande do Sul	250.0
Total	14,312.3

para 1: As well as the issues assigned in (this) table, the said banks, their branches and offices, will be granted an additional one equivalent to the part of their paid-in capital subscribed in the form of gold coins, 22-carat gold bars and silver coins; (...)

para 4: If the present issues of each of these banks, their branches, or offices, exceeds the limits laid down in Table 1, they will be required to reduce them to within the said limits, in the space of three months after publication of the present decree (...). This deadline may be extended by the Minister of Finance for another 30 or 60 days (...)

Art. 2: The issues of the Bank of Brazil and its offices, while not redeemed in gold, cannot exceed twice the amount in its reserve fund and, if the present issue exceeds this limit, the said bank will be required to reduce it in line with para 4, above;

para 1: The issues authorised under Art. 18 of the statutes of the bank are exempted from the rules of the present article;

para 2: The right to increase its issue beyond double the reserve fund, granted by Art. 1, para 7, of Law 683, of 5 July 1853, and by Art. 63 of its statutes, while redemption of its notes in gold is not realised, will only be exercised (...) up to the limit set out in Table 2.

Table 2

Bank of Brazil	Maximum Issue (in <i>contos</i>)
Head office	21,481.1
Ouro Preto branch	1,338.4
São Paulo branch	2,440.9
Rio Grande do Sul branch	890.0
Salvador branch	5,384.4
Recife branch	5,397.7
São Luís branch	941.4
Belém branch	1,079.4
Total	38,953.3

Art. 3: In computing the reserve fund of the Bank of Brazil, the following must be deducted from its paid-in capital: (i) the amounts distributed to the branches to serve as capital, or loaned on current and interest-bearing accounts; (ii) the amount of Government notes withdrawn from circulation (...), (iii) the value of buildings, furniture and sundry objects used by the establishment. The difference between the paid-in capital and the sum of these four (sic) items constitutes the bank's reserve fund. This arrangement is extensive to the bank's branches, when applicable. (...)

Art. 4: If, after six months, counting from 22 August, the Bank of Brazil and its *caixas filiais* have not yet resumed convertibility of their notes, they will not be allowed to maintain more than 75% of their total circulation as notes of denominations of less than 50\$ in the Court and province of Rio de Janeiro, and of 25\$ in the provinces;

Art. 6: If after nine months from the date of Law 1083 (that is, in May 1861) the circulating banks, their branches and provincial offices are not yet capable of redeeming their notes for gold coins they will be required (...) to propose to the government the amount of notes or bills in circulation that they will be retiring the next year, and the following ones, while this incapacity persists.⁹

Decree 2685 had laid down a timetable for banks to adapt to the new issuing limits. Banks created by decree were required to conform to the average issue observed in the first semester of 1860, unless they succeeded to resume convertibility. The Bank of Brazil was limited to its average issues counting from the day it started operations. The former had five months from the date of Decree 2685 to adjust its issues to the limits shown in Table 1 (Art. 1, para 4). As to the Bank of Brazil, if by February 1861 its paper was still inconvertible, it would be forced to retire notes of smaller

⁹ Crack-down on the issue of *vales*, notes, bills etc. without prior government authorisation was carried out further by means of Decree 2694, 17 November 1860. This piece of legislation basically forbade any new issue of such paper without first hearing the Legislative. Issuers were given a moratorium of three months to withdraw any unauthorised paper from circulation, after which severe penalties would apply to anyone found infringing the new rules.

denomination (Art. 4).¹⁰ Finally, if convertibility had not been restored after nine months, all banks would have to negotiate with the government a sliding scale of reduction in their note issues (Art. 6).

One way to assess the impact of the new legislation on the issue of banknotes is to compare the new limits to the outstanding note circulation in a similar period. Thus, when contrasting the limits to (it must be stressed, inconvertible) issues imposed by Decree 2685 with each bank's note circulation in the first semester of 1859, it emerges that some institutions were forced to contract their issue, whilst others were actually given room to increase their circulation. In respect to the provincial banks in Table 1, the new legislation meant a reduction in issuing powers for the Banco de Pernambuco and Banco do Maranhão. Meanwhile, the new limits imposed on the Comercial & Agrícola, Rural & Hipotecário, Banco da Bahia and Banco do Rio Grande do Sul were higher than their individual average issues during the first semester of 1859. This meant that, legally, they could still expand their issue of inconvertible notes. Overall, the new limit on the combined issues of the provincial banks (14.3 thousand *contos*) was 8% higher than their average issues in the first semester of 1859 (13.2 thousand *contos*). As to the Bank of Brazil, the story was different. Unlike the other banks, the government-imposed limits were an average of Bank issues since 1854. In practice, this penalised the provincial branches, while the issuing powers of the head office were slightly increased. For the institution as a whole, the new limits amounted to a 5% reduction of its note issues, or approximately 2,100 *contos*, when compared to the first half of 1859. Taken together, the new limit imposed on the combined inconvertible issues of the banks created by decree and the Bank of Brazil implied a reduction of 1,000 *contos*, or less than 2% of their outstanding circulation of a year earlier. Clearly, in this respect the Law was not as severe as it appeared.

At the time the Law of Impediments was implemented (August 1860) total notes outstanding could be estimated at slightly under 90,000 *contos*, with issues by

¹⁰ Notes of small denomination (1\$000 to 30\$000) issued by the Treasury and banks amounted to slightly over 50% of a total outstanding issue of 96,000 *contos* in mid-1859. See session of 19 July 1859, in *ACD*, Tome III, pp. 177-9.

private banks amounting to more than half the total.¹¹ Yet, between August 1860 and August 1861, total note circulation dropped 8%. This followed a decrease in total note issues of about 6% in the previous 12-month period.

Table 4. 1
Brazil: Total Notes Outstanding, 1858-61
(in *contos*)

	Dec 1858	Aug 1859	Dec 1859	Aug 1860	Dec 1860	Aug 1861	Dec 1861
Bank of Brazil	41,936.8	39,086.6	40,861.9	36,457.0	38,816.2	32,762.1	33,390.1
head office	22,125.5	20,172.7	21,889.8	19,331.2	22,626.3	17,245.2	18,131.9
<i>caixas filiais</i>	19,811.3	18,913.9	18,972.1	17,125.8	16,189.9	15,516.9	15,258.2
Bco. C. & A.	5,790.2	7,137.9	7,237.9	7,237.9	7,237.9	7,237.9	7,237.9
Bco. da BA	1,287.5	3,012.5	3,200.0	2,405.8	2,207.8	2,316.5	2,560.3
Bco. de PE	1,460.0	2,000.0	1,466.0	1,490.0	1,490.0	1,485.9	1,474.2
Bco. do MA	430.0	680.0	680.0	400.0	200.0	249.0	256.0
Bco. do RS	-	14.0	.8	X	X	X	X
Bco. R. & H.	-	2,000.0	1,926.0	1,966.0	1,903.0	1,988.5	1,984.7
Total Banks (a)	50,904.5	53,931.0	55,372.6	49,956.7	51,854.9	46,039.9	46,903.2
Treasury (b)	41,664.7	41,200.0 (*)	40,700.6	39,400.0 (*)	37,599.9	36,300.0 (*)	35,108.4
TOTAL (a + b)	92,569.2	95,131.0 (*)	96,073.2	89,356.7 (*)	89,454.8	82,339.9 (*)	82,011.6

Note: X Issues of the Banco do Rio Grande do Sul had declined to just 10\$000.

(*) estimates

Sources: For Bank of Brazil: Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas*, various issues. For remaining banks: *Relatorio da Comissão de Inquerito Nomeada por Aviso do Ministerio da Fazenda, de 10 de Outubro de 1859* (undated); and *Relatorio da Comissão Encarregada pelo Governo Imperial por Aviso do Primeiro de Outubro e 28 de Dezembro de 1864, de Proceder a um Inquerito Sobre as Causas Principaes e Accidentaes da Crise do Mez de Setembro de 1864* (Rio de Janeiro, Typographia Nacional, 1865). Treasury notes in *Legislação Sobre Papel Moeda* (Rio de Janeiro, Imprensa Nacional, 1923).

At first sight this substantial drop in total notes outstanding would seem to contradict what has just been said about the effects of the Law of Impediments on the operations of the banks of issue. Yet, upon closer examination it emerges that the brunt of the monetary contraction that followed the Law was borne by the Bank of Brazil. And this had little to do with the Law itself. Rather, it was a result of the requirement that the Bank proceed with the yearly withdrawal of 2,000 *contos*' worth of Treasury notes, as mandated by its statutes. In practice, movements in the note circulation of both institutions occurred in tandem. As the Bank continued its annual retirement of government paper money, its own circulation - which was a multiple of the amount of

¹¹ Although official figures for Treasury notes refer to end of year only, the combined sum represented by notes withdrawn from circulation by the Bank of Brazil (2,000 *contos* per annum, in several instalments) and the loss owing to their natural wear and tear suggests a decrease in government paper money of roughly 1,300 *contos* every six months.

Treasury notes and gold it had in reserve - would tend to diminish.¹² Outstanding issues of Treasury notes, which stood at 40.7 thousand *contos* in December 1859, fell to 37.6 thousand *contos* in December 1860 (a decrease of 7.7%), and 35.1 thousand *contos* one year later (down a further 6.6%). Meanwhile, issues of the Bank of Brazil fell even more: 5.1% and 14% in the same periods. In all, total outstanding note issue, combining banks and the Treasury, declined by 15% between December 1859 and December 1861. However, contrary to what the historiography has claimed,¹³ this was not a product of the Law of Impediments. Instead, it was an inexorable consequence of the way in which contemporaries had entrusted the Bank of Brazil with “improving” the quality of the circulating medium - by withdrawing Treasury notes from circulation - combined with the rules that bound the Bank’s issues to its reserve fund. For the Bank, the only way to circumvent the scaling down of its operations would have been either through the importation of specie, or by means of a capital expansion, which would bring more gold or Treasury notes into its vaults.

Although the immediate effect of the Law of Impediments on the banks’ issuing limits appears to have been exaggerated, there is no doubt that contemporaries had real grounds to oppose the government’s attempt at restoring convertibility. The reason being that the rules imposed on the existing banks of issue were virtually impossible to comply with in practice, given the scarcity of gold. In fact, apart from the Bank of Brazil and, later, the Bank of Pernambuco, no other bank would opt for declaring full convertibility of their notes. As a result, they were either forced to undertake a gradual reduction of their outstanding circulation or forego their issuing rights altogether. Most of those that opted out of instituting a fully gold-back circulation did so for good reasons. Convertibility would have meant that these banks, while still being required to accept Treasury notes, would not be allowed to give Treasury paper in exchange for banknotes presented to them for redemption. In giving gold in exchange for their notes, issuing banks would have to make increasing use of metallic currency, leading to a depreciation of Treasury paper.¹⁴

¹² As noted in Section 3.4.1, this problem had been diagnosed by Mauá, in his testimony to the inquiry into the 1857 crisis. See *Comissão de 1859*, Annex A, p. 95.

¹³ See, for example, Cavalcanti, *O Meio*, Vol. 2, pp. 265 ff.; and Guimarães, “Bancos”, Section 4.1.

¹⁴ This point was made in the petition sent by the Bank of Bahia to the Chamber of Deputies on 28 June 1859, transcribed in T. de Azevedo and E. Q. V. Lins, *História do Banco da Bahia, 1858-1958* (Rio de Janeiro, José Olympio, 1969), p. 145.

As expected, the Bank of Brazil was thoroughly unhappy with the government measures, as outlined in Law 1083 and Decree 2685. Its board of directors commissioned five of its major shareholders, including Mauá and the private banker Antônio José Alves Souto, to look into the matter. The presence of Mauá and Souto in the commission - two advocates of expansionist monetary policies - showed up in the final report, published in 1861.¹⁵ The main point in the report referred to the illegal nature of the 1860 legislation, given that it unilaterally altered crucial provisions of the 1853 contract signed between the government and the Bank. Second, amongst the changes implemented by the government was the requirement that the Bank move towards introducing convertibility of its notes into gold, when its statutes expressly authorised it to redeem its notes into either gold or paper money. The fundamental contradiction inherent in the 1860 Law was clearly perceived by the shareholder commission. As just noted, while the government required convertibility of Bank of Brazil notes into gold, its own currency (Treasury notes) remained inconvertible.¹⁶ In essence, the government was demanding that the Bank help it bring the rate of exchange back to par, although approximately 40% of the money in circulation was made-up of currency issued by the Treasury, not the Bank.¹⁷ Clearly, the Bank would be at a disadvantage if forced to accept paper money while being required to give gold in exchange for its own notes.¹⁸ Finally, on the question of the privileges and obligations with which the Bank was entrusted in 1853, the commission admitted that the establishment had benefited from having its notes accepted in payment of taxes, as well as being exempt from the payment of stamp

¹⁵ See Banco do Brasil, *Parecer Apresentado à Assembléa Geral dos Accionistas do Banco do Brasil pela Comissão Especial Eleita em 2 de Maio de 1861* (Rio de Janeiro, Villeneuve, 1861).

¹⁶ On this basic shortcoming of the 1860 Law, see also J. R. Dunlop, *Curso Forçado* (Rio de Janeiro, Typ. Nacional, 1881), p. 38. Actually, this contradiction had been in place ever since the Bank was created, although until 1860 it had the option, which it exercised, of giving Treasury notes, instead of gold, in exchange for its own notes. With the Law, the Bank was required to redeem its paper into gold whenever demanded by noteholders. See A. de A. F. Jacobina, *Esboço de Estudo para a Volta dos Pagamentos em Ouro no Brazil ou Conversão do Papel-Moeda* (Rio de Janeiro, Laemmert, 1881), p. 8.

¹⁷ Banco do Brasil, *Parecer Apresentado à Assembléa*, p. 13. Having stabilised at near par between the end of the 1857 crisis (in August 1858) and early 1859, when the Bank of Brazil once again left gold, the value of the *milréis* oscillated around a declining trend for the next six months. It reached a low of 24d on the eve of the Law of Impediments, giving the government all the motivation it needed to take action and restore the *milréis* to the 27d parity. Hence, Art. 6 of Decree 2685, stipulating the goal of a fully gold-backed circulating medium.

¹⁸ *Ibid.*, pp. 6-7.

duty. On the negative side, however, the Bank claimed that the requirement that it withdraw from circulation 10,000 *contos* in Treasury notes, interest-free, for the duration of its 30-year contract, amounted to a foregone revenue estimated at 46,000 *contos* (!) at the going rates of interest.¹⁹

The government was not convinced by these arguments and the *Relatório da Fazenda* of 1861 was happy to inform that all existing banks of issue immediately adjusted their operations so as to comply with the limits set out in Decree 2685. Banks created by government decree in 1857 and 1858 took advantage of Art. 5 of the new decree and proceeded to swap the railway shares which served as guarantees to their issues for *apólices*. The idea was that bonds of the consolidated debt represented better collateral than railway shares, for backing banknotes. Ultimately, these bonds could be sold by the banks and used to purchase gold to build-up a metallic fund.²⁰

To sum-up the argument so far, the research has shown that there was indeed a monetary contraction in the years immediately after the Law of Impediments was launched. At the same time, it was argued that this contraction was largely due to factors beyond the 1860 Law, namely, the continuing withdrawal by the Bank of Brazil of Treasury notes from circulation. Be that as it may, it must be stressed that overall economic performance in the early 1860s was far better than would have been expected from the fall in the money supply.²¹ Government revenue, for example, increased by 20% between the 1859/60 and 1861/2 financial years, to 52.5 thousand *contos*.²² The deficit, in turn, was brought to its lowest level in more than a decade. During the same period, total foreign trade (imports and exports) increased more

¹⁹ Ibid., p. 10.

²⁰ *RMF* 1861, p. 17.

²¹ The rate of exchange, which in August 1860 had been oscillating around 26d, recovered some ground and stood at par at the end of the year. The rate of discount averaged 9%, and bonds of the consolidated imperial debt were quoted at 106. However, not everything was good news in the Empire. During the second half of the year the province of Bahia experienced a severe commercial crisis, following crop failures in the coast during the previous two years, as well as the drought which had been consuming the interior (*sertão*) of late. The drop in the note circulation of the Banco da Bahia (see Table 4.1) only made matters worse. For the view of an obsequious functionary, who praised the Law of Impediments for preventing an even deeper crisis in the province, see “Relatório do Fiscal do Banco da Bahia”, in *RMF* 1861, Annex K.

²² See Table A9, in the Statistical Appendix.

modestly - just 4%.²³ Still, the £1 million surplus observed in 1861/2 would usher in a whole decade when exports exceeded imports, largely as a result of the performance of the coffee sector.²⁴ The question immediately arises as to how these two opposing trends could coexist, that is, a substantial reduction in the money supply and economic expansion. One possible explanation can be better understood by reference to the equation of exchange:²⁵

$$MV = PT$$

which states that the quantity of money in circulation (M) times the “velocity” of money (V) must be identical to the product of real output (T) times the price level (P). It is highly likely that in the mid-nineteenth century prices were generally flexible. As a result of this “non-stickiness” of prices at the time, it is possible that the monetary contraction of the early 1860s was accompanied by a fall in the price level to such an extent as to allow some expansion of real output.²⁶ A second, more plausible, explanation - which does not exclude the above mechanism - involves a problem referred to in Chapter 2, namely, the nature of the monetary series calculated by Peláez and Suzigan, and used in the thesis. Essentially, their estimates comprise solely money supplied by the government and joint-stock banks. Yet, it is widely known that private banks, and even individuals, issued all sorts of *vales*, which performed a role akin to notes. Given that the monetary contraction observed in the early 1860s refers only to paper issued by the Treasury and joint-stock banks, there remains the possibility that *vale* circulation may have increased after 1860, taking up the void left by “traditional” forms of money. This scenario is all the more likely as the Law of Impediments imposed no limits on the operation of private banks, preferring, instead, to regulate the issue of notes by joint-stock banks.²⁷

²³ See Table A18, in the Statistical Appendix.

²⁴ See Table A20, in the Statistical Appendix.

²⁵ The argument that follows is based on J. Attack and P. Passell (eds.), *A New Economic View of American History* (New York, Norton, 1994, 2nd edn.), pp. 102-3.

²⁶ As it stands, this is just a conjecture. Lack of reliable estimates of either P, V or T for Brazil at the time preclude any firmer claim as to the actual operation of this adjustment mechanism.

²⁷ This point will be taken up in more detail below. On the political front, parliamentary elections in 1861 brought a reinvigorated Liberal party to the Chamber. Even though in actual numbers Liberals only managed to increase their representation by a few seats (reaching about 20% of the total), internal divisions within the Conservatives meant that the position of Ferraz as Prime Minister became

In April 1861 the Bank of Brazil finished withdrawing the last lot of Treasury notes, as mandated by the 1853 Law. These 10,000 *contos*, as already noted, would be repaid, interest-free, upon expiry of the Bank's contract. From then on each additional instalment (of 2,000 *contos* annually) would correspond to a loan to the government, receiving quarterly interest. The burden of phasing-out the remaining paper in circulation was now clearly with the government. It would either have to rely on budget surpluses, or resort to the issue of *apólices* and *bilhetes*, in order to pay the Bank for its services.²⁸ In the meantime, the Rural & Hipotecário and the Comercial & Agrícola, under great pains to comply with the limits set out in Table 1 of Decree 2685, began talks with the Bank of Brazil with a view to transferring their issuing powers to it. In practice, this would have made the Bank the sole issuer in the capital.

Plans to reinstate the monopoly of note issue (at least in Rio) began circulating in the Bank of Brazil in April 1861, but failed to draw much enthusiasm from the directors.²⁹ Meanwhile, and as mandated by the new legislation, the Bank was required to start retiring its notes at a rate of 3% a year, from August 1861 onwards.³⁰ This was a result of its unwillingness to resume convertibility of its notes, due to the shortage of specie in the provinces, which would have prevented *caixas filiais* from complying with the 1860 Law.³¹ In early 1862 the question of a merger, which would partly compensate the reduction of the Bank's circulation, was again brought up. This time the directors of the Bank of Brazil nominated a commission to look into an offer

untenable. He did not wait for the Chambers to reconvene before resigning. On 2 March 1861, a new cabinet was formed, under the presidency of Caxias, whose right arm would be José Maria da Silva Paranhos (Visconde de Rio Branco). Paranhos was born in Salvador, Bahia, in modest circumstances. He was trained as a mathematician and graduated from the Military School, in Rio, where he would later become a lecturer in the disciplines of Artillery, Mechanics, Statistics and Political Economy. It was as a diplomat, however, that he excelled, having been chief negotiator of the imperial government in several missions to the River Plate region. In 1871 he would be appointed Prime Minister and Minister of Finance, positions which he occupied for over four years, the longest cabinet in the history of the Empire. See Pinto do Carmo, *Ministros*, pp. 163-8.

²⁸ *RMF* 1862, p. 26.

²⁹ Pacheco, *Banco do Brasil*, Vol. III, p. 314.

³⁰ Banco do Brasil, "Actas", session No. 571, 18 February 1861, AD 005/11-A.

³¹ In a memorandum sent to Minister Ferraz on 22 February 1861 the president of the Bank asserted that the head office was already in a state where it could declare resumption of its notes, although that was not yet the case with the provincial offices. Rather than have only part of the Bank on gold, which would have been illegal, it was decided that the Bank would have to abide by Art. 1, para 2, of the 1860 Law and, therefore, start retiring notes of smaller denomination in both Rio and the provinces. See *RMF* 1861, p. 16.

to be made to the two other issuing banks in the capital (the Rural & Hipotecário and the Comercial & Agrícola) to cede their issuing rights to the Bank.³²

The commissioners were keen to point out the advantages that would accrue to the Bank of Brazil in having the Comercial & Agrícola leave the market.

The Bank frees itself from a competitor that immediately retires from circulation 7.237:900\$. And since neither the government, nor any private establishment, can issue notes that might fill the vacuum left by the notes of the Banco Agrícola, then clearly it is 7.237:900\$ that the Bank of Brazil must issue and circulate, thus augmenting its own portfolio.

Without discussing the great questions related to banking unity and looking at the agreement (...) solely from the point of view of the Bank's interests, it is evident that it has a lot to gain from the liquidation of the Banco Agrícola. It is of the Bank's interest, and duty, to constitute itself, as far as possible, as the regulator of the circulating medium and, in this regard, the difficulties arising from competition are as manifest as the advantages that come with liberty of action.³³

Having decided in favour of acquiring the issuing rights of the other two banks, the directors forwarded a proposal to the government. After hearing both the Finance Standing Committee of the Council of State and, afterwards, the Conselho Pleno, it was decided that the Legislative should give the final blessing to any such deal.³⁴ A project presented to the Chamber of Deputies was approved with few changes and virtually without debate. In the Senate, however, it attracted harsh criticisms from Souza Franco, who claimed that it only served to lend credence to allegations that the recent legislation was meant to drive the competitors of the Bank of Brazil out of the market.³⁵ The proposal was approved after two more sessions of debates in the Senate, and the final decree regulating the deal was issued on 9 September 1862.³⁶ In essence, it entailed an increase in the Bank's capital (from 30,000 to 33,000 *contos*), the liquidation of the Comercial & Agrícola, the cession of the issuing rights of the

³² See *Parecer da Comissão Especial Nomeada Pela Directoria do Banco do Brasil d'Entre Seus Membros, Sobre a Conveniencia de Negociar-se com os Bancos Commercial e Agrícola e Rural e Hipotecário, a Cessão ao Banco do Brasil do Direito que Aquelles Bancos Tem de Emittir Notas à Vista e ao Portador* (Rio de Janeiro, Typ. do Correio Mercantil, 1862).

³³ *Ibid.*, p. 9

³⁴ Session on 10 July 1862, in *ACE*, Vol. V, pp. 278-94.

³⁵ Pacheco, *Banco do Brasil*, Vol. III, pp. 323-7. Fear of the Bank of Brazil abusing a monopolist position had already been manifested by Souza Franco in the debates held at the Council of State on 10 July 1862. On that occasion he branded as an 'odious privilege' the Bank's plea to retain monopoly of issue for the next twenty years in the places where it operated. See *ACE*, Vol. V, p. 287.

³⁶ Decree 2970. For details, see Pacheco, *Banco do Brasil*, Vol. III, pp. 327 ff.

Rural & Hipotecário to the Bank of Brazil and the withdrawal of the notes of the two smaller banks from circulation. In return, the Comercial & Agrícola received Bank of Brazil shares, and the Rural & Hipotecário would be paid 400 *contos* to relinquish its note-issuing activities, although it would continue to operate as a deposit and discount bank.³⁷

In September 1862 the city of Rio experienced a dress rehearsal of what would later turn out to be the major commercial crisis in the history of the Empire. A seasonal drain of specie, once again, was credited with causing illiquidity in the capital. Resources were being channelled to finance the booming cotton sector in the province of Maranhão, which had benefited from the outbreak of the American Civil War.³⁸ Several private banks (*casas bancárias*) in Rio went under, and those that survived required the assistance of more liquid institutions in the market.³⁹

In the meantime, the deal signed between the Bank of Brazil and its competitors in Rio gave it some breathing space but not enough to allow complacency. On 23 October the Bank finally resumed convertibility. But, given

³⁷ Peláez and Suzigan, *História Monetária*, p. 103. Earlier that year, in May, the opposition in the Chamber of Deputies gave signs of stepping-up its pressure on the Conservative cabinet headed by Caxias. Moderates from both parties formed the embryo of what would later become the Progressive League (Liga Progressista), and directed their attacks on the old-time Conservatives, whom they accused of ‘waging war on the Liberals, excluding the Moderates and, even, despising the Independent Conservatives (...)’. Speech pronounced by Nabuco de Araújo in the Senate in 1862, cited in Nabuco, *Um Estadista*, Vol. I, p. 435. This speech went down to history as the *uti possidetis* and would exert a marking influence in later events. Essentially, Nabuco was expressing the view that in order to preserve the system itself, changes would have to be made so as to provide the basis for a lasting truce between Liberals and Conservatives. His speech served to catalyse the oppositionist spirit, and on 21 May 1862, a vote on an amendment to the Speech From the Throne revealed that the Conservative cabinet was in a minority in the Chamber. The cabinet sought from the Emperor dissolution of the Chamber but, fearing a new election that could boost the opposition even further, Pedro II waited for the dismissal of the Prime Minister and his cabinet. The new government was to be headed by deputy Zacarias de Góis e Vasconcelos, leader of the Liberal minority in the Chamber. Breaking with tradition, for the first time the Emperor drew his Prime Minister from the lower House, and not the Senate. The new experiment was short-lived, however, and the leader of the Progressive opposition in Parliament would retain his new post for just three days. Having lost in the first voting that took place after it came to power, Zacarias took the result as a vote of no confidence in the new administration and, following the usual procedure at the time, asked that the Chamber be dissolved. Once again the Emperor refused to comply with the request and opted instead to invite Pedro de Araújo Lima (Marquês de Olinda) to form a new government. Nabuco, *Um Estadista*, Vol. I, pp. 439-442. The very short life of what would be the first Zacarias cabinet rendered it the name of *gabinete dos anjinhos*, or cabinet of the “little angels”, the expression in Portuguese for dead children. The Olinda cabinet, in turn, went down as the “cabinet of the elderly”, in reference to the average age of its members. See Iglésias, “Vida Política”. Earlier, Pedro II had vetoed Zacarias’ choice of Minister of Finance, none other than Souza Franco. See Caldeira, *Mauá*, p. 389.

³⁸ Schulz, *A Crise*, pp. 41-2.

³⁹ *Ibid.*, p. 42.

difficulty in procuring gold for the reserve fund, and in view of the increasing volume of Treasury bills (*bilhetes*) it was being asked to discount, the limits on its issues were fast being approached.⁴⁰ At the end of 1862 the Bank once again sought permission from the government to increase its leverage from 2:1 to 3:1, to no immediate effect.⁴¹ As feared, on 31 December the combined issues of the head office and the *caixas filiais* in Ouro Preto and São Paulo stood at 25.8 thousand *contos*, 1.3 thousand more than permitted.⁴² This excess would remain until 28 February 1863, when Decree 3054 finally allowed the Bank to expand total issues to three times the reserve fund. The government insisted that this was a temporary measure, to last for six months, until conditions improved. At the same time, the decree forbade the Bank from increasing the rate of discount, so as not to cause further distress to the market. This was a marked shift from earlier occasions, when interest-rate hikes were invariably prescribed to deal with monetary pressures.

Relaxation of the issuing limit, as noted, ran counter to the recommendations of the Finance Standing Committee, which had convened earlier to examine the Bank's request.⁴³ On that occasion, Itaboraí and the Visconde de Jequitinhonha⁴⁴ opposed granting permission for the Bank to increase its note issue to three times the reserve fund. Itaboraí, who was the *rapporteur* for this case, suggested, instead, that the Bank rely on other measures to increase its circulation, such as a capital expansion and the acceptance of interest-bearing deposits.⁴⁵ The third member of the Committee, Cândido Batista de Oliveira, who at the time was also the president of the

⁴⁰ In the *Relatório da Fazenda* of 1863 Minister of Finance Marquês de Abrantes acknowledged that part of the difficulties that the Bank had been experiencing lately derived from 'the needs of the Treasury, not only in December, but also in January, to which the Bank responded immediately, confident in obtaining the increase of its issues to three times (its reserve fund), requested on 4 December 1862'. Cf. *RMF* 1863, p. 23.

⁴¹ On that occasion the government heard the Seção de Fazenda of the Council of State, as well as businessmen operating in Rio, but decided that in order to preserve the spirit of the 1860 Law the Bank's request should not be met, 'lest the risks and dangers (of the days) before the Law return'. *Ibid.*, p. 20.

⁴² *Ibid.*, p. 23.

⁴³ Resolution No. 726, in *SFCE*, Vol. V, pp. 359-368.

⁴⁴ Francisco Gê de Acaiba Montezuma, a *bahiano*, journalist, jurist, and diplomat. Senator for the province of Bahia, he was one of the founders of the Bar Association (Ordem dos Advogados) and of the Instituto Histórico e Geográfico Brasileiro. Tavares de Lyra, *Instituições*, pp. 257-8.

⁴⁵ Indeed, both a capital expansion and the acceptance of *dinheiro a prêmio* would have provided the Bank with new resources. Yet, they would impact the returns earned by current shareholders and, as such, were bound to meet opposition within the Bank.

Bank, unsurprisingly pressed the case for the need to change the limit on note issues. In support, he pointed out earlier instances when relaxation of the limit had been granted under less favourable circumstances, that is, when notes were not required to be convertible into gold, as they now were.⁴⁶ The Finance Standing Committee, by two votes to one, decided against the Bank's request, but this did not stop the government from issuing Decree 3054.

The Bank gladly welcomed the first part of the decree, concerning the elevation of its issuing limit, but staunchly opposed any official curb on its autonomy to set interest rates.⁴⁷ After all, it considered the setting of discount rates primarily as a commercial decision, which had to be taken with the interests of its shareholders in mind and, secondarily, in light of the needs of the market. This position did not go down well with the government and, as a result of it, the Emperor referred the subject to the 12-member Conselho Pleno. The three points on which the councillors were asked to deliberate were: (i) should the restrictions on the interest rates charged by the Bank be lifted; (ii) if not, would an increase in interest rates be the best way to discourage redemption of the notes of the Bank; and (iii) should the Bank be allowed to suspend convertibility, in order to diffuse the current pressure on its reserve fund?⁴⁸ All of the councillors, including Cândido Batista, were opposed to suspension of convertibility, insisting that it should only be used in an emergency. Points (i) and (ii) were, in essence, linked, and most members voted for the outright revoking of Decree 3054, thus taking the Bank back to its original 2:1 limit, on 16 March.⁴⁹ After tempers cooled the Bank once again approached the government, pointing out the difficulties which a prompt return to the lower limit would cause to the market. At the same time, the Bank insisted on obtaining the proposed increase in its issuing powers. In response, the government showed sympathy to the idea of proceeding back to the lower limit slowly. However, it adamantly refused to accede to the renewed demands for the 3:1 ratio, lest this jeopardise the strategy of eventually achieving a fully-backed circulation in the Empire once all inconvertible Treasury

⁴⁶ *SFCE*, Vol. V, p. 367.

⁴⁷ Pacheco, *Banco do Brasil*, Vol. III, pp. 338-9.

⁴⁸ *ACE*, Vol. V, pp. 348-61.

⁴⁹ Decree 3062.

notes had been retired.⁵⁰ Shortly afterwards, the Bank was back within the legal limits on its note issues, as a consignment of gold coins imported from Britain increased the reserve fund.⁵¹

February 1863 saw the arrival of the first foreign bank in Brazil, the London and Brazilian Bank, followed in July of the same year by the Brazilian and Portuguese Bank (later, the English Bank of Rio de Janeiro).⁵² Even though these banks did not engage in issuing notes they would play an important role in the Brazilian market. As pioneers of “modern”, and comparatively conservative, banking principles in a backward market, they emphasised high cash reserves and the need for self-liquidating loans.⁵³

Discounts were to be confined to paper with no more than three months to run, bearing two good names and a guarantee from a third party. The renewal of bills beyond their normal tenure was prohibited. Under no circumstances were advances to be made against growing crops, and if goods were pledged as securities, no advance was to exceed two-thirds of their market value.⁵⁴

This overcautious approach to business, in an environment where personal relations (and a “man’s word”) were common practice, definitely helped to estrange foreign bankers from most of the local community. More importantly, it frustrated the hopes of those contemporaries who expected a lot from these banks. Contrary to what many had anticipated, foreign banks brought little outside capital into the country and, once established, proceeded to attract business from existing banks. Finally, their short-term lending, in line with the best practice of British commercial banks, was deemed unfit for the needs of a capital-poor economy, like Brazil.⁵⁵ Still, the arrival of the first foreign

⁵⁰ At the end of 1862 outstanding Treasury notes amounted to 31.3 thousand *contos*, while banknotes had reached a value of 45.7 thousand *contos*. Figures are from IBGE, *Estatísticas Históricas*, Table 10.4.

⁵¹ Banco do Brasil, *Relatorio* 1863, p. 7.

⁵² The classic account of the operation of the English banks in Brazil is D. Joslin, *A Century of Banking in Latin America* (London, Oxford University Press, 1963). The London and Brazilian Bank had been incorporated in London in June, with a capital of £1,000,000. A few months later it took over the business of the Anglo-Portuguese Bank, in Portugal. See *Banker’s Magazine*, Vol. 22, June 1862, p. 393. The Brazilian and Portuguese Bank was also formed with a capital of £1,000,000, on 3 July 1863. *Banker’s Magazine*, Vol. 23, August 1863, pp. 638-9.

⁵³ On the conservative practices of the English banks, and the resentment generated in Latin American countries, see C. Jones, “Commercial Banks and Mortgage Companies”, in D. C. M. Platt (ed.) *Business Imperialism, 1840-1930: an inquiry based on British experience in Latin America* (Oxford, Clarendon Press, 1977).

⁵⁴ Joslin, *A Century*, p. 67.

⁵⁵ Jones, “Commercial Banks”, pp. 36 ff.

banks also had a deeper significance. These were establishments that perceived the potential gains to be made in a growing market. But, crucially, they did not seek to become banks of issue, but rather to operate with deposits and discounts. Their subsequent success served to show that gaining the right to issue notes was not a prerequisite for expanding business, nor the only available means to support commercial activity.

On 18 May 1863, shortly after the arrival of the London and Brazilian Bank, additional signs of what would be a major financial crisis were looming on the horizon. The *casa bancária* of Antônio José Alves Souto & Cia. (Casa Souto), Rio's largest non-corporate private bank, sent an urgent request to the Bank of Brazil. It asked for the 'necessary amount (of money) to satisfy the commitments of that day, given that the resources with which it was counting were not forthcoming'.⁵⁶ In spite of the reluctance of some directors, who pointed to Souto's virtual insolvency, the Bank raised their credit limit from 14 thousand to 20 thousand *contos* (£2.3 million).⁵⁷

For much of the remainder of 1863 and well into 1864 the minutes of the meetings of the directors of the Bank of Brazil reveal little but discussions over the day-to-day operations of the Bank, the exception being allegations of mismanagement in the operation of some of its *caixas filiais*.⁵⁸ This state of relative tranquillity was reflected in the introductory remarks to the report of the commission that investigated the subsequent events of September 1864.⁵⁹

Commerce in general had been undergoing a liquidation of sorts, and after continuous suffering and losses it had adopted a more solid system, and arrived at a relatively more prosperous state. Alongside moderate imports there were sufficient exports; arrears were on the decline and commerce displayed a satisfactory aspect. Our general import and export trade with foreign countries increased 13.92% in 1863-4, compared to 1862-3. Public taxes collected in the Court and province of Rio de Janeiro in 1863-4 (...) amounted to 28 thousand *contos*, an increase of 3.5 thousand on the year before. Prices of foodstuffs had not increased. If there was not

⁵⁶ Meeting of the Board of Directors of the Bank of Brazil on 18 May 1863, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 7.

⁵⁷ *Ibid.*, p. 8.

⁵⁸ *Ibid.*, pp. 8-10.

⁵⁹ *Comissão de 1864*, Introduction.

money in abundance (to use the popular expression) at least no shortage of capital was being felt.⁶⁰

At least on the surface things appeared calm as far as the economy was concerned. At the political level, however, the remarkable ministerial instability that followed the end of the *Conciliação* period continued. After a humiliating defeat for the Conservatives in the parliamentary elections of January 1864, when they were left with just a single deputy in the Chamber, the Olinda cabinet resigned. This opened the way for the return of Zacarias de Góis and his Progressive Party. This time, his tenure in office lasted eight months, after which a new Progressive-Liberal government was installed, on 31 August, under the leadership of Francisco José Furtado.

4.2 - The Souto Crisis and its Aftermath

Shortly after the new cabinet had taken office, the city of Rio de Janeiro was hit by the worst commercial crisis in its history. At around 10 a.m. on 10 September, and without prior notice, José Antônio Alves de Souto suspended operations at his bank, in the centre of town. The news soon spread to the rest of the city, leading to a run on other *casas bancárias*. At 3:00 p.m. a mass of people had gathered in the financial district of Rio de Janeiro, at the Rua Direita, demanding prompt redemption of paper issued by the main banks. Police were called to ensure the safety of bankers and prevent disturbances.⁶¹ The Bank of Brazil, unlike most of its competitors, was not subject to a run. Gold withdrawals from its reserve fund on 10 September amounted to just over five *contos*. On that day it did, however, act as a lender of last resort, helping *casas bancárias* to the tune of 2,870 *contos*, most of which was taken-up by the house of Montenegro, Lima & Co.⁶² Unlike the events of 1857, the Bank of Brazil was keenly aware of its crucial position in the Rio money market.⁶³

⁶⁰ *Ibid.*, cited in Cavalcanti, *O Meio*, Vol. 2, pp. 274-5. Needless to say, this reference to prices of foodstuffs that ‘had not increased’ (in the early 1860s) does not amount to the price deflation which would have ensured the co-existence of monetary contraction and output growth alluded to earlier in the chapter.

⁶¹ *Comissão de 1864*, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 27.

⁶² *Ibid.*, p. 29.

⁶³ This point will be elaborated in Chapter 7.

Accordingly, it spared no efforts in providing discounting facilities for institutions experiencing hardship. At the same time, it sought support from the government in allowing a relaxation of the limits on note issues, and the suspension of convertibility.⁶⁴

Contemporaries initially claimed that the Bank of Brazil precipitated the crisis, by refusing to advance Souto a “mere 900 *contos*” to help it settle its commitments on that fateful September day.⁶⁵ This is not an accurate description of the events. The minutes of the extraordinary meeting of the board of directors of the Bank of Brazil, convened on 10 September at 2:00 p.m., reveal that the house of Souto had never asked the Bank to advance that amount. Instead, they show that Souto had simply approached an inspector of the Bank (Coelho de Castro) and sought his advice on how to proceed in face of its adversities, to which Castro replied with the recommendation that Souto suspend operations.⁶⁶ The extraordinary board meeting decided that the Bank suggest to the government the liquidation of the Casa Souto, under the supervision of its main creditors. The Bank felt that small investors should have priority in receiving their money, after which the remaining creditors would attempt to agree on conditions for the final liquidation. To that end, the Bank would be willing to receive on deposit the outstanding bills of small investors, paying interest at 5% p.a. Should the investors instead prefer prompt payment, it would advance them the money, so long as the government guaranteed the Bank the corresponding 5% interest. Finally, the Bank said that it was only awaiting a signal from the government before proceeding to help smaller creditors.⁶⁷

The next day, the president of the Bank of Brazil presented this proposition to the recently-appointed Prime Minister, Francisco José Furtado. After hearing the joint session of the Finance and Justice standing committees of the Council of State, the government stated that it was in principle sympathetic to the idea and would do its utmost to help the Bank. However, it alleged that it could not go ahead with the

⁶⁴ Banco do Brasil, *Relatorio* 1865, pp. 5-12.

⁶⁵ See *Comissão de 1864*, Annex, p. 52.

⁶⁶ See Banco do Brasil, “Actas”, session No. 811, 10 September 1864, AD 007/11-A. Contemporary estimates put Souto’s debts with the Bank of Brazil alone at the outbreak of the crisis at 14,000 *contos* (£1.6 million). See Soares, *Esboço*, p. 51.

⁶⁷ Pacheco, *Banco do Brasil*, Vol. IV, p. 31.

liquidation, for this would give rise to a conflict between the ‘constituted powers’.⁶⁸ Later that night, the Ministers of Finance and Agriculture went over to the headquarters of the Bank of Brazil. Although acknowledging the gravity of the situation, they argued that the government could not commit itself to any “extralegal” rescue operation unless the Bank could assure them of the final success. Obviously, it could not guarantee anything, and the meeting ended at 2:00 a.m. on 12 September without any decision being taken.⁶⁹ During the course of that day renewed appeals were made to the imperial government to take action to quell the panic. Once again the official position was one of indecision. The next day crowds gathered at the doors of the Bank of Brazil and demanded prompt redemption of its notes in gold. Several *casas bancárias* decided to shut that day, signalling their incapacity to honour payments any further. At the sight of the throng outside, which prevented the entrance of its president, and in the face of a clamour for gold that threatened its reserves, the Bank once again turned to the government. This time it requested the ‘suspension of all payments in this market for 30 days, in view of the extraordinary and abnormal circumstances, so as to allow for, in the meantime, the adoption of the necessary measures demanded by commerce (...)’.⁷⁰ The Bank of Brazil claimed that the sheer amount of discounts it had performed over the previous two days (close to 13,000 *contos*) could not be kept up for long without a severe loss of gold.⁷¹ Furthermore, and in order to allow it to carry on its rediscounting activities with the *casas bancárias*, the Bank also sought an extension of its issuing limit to three times the value in the reserve fund.⁷² The government allowed an increase in the Bank’s

⁶⁸ Banco do Brasil, “Actas”, session No. 812, 12 September 1864, AD 007/11-A. It is not exactly clear what those “constituted powers” were, if the interests of other commercial houses and investors, or the Legislative.

⁶⁹ Ibid.

⁷⁰ Memorandum sent by the Bank of Brazil to the imperial government on 13 September, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 34. At the time the Bank had clearly broken the limits on its issues, its reserve fund amounting to 10.9 thousand *contos*, while outstanding issues exceeded 35.9 thousand *contos*. Ibid., pp. 34-5.

⁷¹ Between 12 and 14 September the *fundo disponível* lost almost 3,000 *contos*. Figures from “Banco do Brasil: Quadro do Troco Realizado em Moeda Metálica em Setembro de 1864”, in the Annex to *Comissão de 1864*. Later, it emerged that some 90% of the gold losses (2,800 *contos*) had been due to shipments made by the Mauá, MacGregor Bank to its offices in the River Plate, apparently in a move to pre-empt a run on them upon arrival of the news of the crisis in Rio. Pacheco, *Banco do Brasil*, Vol. IV, p. 53.

⁷² The run on the *casas bancárias* in Rio put them in a very delicate position, given that while they had borrowed short their assets were often immobilised in long-term rural loans. This left them to rely on

leverage, through Decree 3306, 13 September. On 14 September suspension of convertibility was also decreed ‘for the time being’, and Bank of Brazil notes were made legal tender in the provinces where they had been issued.⁷³

On 15 September, the Bank and the Rural & Hipotecário sent a joint petition to the Emperor. They proposed that while the Legislative did not convene extraordinarily, the government supervise the process of liquidating banks with liabilities in excess of 10,000 *contos* and that had closed their doors.⁷⁴ In other words, both banks were urging the government to take an administrative act in order to tackle the crisis of confidence in the market.⁷⁵ On the same day, the views of the Justice and Finance standing committees of the Council of State were heard informally by the Emperor.⁷⁶ On the occasion, commissioners refused to sanction a step that would have implied going against commercial law, which established that it was up to the courts to decide on similar issues.

As tension in the market (and on the streets of Rio) rose, the Emperor decided to turn once again to his councillors in search of guidance. This time, the Justice and Finance Committee agreed with the suggestions put forth by the Bank of Brazil and the Rural & Hipotecário. The Conselho Pleno was held on the same day (16 September) at 21:00 and endorsed the opinion of the Committee. They consisted, basically, of enacting provisional rules for the liquidation of private banks, the appointment of inspectors to oversee liquidations, and the adoption of a 30 to 60-day moratorium on both bankruptcies and the payment of bills, *vales* and other commercial paper.⁷⁷ Accordingly, on 17 September the government issued Decree 3308, mandating a 60-day moratorium on all payments in the Court and province of Rio de Janeiro. This was one of the most controversial measures in the package adopted by the government, because it ran counter to the provisions of the

the Bank of Brazil to provide the necessary liquidity to meet the demands from panic-stricken clients. See *RMF* 1865, p. 13. This point will be examined in more detail in Part III.

⁷³ Decree 3307. Note that although the decree made no reference to the *caixas filiais* the Bank interpreted it as extending the new limit to its provincial offices as well.

⁷⁴ *Comissão de 1864*, Annex, p. 36.

⁷⁵ As already noted, the Bank of Brazil had made a similar proposal on 11 September, the day after Souto & Cia. shut its doors, to no avail.

⁷⁶ Nabuco, *Um Estadista*, Vol. I, p. 468.

⁷⁷ *ACE*, Vol. V, pp. 393-7.

Commercial Code. In practice, it prevented creditors from claiming their assets, while sheltering both bona fide and unscrupulous bankers from these very claims.⁷⁸ Subsequently, Decree 3309, of 20 September, regulated bankruptcies of both joint-stock banks (*bancos*) and, especially, private banks (*casas bancárias*). The usual provisions of the Commercial Code did not cover the latter, so that the new legislation was addressing the special circumstances of the moment.

The Bank raised the discount rate from 8% to 9% on 26 September, then to 10% on 8 October, where it remained until 12 April 1865.⁷⁹ Monetary expansion was unequivocally pursued this time.⁸⁰ Between August and September the total amount of Bank of Brazil notes in circulation increased by 30%, to 62.7 thousand *contos*.

Table 4.2
Bank of Brazil: Notes in Circulation and Portfolio
Balances, July 1864 - June 1865
(in *contos*)

Date	Head Office		<i>Caixas Filiais</i>		Total	
	Notes in Circulation	Portfolio Balances	Notes in Circulation	Portfolio Balances	Notes in Circulation	Portfolio Balances
31 Jul 1864	25,260.5	37,831.3	23,785.1	4,447.3	49,045.6	42,278.6
31 Aug	25,167.3	38,310.4	23,152.8	4,326.3	48,320.1	42,636.7
30 Sep	42,333.4	67,082.3	20,394.4	4,450.8	62,727.8	71,533.1
31 Oct	45,790.9	68,430.7	20,866.2	5,028.3	66,657.1	73,513.0
30 Nov	45,035.5	68,408.6	22,042.2	5,341.2	67,077.7	73,749.8
31 Dec	43,168.0	63,975.6	23,270.5	6,025.0	66,438.5	70,000.6
31 Jan 1865	40,126.2	59,536.0	25,443.2	5,876.4	65,569.4	65,412.4
28 Feb	39,605.6	62,232.9	26,216.1	5,772.7	65,821.7	68,005.6

⁷⁸ Together with Decree 3308, the other piece of legislation to arouse most opposition was the appointment, by the government, of inspectors, who would oversee the liquidation of the major *casas bancárias* in difficulty (Decree 3322, 22 October 1864). Not only would these inspectors be handsomely paid (by the businesses undergoing liquidation), but also they were often leading politicians of the time. Thus, Souza Franco was chosen to supervise Casa Souto, Ferraz took the house of Gomes & Filhos, and Paranhos (Visconde de Rio Branco), Montenegro, Lima & Cia. and Oliveira & Bello. See Nabuco, *Um Estadista*, Vol. I, p. 471, footnote 2. Incidentally, both decrees (3308 and 3322) were for the most part drafted by Senator José Thomas Nabuco de Araújo, by then a highly respected jurist, but not a member of the cabinet in power. Nabuco's crucial participation in the events that followed the 1864 commercial crisis went unnoticed to most contemporaries, until they were unearthed by his son, Joaquim Nabuco, when writing the biography of Nabuco, which remains, after a century, the single most important history of the Brazilian Empire.

⁷⁹ Figures are from the statistical Annex to *Comissão de 1864*.

⁸⁰ This time, unlike the events of the 1857 crisis, suspension of convertibility and liberal lending, however belatedly, became the official strategy. The aim was to shelter the market from the inevitable monetary contraction which full operation of the gold standard would have entailed. Chapter 7 will compare the reactions to the 1857 and 1864 crises.

31 Mar	41,636.6	65,722.1	26,913.4	6,483.2	68,550.0	72,205.3
30 Apr	44,523.2	69,158.0	27,424.2	5,819.0	71,947.4	74,977.0
31 May	44,437.4	69,260.7	27,753.6	5,554.3	72,191.0	74,815.0
30 Jun	45,139.4	74,237.6	n.a.	n.a.	n.a.	n.a.

Notes: n.a. = data not available.

Source: Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas*, 1865 and 1866.

Most of this increase in outstanding note issues was accounted for by the operations of the head office of the Bank, which also discounted the bulk of commercial paper.⁸¹ The private bank of Bahia & Irmãos, for example, discounted approximately 10,000 *contos* with the Bank. The Rural & Hipotecário, Mauá, MacGregor, and Gomes & Filhos received, each, more than 5,000 *contos* from the Bank in order to meet the run on their own tills.⁸² The Bank's portfolio, as a result, increased nearly 70% between August and September 1864, from 42.6 thousand *contos* to 71.5 thousand *contos*. According to an observer, the massive increase in its discounting operations forced the Bank's directors to spend the night of 14 September signing fresh notes to be put in circulation the following morning.⁸³

Contemporaries disputed the impact of the government measures. For some, they succeeded in 'helping dissipate considerably the panic, while things got slowly back to normal'.⁸⁴ Others argued that 'the government's arbitrary measures provided a temporary truce', which in the end only benefited poorly managed banks.⁸⁵ Finally, it was claimed that 'the increased issues of the Bank and suspension of convertibility made the panic go away, and the crisis died from exhaustion (...)'.⁸⁶ These conflicting appraisals of the effectiveness of the measures adopted to deal with the

⁸¹ Provincial offices played a less prominent role in the provision of liquidity to the market, reflecting the marginal impact of the crisis outside Rio de Janeiro.

⁸² *Comissão de 1864*, p. 73. The house of Bahia & Irmãos, and the Rural & Hipotecário endured the largest withdrawal of deposits during the crisis, 16,000 and 15,000 *contos*, respectively. *Ibid.*

⁸³ See *Banker's Magazine*, Vol. 24, November 1864, p. 1006.

⁸⁴ *Jornal do Commercio*, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 39.

⁸⁵ *Ibid.* The extent of the controversy generated by the official measures implemented to tackle the crisis can be gauged by a one-page daily bulletin which began circulating on 12 September. The *Boletim Commercial* maintained a rabid anti-government, anti-Portuguese (and anti-Semitic!) tone throughout its short life of some twenty issues. The leaflet was adamantly opposed to the extra-legal measures decreed by the government, as well as the decision to expand liquidity and suspend convertibility. See *Boletim Commercial*, No. 18, 1 October 1864.

⁸⁶ Testimony collected by the enquiry into the crisis of 1864, cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 40. Unsurprisingly, the *Relatório da Fazenda* of 1865 congratulated itself (and the Bank of Brazil) for reacting to the crisis in the right manner, that is, by suspending convertibility and lending liberally. See *RMF* 1865, p. 13.

crisis were to be expected. In essence, they reflected *a priori* views on the role of the market in “punishing” malpractice, against the opinion of those who deemed government intervention necessary in such cases. With hindsight, it appears that concerted action by Bank and government did indeed provide an environment where solvent, but illiquid, institutions could survive the turmoil.⁸⁷ Be it as it may, the toll from the crisis was substantial, claiming some of the largest private banks in Rio.

Table 4.3
Souto Crisis: major commercial failures

Private Bank	Assets (in <i>contos</i>)	Liabilities (in <i>contos</i>)	Observations
Souto & Cia.	30,445.8	41,187.9	Administrative liquidation on 23 September 1864
Gomes & Filhos	18,568.2	20,219.0	Receivership on 16 March 1865
Montenegro & Filhos	9,864.3	11,831.3	Receivership on 28 April 1865
Oliveira & Bello	1,028.1	4,069.7	Receivership on 23 March 1865

Source: *Relatorio da Comissão Encarregada pelo Governo Imperial por Aviso do 1o. de Outubro e 28 de Dezembro de 1864, de proceder a um inquerito sobre as causas principaes e accidentaes da crise do mez de setembro de 1864* (Rio de Janeiro, Typ. Nacional, 1865), Table 22B.

The four private banks listed in Table 4.3 accounted for approximately 80% of losses incurred by the sector during the crisis. At the time, the assets of the Souto were second only to those of the Bank of Brazil (81,000 *contos* in 1864), which serves to show the scale of the operation of *casas bancárias*. Furthermore, the huge combined liabilities of the four major private banks that failed in 1864 suggests that the Rio money market was far larger than indicated by the operations of the joint-stock banks alone. Finally, it is worth remarking that the liabilities of A. J. Souto & Cia. amounted to about £4 million, not far from the £5 million of Overend, Gurney, which failed in London two years later.⁸⁸ This illustrates the extent of the damage caused to a market that was infinitely smaller than London.

The origins of the crisis were subject to an investigation by a commission set up by Minister of Finance Carlos Carneiros de Campos shortly after the events, in late

⁸⁷ This point will be analysed in detail in Chapter 7.

⁸⁸ See M. de P. Abreu and L. A. C. do Lago, “Property Rights and the Fiscal and Financial Systems in Brazil: colonial heritage and the imperial period”, *Texto para Discussão*, Department of Economics, PUC-Rio, No. 370, August 1997, p. 49.

1864.⁸⁹ To chair the proceedings, Campos appointed Angelo Muniz da Silva Ferraz, former Prime Minister and Minister of Finance responsible for the 1860 Law of Impediments. The two other members were José Pedro Dias de Carvalho, who had very briefly occupied the Finance portfolio in the past, and Francisco de Assis Vieira Bueno.⁹⁰ The organisation of the 1864 report was in many ways similar to its 1859 predecessor, although the final text is not as illuminating, perhaps because only 19 of the 79 individuals invited by the Commission ended up being interviewed.

In an attempt to ascertain if the 1864 crisis might have been influenced by events overseas the Commission asked to what extent similar difficulties in Europe and the American Civil War were to blame. The interviewees were unanimous in exculpating these foreign events, in support of which they pointed out the fact that coffee exports had not been affected and that cotton was actually benefiting from the conflict in the United States.⁹¹ On the crucial point (“What influence did the Law of August 1860 have on the crisis of September 1864?”), the Commission gladly reported that ‘all those heard unanimously stated that the legislation of August 1860 in no way whatsoever contributed to the crisis (...)’.⁹² It is only natural, then, to learn that ‘the Law (of Impediments) actually prevented a more severe crisis’.⁹³ In support of this claim the commissioners observed that the issuing limits imposed by that law were never reached and, therefore, could not have provoked any monetary crunch.

The above conclusions are hardly surprising, given that Ferraz, the architect of the 1860 Law, was heading the investigation. Moreover, looked at from the banks’

⁸⁹ See *Comissão de 1864*. Carlos Carneiro de Campos (3rd Visconde de Caravelas) was of *bahiano* origin. A graduate in Law and Social Sciences from the University of Paris he served in three cabinets with distinct political orientations. Under Zacarias, then a leader of the Progressive League; in 1864 with Furtado, a historic Liberal and, finally, as a member of the Conservative Paranhos government in 1871, as Minister of Foreign Affairs. Carneiro de Campos himself explained this apparent inconsistency as resulting from his being ‘a man of the government, more than of parties’. Tavares de Lyra, *Instituições*, pp. 244-5.

⁹⁰ A *mineiro* by birth, Dias de Carvalho was a teacher of Latin and local journalist. A leader of the Liberal party, he occupied the Finance portfolio on four different occasions (1848, 1862, 1864 and 1865). With the fall of the Furtado cabinet, in May 1865, Carvalho would occupy the Ministry of Finance in the incoming Olinda government. In that capacity he would appoint his fellow commissioner Bueno to the presidency of the Bank of Brazil, a post which himself had occupied (as a vice-president and acting president) in the crucial months following the 1857 commercial crisis, and again in 1861. *Ibid.*, p. 308.

⁹¹ *Comissão de 1864*, p. 74.

⁹² *Ibid.*

⁹³ *Ibid.*

perspective, in the impossibility of resuming convertibility of their notes, the limits imposed in 1860 represented a freeze on any increase in issues and, hence, discounting. Finally, the banks did not exceed the limits precisely because they were limits, and infringement would have brought heavy penalties.

Below is a summary of the main questions asked by the Commission, and excerpts from the replies given.

1. Q: What is the nature of the economic events that occurred on the 9th, 10th, and following days in September 1864?

A: The crisis of September is easily explainable. Bankers had contracted enormous obligations payable on demand, and had invested these sums in operations which could only be liquidated after a long period of time.

2. Q: What are the means by which capital is supplied to agriculture, and what influence did these operations have on the economic events of September 1864?

A: Such advancements were usually made by *casas bancárias*, by means of notes of more than four-month maturity, as well as through a system of current accounts. It seems to us that these operations had a major influence on the events of September 1864, in light of the substantial amount of such notes found in the portfolios of the banks that failed at the time. The financial embarrassment arising from these operations will become evident when the time comes to settle debts, for it implies immobilising capital that is lent, to the detriment of circulating capital.

3. Q: Were the *bilhetes* and *vales* issued by the private banks in return for money received in deposit receipts given in conjunction with current accounts, or a veiled issue of notes, as in a system of banks of issue?

A: The receipts issued to bearer by the banks that failed were in practice a covert form of issue, many times more dangerous and harmful to the public than those from circulating banks. This is because while they performed the role of currency in commercial transactions, they were not bound by any limit whatsoever, except the individual credit of the signatures they contained. In other words, this was an illicit means put in practice in order to circumvent the dispositions of the Law of 22 August 1860.

4. Q: Was the circulation of such notes, or receipts, limited, or did it replace, or compete, with government currency and notes of the Bank of Brazil?

A: The receipts that businesses draw on bankers, and which constitute actual cheques, do replace ordinary circulating medium insofar as they pass from hand to hand, before being cashed. However, this does not occur but to a very limited extent, because the commerce of Rio de Janeiro has not achieved a state of development where such a useful and simple means of payment is widespread.

As to the possibility of preventing similar crises in the Empire the report came up with a comprehensive list of elements that indicated possible sources of instability in the Rio market, to wit:

i. The need to transfer funds to Europe, either because of our commitments related to the external debt, and other public expenditures, or as a result of considerable (overseas) travel expenses, or still due to the constant remittances (...) which immigrants (*colonos*) and other foreigners resident in the Empire make to their countries;

- ii. The regular shipment of funds to the River Plate to supply and help the issuing banks established there by businessmen from this market, and which last year amounted to 5,695:064\$ (...);
- iii. Our defective monetary system;
- iv. The imbalance between revenues and expenditures of the state, and the considerable expenses which the war in which we find ourselves currently demands (...);
- v. Mismanagement in some banks;
- vi. The legal tender status given to Bank of Brazil notes and the excessive circulation of inconvertible fiduciary paper.⁹⁴

In short, the commissioners recognised a host of factors - some more plausible than others - that had a bearing on the stability of the commercial and financial system of the Empire. Although not all of the factors were of a monetary nature, in the end the report preferred to stick to the *metalista* litany that permeated most documents of the time.⁹⁵ “Overissue”, “abuse of credit”, and “speculation”, in other words the usual suspects, were paraded and judged guilty by the commissioners. And the diagnosis was right, at least in part. In fact, there had apparently been excesses in the recent past, but banks had not committed these. They had been under strain ever since the Law of Impediments and accompanying government acts imposed clear limits on their business. And not only on the amount of notes they were allowed to issue, but also on their day-to-day operations, which were closely monitored by an inspector. The agents of “overissue”, if any, were from a much less glamorous end of the financial sector, the *casas bancárias*. Their activities did not even merit the attention of the Minister of Finance in his annual report to the Assembly. In fact, as noted by Pacheco, the section on “Banks and the Circulating Medium” in the *Relatório da Fazenda* devoted a few paragraphs to small savings and loans houses (*caixas econômicas*) and philanthropic pension societies (*monte-pios*). Yet, strangely, it did not bother to examine the activities of the much larger *casas bancárias*, such as the Casa Souto, Montenegro, Lima & Co., and Alves & Filho.⁹⁶

⁹⁴ Ibid., p. 89. Although far from being a synthesis of the testimonies heard on the occasion, the commissioners added that the 1864 crisis was actually the result of the “monetary excesses” that followed the events of 1857. Later commentators, who more often than not just parroted the conclusions of contemporary reports, shared this diagnosis. See, for example, Ortigão, *A Moeda*, p. 73.

⁹⁵ See, for example, the account of the crisis given by the Minister of Finance, in *RMF* 1865, pp. 12-5.

⁹⁶ See Pacheco, *Banco do Brasil*, Vol. IV, p. 55. As a result of this official neglect, private banks were not required to file financial statements to the government and, therefore, have left very little record of their operations. A similar problem also besets the study of the early financial history of the United States. For a discussion, see R. Sylla, “Forgotten Men of Money: private bankers in early U.S.

This point is most important. Before the Souto crisis, hardly any mention was made to non-corporate banks. Indeed, in the long-running debate between proponents of a liberal banking system and advocates of a more restricted environment, attentions were concentrated on joint-stock banks and, more specifically, on banks of issue. At the time, banks of issue were wrongly thought to be the only ones capable of expanding the money supply. Clearly, these banks were not alone in this capacity. Deposit and discount banks and, even more dramatically, given their sheer size, private banks, had an important influence on the general level of liquidity in the economy. This fact is reflected in the replies to questions 1 to 4, above. *Casas bancárias*, like joint-stock banks, could increase the money supply both directly, via the issue of *vales*, and indirectly, through the operation of the money multiplier, a possibility that seems to have escaped policymakers until the events of 1864.

The role of private banks in creating money was vividly demonstrated in the years following the Law of Impediments. Indeed, if only note circulation or, even, M1 are taken into account, the extent of the monetary contraction after 1860 was less severe than previously claimed. Yet, as noted in Chapter 2, traditional monetary series capture the behaviour of joint-stock banks only, but not *casas bancárias*, whose business was flourishing. Contemporaries put the combined issue of *vales* by the banks that failed in 1864 at 30,000 *contos*.⁹⁷ Furthermore, according to some estimates, total deposits in the private banks amounted to 50,000 *contos* in 1864.⁹⁸ Taken together, this was more than the volume of deposits held by joint-stock banks at the time - 43,000 *contos*.⁹⁹ Supposing that a fraction (say, one-third) of the deposits in the *casas bancárias* were counted as part of the money supply (M1) in the early 1860s, then the story that emerges is very different from the usual one. First, the monetary stock in 1860 would have been far higher than the 96.6 thousand *contos* indicated in the traditional estimates. Second, it is to be expected that in light of the restrictions imposed by the Law of Impediments, private banks could have stepped-in to fill the gap left by the partial retreat of the joint-stock banks. As such, there is the

History”, *Journal of Economic History*, Vol. XXXVI, No. 1, March 1976, pp. 173-88, and comments by L. Davis and T. Cochrane in the same volume.

⁹⁷ See *Comissão de 1864*, Annex C, p. 52.

⁹⁸ Peláez and Suzigan, *História Monetária*, p. 105.

⁹⁹ See Table A1, in the Statistical Appendix.

possibility that the apparent monetary contraction that immediately followed the Law would have been more than offset by the operation of the private banks.¹⁰⁰ By the same token, the failure of several private banks in 1864 also meant the disappearance of substantial amounts of money, both in the form of deposits and *vales*.¹⁰¹

Table 4.4 reveals yet another point overlooked in the literature in connection with the effects of the Law of Impediments on the money supply. Even if the behaviour of the private banks is left aside, the fact remains that policymakers at the time were seldom aware of the existence of the monetary multiplier, that is, the capacity of the banking system to create credit. As a result, monetary controls in an era of plurality of issue took the shape of imposing limits on the creation of monetary base, or high-powered money. “Manufacture of money” by means of deposit creation was left unregulated. When the latter is taken into account, the picture that emerges is striking.

Table 4.4
Brazil: Selected Monetary Indicators, 1860-4
(in *contos* ‘000)

	High - Powered Money	Currency Held by the Public (a)	Demand Deposits (b)	M1 (c) = a+b
1860	87.0	77.4	19.2	96.6
1861	80.4	58.6	23.6	82.2
1862	76.7	58.5	25.9	84.4
1863	78.0	62.3	29.3	91.6
1864.I	82.8	70.3	25.9	96.2
II	82.8	68.1	29.9	98.0
III	95.4	75.6	33.2	108.8
IV	98.7	84.2	28.5	112.7

Source: Table A1, in the Statistical Appendix.

In 1863, that is, a full year before the Souto crisis broke out, average money supply (M1) was only slightly below its level in 1860. In fact, although the issue of monetary based fell by approximately 10% in the period, M1 retreated by just 5%. This was due to an expansion in the volume of demand deposits held in joint-stock

¹⁰⁰ In the absence of data on either *vales* or deposits held by private banks in years other than 1864, it is impossible to gauge the extent of their growth in the period immediately after the Law of Impediments.

¹⁰¹ See Goldsmith, *Brasil*, pp. 44 ff.

banks, giving proof of the process of modernisation of the banking system. In part, this process was boosted by the operation of the English banks, which arrived in Rio in the first half of 1863.¹⁰² By the first quarter of 1864, money supply - again, disregarding the behaviour of the *casas bancárias* - was at a similar level as in 1860. As a result, by the time the Souto crisis erupted, in September, monetary contraction was not as severe as it is sometimes claimed.¹⁰³

In short, the essence of the problems leading up to the Souto crisis was not, as supposed, a severe monetary contraction following the Law of Impediments.¹⁰⁴ Monetary contraction was fairly modest. Instead, the crux of the matter lay at the absence of official surveillance of an important component of the financial system - the private banks.¹⁰⁵ The conduct of business by Casa Souto was symptomatic of the old-style mores still prevalent in a sizeable part of the Rio money market. The bank had been created as an association between Souto, his relatives, and close friends. Yet, despite its reputation and the huge amount of business conducted, it never bothered to register a contract with the Commercial Board (Junta Comercial)! Souto's bookkeeping was primitive and inconstant. Many operations went unrecorded. Credit was granted on a personal basis to friends, relatives, politicians,

¹⁰² See Jones, "Commercial Banks". Indeed, by 1865 total (sight + interest-bearing) deposits accounted for 30% of the money supply (M2), up from 20% in 1855. Calculated from Table A1, in the Statistical Appendix.

¹⁰³ Of course, in all likelihood a nominal money supply at the same level as four years earlier constituted a real (inflation-adjusted) contraction, especially if the economy was growing. Still, it must be stressed that the extent of the drop in the volume of high-powered money itself was less severe than might have been expected. Admittedly, in the first three years after the 1860 Law high-powered money contracted palpably (-12% between 1860.III and 1863.III), as the banks had to conform to the new issuing limits shown in Tables 1 and 2 of Decree 2685. However, in September 1862 the Bank of Brazil took over the issuing rights of its two competitors in Rio. One month later it resumed convertibility of its notes, so that its issuing limits were no longer bound by Decree 2685. The acquisition of bullion in Britain, in mid-1863, by increasing its reserve fund, made possible a further expansion of its note issue. This served to partly offset the drop in the outstanding note issues of the Treasury and the other joint-stock banks, so that by June 1864 - that is, less than three months before the Souto crisis - total Bank of Brazil issues amounted to 49,100 *contos*. This was a full 30% increase on Bank issues in June 1860, shortly before the Law of Impediments was announced.

¹⁰⁴ This is Cavalcanti's view, according to which the root of the problem lay at the contraction of the money supply attempted through the 1860 legislation. 'In one word, it was the abuse of the public powers against the abuse of credit, by restricting the circulating medium at a time when business was expanding fast, which caused the suppression of the partial movements (...) of the great economic mechanism, which was thus forced to an abrupt halt'. Cf. Cavalcanti, *O Meio*, Vol. 2, p. 279.

¹⁰⁵ Other contributing factors, as noted by Schulz, were the increase in Bank (of England) Rate - mostly as a result of a reduction in Britain's foreign reserves - and fears surrounding Brazil's military involvement in the River Plate, prompting hectic speculation in the Rio money market. See Schulz, *A Crise*, pp. 42-3.

often with little regard for their commercial merits. Its portfolio was over-stretched with long-term loans to the agricultural sector, while the issue of *vales* and acceptance of current accounts demanded a degree of liquidity that it could hardly sustain.¹⁰⁶ As soon as panic set in, the inevitable occurred and Souto, like many other private banks, went under.

Parliament was not late in criticising the behaviour of *casas bancárias*. Speaking in the Senate on 10 and 27 June 1865, former Prime Minister Zacarias de Góis e Vasconcelos attacked the government for single-handedly legislating on the crucial question of bankruptcies and receiverships (*moratórias*). Although acknowledging the exceptional circumstances of the time, he claimed the ultimate blame for the crisis rested with the private banks in Rio de Janeiro, which, ‘operating without attention to the rules of banking art (sic) and science, would inevitably fail. The reverse would have been a miracle, a real exception to the laws of Economics’.¹⁰⁷

Meanwhile, attacks on the Bank of Brazil were mounting. The government argued that the increase in the Bank’s inconvertible note issue was generating generous profits for shareholders.¹⁰⁸ Many commentators came to the rescue of the Bank, among them Mauá. In a letter sent from London he observed that an inspection of the accounts of the Bank at the end of 1864 revealed that at that point it was in a position to consider resumption of convertibility. Yet, its ability to do so had been compromised by the government, which began to place heavy strains on its operations, by issuing short-term Treasury bills (*bilhetes*), some of which ultimately ended up in the Bank’s portfolio. Inevitably, Mauá pointed out, Bank issues would

¹⁰⁶ Levy, “História dos Bancos”, pp. 28-30; and P. A. Ferreira Vianna, *A Crise Commercial do Rio de Janeiro em 1864* (Rio de Janeiro, Garnier, 1864), p. 5. Contrary to most of the opinions collected in the inquiry into the 1864 crisis, the system of current accounts *per se* was not necessarily bad. Rather, the absence of prudential controls, which ensured a proper term structure in banks’ portfolios, was to blame.

¹⁰⁷ Cited in Pacheco, *Banco do Brasil*, Vol. IV, p. 66.

¹⁰⁸ The point was made bluntly by the Minister of Finance in May 1865. ‘It is undisputedly pernicious to industry and the finances of the State that the circulation of values be made by (...) inconvertible paper, especially when this issue is entrusted to a private entity, which finds in the expansion of the faculty to issue a source of profits’. Cf. *RMF* 1865, p. 14. The government’s message was clear: ‘it is (...) absolutely paramount that the Bank of Brazil put itself as soon as possible in a condition such that its circulation becomes solid, relying exclusively on the trust it deserves, and resume convertibility; otherwise, and especially if the amount of paper increases, its value will no longer be equivalent to the metal it represents (...)’. *Ibid.*

have to increase to accommodate the discounting of government paper, an operation which it never failed to undertake.¹⁰⁹

To address the question of financing the government's budget deficit, the Council of State was heard on 21 January 1865, during the Legislative recess.¹¹⁰ Given that an extraordinary summoning of members of Parliament would take at least three months, councillors suggested that the government issue more Treasury bills, in order to help fund the war against Paraguay, which had broken out in December 1864.¹¹¹ Council members were quick to cite reasons of State for allowing extraordinary expenditures. These reasons clearly dominated the legal impediment to such an act, which would have required prior approval by the General Assembly.

Throughout the remainder of 1865, the Olinda cabinet seemed to hesitate as to the best course of action in the financial realm. Finally, in January 1866 the government sent a communication to the *Seção de Fazenda* of the Council of State, asking for their opinion on the following questions: (i) were Decrees 3306 and 3307, which granted the Bank of Brazil permission to increase its note issue to three times the reserve fund, and suspended convertibility of its notes, compatible with any measures designed to improve the circulating medium; (ii) if so, what would those measures be; (iii) if not, should the said decrees be revoked?¹¹² The *Seção de Fazenda* was of the opinion that the decrees and the "reckless" monetary expansion undertaken by the Bank in its wake were at the root of the current difficulties. Nevertheless, to revoke the articles would have resulted in the Bank being well in excess of the legal limit on its outstanding note issue and, hence, liable to liquidation. Thus, the signatories opined that a more sensible solution would be to remove the issuing powers from the Bank, and require that it gradually withdraw its notes from circulation.¹¹³ As this would have meant an important change of course, with numerous political and legal implications, the Emperor thought best to obtain the

¹⁰⁹ Pacheco, *Banco do Brasil*, Vol. IV, p. 88.

¹¹⁰ See *ACE*, Vol. VI, pp. 5-16.

¹¹¹ On the Paraguayan War, see M. E. C. M. Marques (org.), *A Guerra do Paraguai: 130 anos depois* (Rio de Janeiro, Relume Dumará, 1995); and W. P. Costa, *A Espada de Dâmoçles: o Exército, a Guerra do Paraguai e a crise do Império* (São Paulo, Hucitec/Ed. da Unicamp, 1996).

¹¹² *ACE*, Vol. VI, pp. 35-48.

¹¹³ *Ibid.*, p. 37.

views of the Conselho Pleno. Most of the councillors, including both Itaboraí and Souza Franco, seconded the opinion of the Finance Standing Committee. The only dissonant voice was that of Jequitinhonha who pleaded for the salvation of ‘the sole credit establishment in the country’.¹¹⁴ He was isolated, however, and the opinion that prevailed was that the Bank of Brazil should cease to be an issuing bank. The first casualty of the decision would be Minister of Finance Dias de Carvalho, a long-time director of the Bank, who resigned in protest on 7 March.

4.3 - Monopoly Restored: Law 1349, of 12 September 1866

At the start of the legislative session, on 9 April, the new Minister of Finance, João da Silva Carrão,¹¹⁵ presented a project designed to curb the Bank’s right of issue and restore stability to the monetary system through a return to gold. In essence, his proposal aimed at requiring the Bank to retire part of the stock of notes in circulation until it reached twice its reserve fund (or 50,000 *contos*, whichever was lower). At this point, the Bank was to resume convertibility of its notes. The joint Finance and Special Committee of the Chamber of Deputies endorsed the main points of the project.¹¹⁶

Simultaneously with the Minister’s proposal, two petitions were sent to the Chamber of Deputies, one from the directors of the Bank of Brazil, the other by representatives of *fazendeiros* from the province of Rio de Janeiro.¹¹⁷ The Bank attempted to justify the state of the monetary circulation at the time. Its argument ran as follows. Had the Bank acted selfishly at the outbreak of the Souto crisis, it could

¹¹⁴ Ibid., p. 44.

¹¹⁵ A lecturer of Political Economy at the prestigious Law School of São Paulo, Carrão was a moderate Liberal representative for that province. He espoused opinions on monetary affairs consistent with advocates of hard money, as revealed by his report presented to the Assembly in May 1866. First, he stressed that at some 28,000 *contos* Treasury notes could not be deemed excessive, given that they had to meet the needs of all the Empire, including the twelve provinces not served by the Bank of Brazil. He then added that their ‘existence, even in this amount, (could) not fail to be an evil, a fact that ha(d) been repeatedly recognised by the powers of the Empire’. In addition, ‘present experience must have convinced all spirits that while paper money remained in circulation credit institutions with issuing (rights) must be reputed dangerous (...)’. Cf. *RMF* 1866, pp. 6-7.

¹¹⁶ See Cavalcanti, *O Meio*, Vol. 2, pp. 281-9.

¹¹⁷ See “Representação da Directoria do Banco do Brasil” and “Representação dos Lavradores”, in *Proposta do Poder Executivo sobre o Meio Circulante e Documentos Relativos Mandados Publicar para Serem Presentes á Assembléa Geral Legislativa* (Rio de Janeiro, Typ. Nacional, 1866).

have easily sat back, suspended its discounting operations, and waited for its titles to fall due, while continuing to redeem its notes on demand, presumably in Treasury notes.¹¹⁸ However, perceiving the gravity of the situation, and conscious of its weight in the Rio money market, the Bank had decided to ask the government for permission to increase its issues. With this, it sought to provide the necessary liquidity to institutions in distress, thus performing the role of a lender of last resort. The Bank was confident that, soon after the “abnormal state” had passed, the supply of notes would resume levels prior to the crisis, had it not been for the onset of the Paraguayan War and the accompanying demands of the Treasury.¹¹⁹ For its part, the petition signed by *fazendeiros* of the province of Rio de Janeiro, very short on specifics, basically urged the Bank to reduce to 6% the rate of discount it charged *comissários*. The latter, in return, committed themselves to lend the money on to the agricultural sector at 9%.¹²⁰

The Bank’s arguments fell on deaf ears. Yet, planters’ pleas were partially addressed by the new arrangement envisioned for the Bank, which would set up a mortgage department.¹²¹ In the meantime, the Minister of Finance appointed Jequitinhonha to head the Bank of Brazil, on 22 April 1866. This was an attempt to rein-in an institution thought to have become increasingly unruly.¹²² Under the prodding of Jequitinhonha, and in face of opposition from part of its directorate, the Bank found itself in a corner. At the same time that the government demanded that the Bank show restraint in its issuing activities and effect a quick return to convertibility, it also required the Bank to discount increasingly large amounts of Treasury bills. Additionally, and against the Bank’s will, the government asked for help in obtaining essential hard currency needed to purchase war material abroad.

¹¹⁸ Ibid., p. 29.

¹¹⁹ Ibid., pp. 31 ff.

¹²⁰ Ibid., p. 46. Regular annual interest rates charged by *commissários* to their planter clients varied between 8% to 14%. See Sweigart, *Coffee Factorage*, pp. 120-1.

¹²¹ A contemporary pamphlet urged the government to follow yet a different path, and create a new mortgage bank, outside the Bank of Brazil. ‘Let us effectively organise rural credit, which only exists on paper in the current mortgage legislation, and in the embryonic development of rural titles, that presently obstruct the channels of mercantile circulation. Let mortgage credit have a powerful centre, just as commercial credit has the Bank of Brazil’. Cf. *Ao Visconde de Itaborahy: carta de Erasmo sobre a Crise Financeira*. Rio de Janeiro, Typ. de Pinheiro & Companhia, 1866, p. 10.

¹²² See Pacheco, *Banco do Brasil*, Vol. IV, pp. 114 ff.

The same ambiguity was displayed by the government throughout the month of June, as news of the crash of Overend, Gurney & Co., in Britain, brought nervousness to the major markets of the Empire. This led to a run on many institutions, including the London & Brazilian Bank, which turned to both the government and the Bank of Brazil for help.¹²³ At that time the Bank was operating at the limit of its issuing powers and, therefore, sought advice from the government on how to proceed. On 14 June Minister of Finance Carrão replied that he was awaiting the outcome of a project under discussion in Parliament, which would have allowed an increase in the Bank's rights of issue.¹²⁴ Five days later Carrão gave his consent to an assistance to the London and Brazilian Bank, while urging the Bank of Brazil to do its utmost to keep issues within the assigned 3:1 ratio.¹²⁵ Finally, and upon hearing the opinion of the financial community in Rio, the government momentarily relaxed the limits on the issues of the Bank. From then on both the Bank and the Treasury were able to provide discount facilities against solid securities, thus enabling the London and Brazilian Bank to meet its demands for discounts.¹²⁶

Amid the turbulence of the day, the Olinda cabinet began to show the first signs of internal strife. On 11 June 1866, the Minister of Agriculture, Antônio Francisco de Paula e Sousa, had taken the initiative, 'in a private capacity, as a deputy', to present to the Chamber his own project aimed at dealing with the events of June - the fallout from the Overend, Gurney crisis.¹²⁷ The main points of the new proposal consisted of allowing Bank and government to jointly issue up to 12,000 *contos*, while giving the former unlimited powers to discount Treasury bills in excess of its normal limits.¹²⁸ The opposition in Parliament could not fail to point out the sheer contradiction of the bill, coming as it did through the hands of a cabinet

¹²³ According to a director of the Bank of Brazil, over a period of 'ten or fifteen days (they) were called upon to pay upwards of £1,000,000 in deposits'. See *Banker's Magazine*, Vol. 27, February 1867, p. 166.

¹²⁴ This was the Paula e Sousa bill, discussed below. The bill was credited with 'hastening by a material measure the (restoration) of confidence (in the Rio market)'. Cf. *The Brazil and River Plate Mail and South American Journal* (hereafter, *SAJ*), 23 July 1866, p. 316.

¹²⁵ Pacheco, *Banco do Brasil*, Vol. IV, pp. 126-8; and, *SAJ*, 7 July 1866, p. 292.

¹²⁶ *Banker's Magazine*, Vol. 27, February 1867, p. 166; and *SAJ*, 23 July 1866, p. 316.

¹²⁷ Paula e Sousa was accused of serving as a figurehead for Carrão, his bill presumably bearing the handwriting of the Minister of Finance. See session of 12 June 1866, in *ACD*, Tome II, p. 88.

¹²⁸ Pacheco, *Banco do Brasil*, Vol. IV, pp. 141-5.

member, and at odds with the earlier project submitted by the Carrão.¹²⁹ To make matters worse, earlier in April the Minister of War (and author of the 1860 banking and corporate law), Ferraz, had called for the “regeneration” of the Bank of Brazil, in the Chamber of Deputies.¹³⁰ Clearly, ministers were not speaking with one voice on an important issue at a critical juncture. Nevertheless, by 30 June, before any decision had been taken on the bill, the Bank was already exceeding its issuing limits by more than 9,600 *contos*.¹³¹

On 3 July, and while the texts from the Ministry of Finance and Paula e Sousa were being debated in the Chamber of Deputies, senator Silveira da Mota (Liberal for the province of Goiás) took an allegedly individual initiative to submit a different project to the upper House. Essentially, he proposed a review of the contract agreed between the government and the Bank of Brazil in 1853. This implied a termination of the right of the Bank to issue notes, turning it into a bank of deposits, discounts and mortgages.¹³² Also, it suggested that the Bank be required to sell its metallic reserves to the government. After some deliberation, and in spite of the disapproval of the then Minister of Finance (Carrão), the Finance Committee of the Senate endorsed the Silveira da Mota text, with a few modifications.¹³³

It is noteworthy that the final draft of the Senate project bore the imprint of the two leading financial experts of the day - Itaboraí and Souza Franco - both of whom were the spiritual leaders of the opposing “schools” of thought on banking and

¹²⁹ Ibid., pp. 145-7. See also the “Annual Retrospect for Brazil”, translated from the *Jornal do Commercio* and published in *SAJ*, 7 March 1867, pp. 8-9.

¹³⁰ Nabuco, *Um Estadista*, Vol. I, p. 633, footnote 4. As pointed out by Pacheco, it was as though the Olinda cabinet had four different Ministers of Finance: Dias de Carvalho, later replaced by Carrão, Paula e Sousa (Agriculture) and Ferraz (War). See Pacheco, *Banco do Brasil*, Vol. IV, pp. 152-3.

¹³¹ See Nabuco, *Um Estadista*, Vol. I, p. 635, footnote 7.

¹³² Pacheco disputes the version that the project was at the sole initiative of Silveira da Mota. Instead, he claims it had been, at the very least, “inspired” by Silveira da Mota’s conversations with Itaboraí and Torres Homem, as well as the reading of articles which they had been publishing lately. At the time, accusations of plagiarism were made against the author of the project, charged with taking excerpts right out of earlier documents from the Council of State. Pacheco, *Banco do Brasil*, Vol. IV, p. 158.

¹³³ The Silveira da Mota project contained six articles, while the version of the committee had ten. Their essence was the same, however: to end the issuing activities of the Bank of Brazil, create a mortgage department, the purchase by the government of the Bank’s metallic fund and the progressive retirement of its outstanding circulation. For the Silveira da Mota project, see Cavalcanti, *O Meio*, Vol. 2, pp. 287-8; and for the text of the Committee’s project, Pacheco, *Banco do Brasil*, Vol. IV, pp. 160-5.

monetary affairs. At that point the two men showed signs of fatigue after almost two decades of disputes between *metalistas* and *papelistas*.¹³⁴ Both had modified their earlier positions and, in a way, moved towards a common middle ground. Itaboraí, by admitting an end to the issuing powers of his own brainchild.¹³⁵ Souza Franco, in turn, having seen his worst fears about circulating banks running amok come true, thought best to do away with the issuing powers of the Bank. If the price for the restoration of a sound currency was the institution of a government monopoly of issue, so be it. Their joint statement summarised the final opinions of the Finance Committee of the Senate on the Silveira da Mota project. And it signalled a truce between monopolists and advocates of plurality of issue, after years of bitter dispute.

Invested, for more than two years, with legal tender status, and during this period having increased the issues of its head office by almost twice (the amount) in early September 1864; with two-thirds of its portfolio composed of bills which cannot be discounted in the short-run, or of difficult and doubtful liquidation, the Bank of Brazil can no longer satisfy the essential conditions of when it was created. If its right to issue notes is not revoked, it will remain, as now, merely a paper-money factory, steered at the whim of its directorate, without support nor intervention from the General Legislative Assembly, and subject only to governmental inspection, which has, unfortunately, encouraged, instead of prevented, the abuses which led the monetary circulation to its present state.¹³⁶

The opinions uttered by the two financial statesmen delivered the final blow to a crumbling cabinet. Paula e Sousa, the Minister of Agriculture, saw much in common in the project finally approved by the Senate and his own, and came to its support. Minister of Finance Carrão, as already noted, was opposed to the Silveira da Mota proposal finally embraced by the Senate. Prime Minister Olinda, in turn, showed increasing signs of failing health. All ingredients were in place for an administrative re-shuffle. This came about in the early days of August 1866 when, upon the resignation of the 1865 cabinet, the Emperor summoned once again Zacarias to occupy the chair of Chief of the Council of Ministers.¹³⁷

¹³⁴ These conflicts will be examined in Chapter 6.

¹³⁵ The smaller Banco da Bahia, Banco de Pernambuco and Banco do Maranhão would retain a residual note circulation until the end of the Empire. However, given the volume of their total outstanding notes (less than 4,000 *contos* as of February 1867), and the fact that they were not accepted in payment of taxes and debts to the State, their impact on the money supply was marginal.

¹³⁶ Quoted in Nabuco, *Um Estadista*, Vol. I, p. 636, footnote 9.

¹³⁷ Zacarias was yet another Olinda School-trained *bahiano* to occupy the Ministry of Finance. Originally a Conservative, he helped found the Progressive League (or Party) in the early 1860s, and

Deeming control of the Bank of Brazil strategic for his efforts to tackle the financial difficulties facing the government, Zacarias soon sacked the Visconde de Jequitinhonha as head of the Bank. He was replaced by former Minister of Finance, and leading *metalista*, Torres Homem. Jequitinhonha did not leave silently. Speaking soon afterwards, in the Senate, he would criticise the government for its ongoing attacks against the Bank, positioning himself against the Silveira da Mota project. Jequitinhonha insisted that the only reasons why the Bank failed to remain within the limits on its note issue had been precisely its operation as a lender of last resort during the Souto Crisis and, ever since, its discounting of government paper.¹³⁸ Zacarias was unimpressed. On 9 August he formally endorsed the modified version of the Silveira da Mota project being debated in the Senate, insisting that it was better than the one presented by his predecessor. Not only did it propose measures to revamp the Bank of Brazil but, crucially, ‘afforded the government the means to face the deficit’.¹³⁹ The real motive behind the coming Law 1349 could not have been presented more bluntly.

Debates in the Senate continued until late August, when the project was approved and sent to the Chamber of Deputies. In the lower House discussion was less vibrant and shorter. In the end, and with minor modifications, the project of the Finance Committee of the Senate left Parliament to receive Imperial sanction, becoming Law 1349 on 12 September 1866. Its principal points were:

Art. 1: The Government is hereby authorised not only to innovate the agreement made with the Bank of Brazil under law 683, 5 July 1853, but also to modify the provisions of the said law and of the statutes approved by decree 1223, of 31 August of the same year, under the following conditions:

para 1: The bank shall cease immediately to issue notes payable to bearer and on demand, but is allowed to undertake the remaining operations covered by its statutes, as well as mortgages.

championed the Liberal cause. Feared for his obstinacy in criticising his countless political enemies, he was equally loathed for his reported thirst for power.

¹³⁸ Pacheco, *Banco do Brasil*, Vol. IV, pp. 168-9. Jequitinhonha had often given signs of sympathy for the Bank of Brazil during discussions in the Council of State. For example, in the session held on 10 July 1862, after maintaining that the Bank was ‘a great source of prosperity for the country and (as such) deserved to be helped (by the government)’, he added that, as a “unitarian” (in favour of monopoly of issue), he urged the government to allow the Bank ‘to carry out its services conveniently’ (and therefore, give the go-ahead to the proposed merger with the two other banks of issue in the city of Rio). See *ACE*, Vol. V, pp. 280 ff. Jequitinhonha’s opinions on monetary matters will be examined in Chapter 5.

¹³⁹ Pacheco, *Banco do Brasil*, Vol. IV, pp. 171-2. See also the “Annual Financial Retrospect for Brazil - 1866”, in *SAJ*, 22 March 1867, pp. 6-7.

To that end the bank shall be divided into two separate departments, albeit under the same administration, and no part of the capital or reserves of one must be made available to the operations of the other;

para 2: The mortgage department shall receive as a fund designated exclusively for its operations the sum of 35,000 *contos* in bonds currently in the portfolio of the Bank of Brazil, and most suitable for conversion into mortgage bonds (...);

para 4: The Government shall pay the bank not only the amount of paper money withdrawn from circulation according to arts. 2 and 4 of the said law of 5 July 1853, but also any Treasury bills (*bilhetes*) which exist in its portfolio.

The sum of both these amounts, and of the sale of specie that the bank has in its reserve fund, shall be fully employed towards the retirement from circulation of an equal amount of its notes;

para 6: The bank's notes that remain in circulation will continue to be accepted at the tax offices, and shall be retired annually by the bank at the rate of 5% to 8% of its initial amount;

para 8: The General Assembly, as soon as the state of war is over, shall include in the budget law for each year the amount which will have to be applied towards the retirement of the paper money in circulation

The 1866 law turned the clock back to the 1830s, when the Treasury replaced the first Bank of Brazil as the sole issuer of paper currency in the Empire. Apart from revoking the right of the Bank to issue notes, the law allowed for the purchase of its metallic fund, a crucial resource in the war effort. The determination to replace the Bank's issues with Treasury notes was provided for with paragraphs 4 and 6, the latter having established a timetable for conducting the retirement of Bank of Brazil paper. The idea of a mortgage department, in turn, arose out of the belief that it would be able to address the demands of the rural sector.¹⁴⁰ Finally, the exceptional nature of the measures, at least as regards the issue of government fiat money, was acknowledged in para 8, which provided for a gradual retirement of this type of paper after the war against Paraguay was over.¹⁴¹

¹⁴⁰ As will be elaborated later, contemporaries sought to increase the amount of resources channelled into agriculture by advocating plurality of note issue. Nevertheless, rural credit was largely ignored by joint-stock banks, and left to be provided by *comissários*. These points will be examined in greater detail in Chapter 7.

¹⁴¹ Decree 3720, of 18 October 1866, laid down the finer points for the proper execution of Law 1349 as regards the issues of the Bank of Brazil and the repayment of Treasury debts. On 23 November, the Bank's new statutes were approved (Decree 3739). For details, see *RMF* 1867, pp. 17-9; and Pacheco, *Banco do Brasil*, Vol. IV, pp. 220-2. Zacarias, in charge of the Ministry of Finance during the early days of implementation of the 1866 Law, preferred to stress what he saw as the beneficial effects of the innovation of the agreement between Bank and government. Removal of the Bank's issuing powers, he argued, far from a liability, actually ushered in a new era for the establishment. Free from the 'false idea that an issuing bank had as its main task the rescue of every victim of the forced expansion of credit, at the expense of its own private fortune', the Bank would henceforth be in a genuine position 'to meet the needs of commerce and agriculture'. Cf. *RMF* 1867, p. 19. Under the new statutes of the Bank of Brazil its president would no longer be appointed by the government but, instead, should be elected by an assembly of shareholders. Accordingly, on 10 December, former Minister of Finance,

The letter of the Law implied the retirement of one class of paper and its replacement by another. In other words, unbacked Treasury notes would gradually take the place of notes issued by the Bank of Brazil - which at the time were also inconvertible. Thus, with the outlay of 40.6 thousand *contos* made by the Treasury, an equivalent amount of Bank notes were removed from circulation.¹⁴² Yet, the government's objective was more prosaic than this swap of inconvertible private notes for government paper money. First, the law allowed it to get hold of the metallic reserves of the Bank which, as noted, were greatly needed in wartime. Second, by taking over the Bank's issuing powers, the government could henceforth finance itself directly, instead of having to rely exclusively on debt, as had been the case until then. This point was crucial, in light of its widening budget deficit.

Table 4.5
Revenue and Expenditure of the Imperial
Government, 1860/1 to 1870/1

(in *contos*)

Financial Year	Revenue	Expenditure	Balance
1860/1	50,052	52,358	-2,306
1861/2	52,489	53,050	-561
1862/3	48,342	57,000	-8,658
1863/4	54,801	56,494	-1,693
1864/5	56,996	83,346	-26,350
1865/6	58,523	121,856	-63,333
1866/7	64,777	120,890	-56,113
1867/8	71,201	165,985	-94,784
1868/9	87,543	150,895	-63,352
1869/70	94,847	141,594	-46,747
1870/1	95,885	100,074	-4,189

Source: Table A9, in the Statistical Appendix.

Francisco Sales Torres Homem, who had been in command as the last officially appointed president, was elected.

¹⁴² The breakdown of Treasury notes issued in conjunction with Law 1349 is as follows: 3,800 *contos* in payment of Treasury bills belonging to the Bank of Brazil; 25,800 *contos* for its metallic reserves and 11,000 *contos* corresponding to government notes which the Bank had retired from circulation, in accordance with its statutes. See *RMF* 1872, Table 42, in the Appendix. The remaining note issue of the Bank, after allowing for the swap for Treasury notes (and their subsequent retirement), was estimated at 45,600 *contos* on 16 March 1867. On that day, Decree 3814 (Art. 3) determined that the Bank withdraw each year, beginning in June, 5% of this amount, so that after twenty years no more of its notes would be circulating. See Pacheco, *Banco do Brasil*, Vol. IV, pp. 227-8.

At the time the Law of Impediments was implemented, the budget deficit was still manageable, with expenditures not exceeding revenues by a large margin. By the mid-1860s, as the Paraguayan War broke out and the need for additional resources arose, the combined expenditures of the Ministries of War and Navy jumped from an average of 40% of the total in the mid-1850s to 60% at the height of the Paraguayan conflict, in 1867-8.¹⁴³ Clearly, the government had to find other sources of finance.

With a view to obtaining the necessary resources to pay for domestic expenditures linked to the war effort, and the other expenditures of the imperial government, Zacarias turned to Parliament for permission to go ahead with an issue of 45,000 to 50,000 *contos* in Treasury notes. The usual opposition to “overissue”, “recklessness” and “abuse” was mustered in both Houses, dragging the discussion well into the legislative year.¹⁴⁴ Finally, on 28 September 1867, Law 1508 authorised the government to issue up to 50,000 *contos*, which it promptly did.¹⁴⁵ The exchange rate, meanwhile, felt the blow. Between December 1867 and early 1868 it dropped sharply, from around 19d to a low of 14d in mid-February, just when news of the decisive Allied victory at Humaitá arrived. Subsequently, it recovered its earlier level and stabilised at 19-20d in April.¹⁴⁶ By then, Zacarias’s hold on his post showed the first signs of weakening. Three months later he was replaced as Prime Minister.¹⁴⁷

¹⁴³ Figures calculated from Table 5 in the Annex to *RMF* 1872.

¹⁴⁴ For a summary, see Pacheco, *Banco do Brasil*, Vol. IV, pp. 241 ff.

¹⁴⁵ Additionally, a major overhaul of the tax system was undertaken, Law 1507, of 6 September 1867, provided an increase in the revenues of the imperial government in the following years. For details, see *RMF* 1868, pp. 41-4. Both the tax increase and the note issue received warm support from the *South American Journal*, who in its leader column noted that ‘the war with Paraguay, to which alone the present financial difficulty (was) attributable, (had) not been of Brazilian creation, and it (made) it the more incumbent on the people to second the efforts of their excellent Sovereign to bring it to an honourable and successful issue’. *SAJ*, 22 October 1867, p. 12.

¹⁴⁶ In his report to the Assembly, Zacarias downplayed the influence of the monetary expansion on the depreciation of the *milréis*. Instead, he attributed the drop in the rate of exchange to the exhaustion of the resources obtained with the 1865 foreign loan, in the amount of £5,000,000. See *RMF* 1868, p. 8. The 1865 loan had been contracted under the most adverse terms for the Brazilian Treasury, facing a discount of 26% and paying interest of 5%. The money thus obtained (68,850 *contos*) was entirely used in financing the military campaign in Paraguay. For details, see Bouças, *Finanças*, Vol. XIV, pp. 157-61.

¹⁴⁷ The episode that would spell the beginning of the end of the Progressive-Liberal cabinet came on 20 February 1868, immediately after the success at Humaitá. Feeling a lack of support from the incumbent administration, Field Marshal Caxias, commander of the Allied troops in the Paraguayan theatre of war, sent a telegram to the Emperor requesting his dismissal from duty, unless it was deemed that his services were indispensable. The issue that was brought to discussion before the Council of State narrowed down to keeping Caxias or the cabinet. In the end it was decided that neither Caxias nor the cabinet would be dismissed. Still, the episode had shown whose side the Emperor was on -

The Emperor, breaking with all tradition in a parliamentary system, invited Itaboraí, old-time Conservative, to preside over a new cabinet amid a Liberal-controlled Assembly. Itaboraí was also entrusted, as Minister of Finance, with solving the financial difficulties in which the Empire found itself. The remaining cabinet members were experienced politicians as well. The new administration included Paranhos at the Ministry of Foreign Affairs and José Antônio Pimenta Bueno (Marquês de São Vicente) as Minister of the Empire (Interior). Finally, and in order to increase his room for manoeuvre, Itaboraí asked the Emperor to dismiss the Assembly, to which the monarch agreed. Taking advantage of the dissolution of the Assembly, and before a new one could convene, Itaboraí issued Decree 4232 (5 August 1868), authorising an additional issue of up to 40,000 *contos* in Treasury notes, in order to meet pressing needs linked to the war against Paraguay. In the preamble to this decree, Itaboraí admitted that the Executive was acting beyond its powers, but had decided to go ahead in view of the urgency of the situation.¹⁴⁸ Shortly afterwards - and on top of the earlier note issue - a new decree (No. 4244, 15 September) gave permission to the Ministry of Finance to contract a domestic “gold” loan of up to 30,000 *contos*. This was intended as a means to extend the maturity of debt - hitherto concentrated for the most part in short-term (less than one year) *bilhetes* - and reduce the need for the issue of paper money. Subscription to this issue of the National Loan (Empréstimo Nacional) exceeded all expectations, and reached 120,000 *contos*, a sixth of which came from the Bank of Brazil.¹⁴⁹ This suggests at least two things: the existence of substantial resources in the economy, awaiting

Caxias’. After that, Prime Minister Zacarias felt his position to be untenable. The spark which triggered his parting from the Emperor came in the aftermath of the Senate elections for a province of Rio Grande do Norte seat. Custom had it that the monarch pick one of three names from a list of candidates with the most votes, in consultation with his Prime Minister. On this occasion, Zacarias’ favourite candidate was precluded by the one endeared to Pedro II, none other than Torres Homem. A former Minister of Finance, a staunch *metalista*, and, two years earlier, appointed to the presidency of the Bank of Brazil by Zacarias himself. The episode, Zacarias later alleged, prompted the demise of his cabinet on 16 July 1868. The “real” reason for the fall of the Zacarias government is still disputed by scholars. Iglésias, siding with Nabuco, maintains that the conflict with Caxias was the main motive behind Zacarias’ resignation. Bethell and Carvalho, on the other hand, insist that the real driving force lay in the abolitionist issue, more precisely, with opposition emanating from the Council of State to the march of reforms advanced by the Progressive-Liberal government. See Iglésias, “Vida Política”; and Bethell and Carvalho, “1850-1870”, pp. 156-7.

¹⁴⁸ Pacheco, *Banco do Brasil*, Vol. IV, pp. 302-6; and *RMF* 1869, p. 8. In the end, the government issued 23,390 *contos* out of the 40,000 *contos* that the decree entitled it to. See Table A13, in the Statistical Appendix.

¹⁴⁹ *SAJ*, 7 November 1868, p. 12.

profitable investment opportunities, and the good reputation of the imperial government.¹⁵⁰ In the end, a proportional distribution was made in order to accommodate all investors, who bought the Treasury bonds (*apólices*) at 90% of their face value, and were guaranteed 6% real (exchange-rate indexed) interest annually. From then on issues of bonds of the consolidated imperial debt would become the main source of deficit financing, being vital for meeting the expenses associated with the War. Accordingly, payments of interest on the domestic debt would take up a growing share of government expenditures, the cost having increased from 4,800 *contos* in the 1864/5 financial year (5.8% of total expenditures) to 17,200 *contos* in 1870/1 (17.2% of expenditures).¹⁵¹

The combined effect of Decrees 4232 and 4244 on the structure of imperial government liabilities was a decrease, after 1868, in reliance on the issue of *bilhetes* to finance current expenditures.

Table 4.6
Liabilities of the Imperial Treasury, 1864-1871
(in *contos*)

	Long-Term Debt (<i>apólices</i>)	Short-Term Debt (<i>bilhetes</i>)	Treasury Notes
1864	76,777.4	8,248.5	28,300
1865	80,376.4	29,174.0	28,100
1866	90,442.2	38,986.8	38,900
1867	106,350.6	59,572.7	72,000
1868	125,206.7	72,705.6	115,900
1869	191,076.5	64,575.3	143,900
1870	234,312.0	42,586.1	150,700
1871	280,456.9	n.a.	150,900

Notes: Figures for *apólices* are as of March. Other data refer to end of year.

n.a. = data not available.

Sources: For *apólices* and *bilhetes*, Brasil, Ministério da Fazenda, *Proposta e Relatório Apresentados pelo Ministro e Secretário d'Estado dos Negócios da Fazenda à Assembléa-Geral Legislativa*, various issues; Treasury notes, from IBGE, *Estatísticas*

¹⁵⁰ Indeed, even “gold” (exchange-rate indexed) issues, such as this one, were subject to default. The massive oversubscription to the 30,000 *contos* loan indicates that investors did not deem this likely.

¹⁵¹ See Table A12, in the Statistical Appendix. Interest payments on the foreign debt would also experience a marked increase in the period - to 8,000 *contos* - from an average of 4,000 *contos* in the first half of the 1860s. This reflected both the growth of outlays in sterling and the drop in the rate of exchange during the Paraguayan War.

Históricas do Brasil (Rio de Janeiro, IBGE, 1987),
Table 10.4.

The reverse side of the decline in the use of *bilhetes* was a ballooning of the outstanding stock of *apólices* and notes. The consolidated imperial debt reached a staggering 280,000 *contos* in March 1871 (a 250% increase on the amount outstanding at the outbreak of the War). Meanwhile, the end to the issuing rights of the Bank of Brazil, in 1866, made way for a four-fold increase in outstanding Treasury notes, which totalled more than 150,000 *contos* in December 1871.¹⁵² Despite the government's apparent decision to rely less on the use of the printing press, total note issue (which included private banks) almost doubled between 1864 and 1870, from 98,700 *contos* to 193,800 *contos*. If only the five years after the introduction of the government monopoly of issue in 1866 are taken into account, the increase in the total stock of notes is still a hefty 57%. However, with the inflation of the war years, the real rate of growth would have been more modest.¹⁵³

Table 4.7
Brazil: Total Notes Outstanding, 1864-71
(in *contos*)

	Treasury Notes	%	Banknotes	%	Total
1864	28,300	28.7	70,400	71.3	98,700
1865	28,100	25.8	80,800	74.2	108,900
1866	38,900	31.5	84,600	68.5	123,500
1867	72,000	53.6	62,400	46.4	134,400
1868	11,900	73.0	42,900	27.0	158,800
1869	14,900	72.0	56,000	28.0	199,900
1870	150,700	77.8	43,100	22.2	193,800
1871	150,900	76.4	46,700	23.6	197,600

Source: IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987),
Table 10.4

¹⁵² This dramatic rise in the value of the liabilities of the imperial government, as noted, went towards financing the costs of the Paraguayan War. At the time, two highly discrepant estimates were made of the total financial cost of the conflict. The lesser one, by the Ministry of Finance, came up with the final figure of 461,000 *contos*, while Treasury estimates put the total cost at 614,000 *contos*. The main difference in the two estimates refers to the actual amount of taxes directed to financing the war effort. Either way, in both cases the issue of Treasury notes figures prominently. Treasury estimates from Peláez and Suzigan, *História Monetária*, p. 114; Ministry of Finance data in *RMF* 1872, Table 15A, Annex.

¹⁵³ There are no reliable estimates of inflation in Brazil for the pre-1870 period. A composite index of the cost of living, which consists of an average of crude indices found in the literature, reveals an average inflation of 5.3% p.a. during the second half of the 1860s. See Goldsmith, *Brasil*, p. 29.

The War of the Triple Alliance came to an end on 1 March 1870, with the death of the Paraguayan leader, Solano López. Months before, deeming that the conflict could not last for much longer, parliamentary debates were increasingly directed to the issue of the emancipation of slaves. Speaking in the Senate on 17 June 1869, Nabuco de Araújo demanded from the government a clear position on the subject. He claimed that in spite of its inclusion in the “Speech from the Throne” for two consecutive years no proposal was forthcoming from the Conservative administration.¹⁵⁴ One year later, Nabuco insisted on the gravity of the situation, pointing out to the Emperor that the Liberals, then in opposition, did not have the power to push through the gradual abolition of slavery. But he believed that there were moderate Conservative back-benchers up to the task. The message was clear: the current Itaboraí cabinet, as a representative of the older (*saquarema*) generation of Conservatives, was not truly committed to emancipation.

The turning point came with yet another Nabuco initiative - the inclusion, on 19 September, of an amendment to the imperial budget determining that the government set aside 1,000 *contos* every year to provide for the manumission of slaves. Itaboraí and part of his cabinet refused to accept this Liberal initiative, which nevertheless was welcomed by other ministers. Amongst them, Paranhos, just returned from Paraguay and resuming his post as Minister of Foreign Affairs. In view of the split in the Conservative ranks, Itaboraí resigned, making way for moderate Conservatives, with Paranhos as Prime Minister, to consolidate their hold on the government.

From 1870 on the monetary and banking question would no longer be as prominent a theme in imperial political economy as it had been before. Instead, abolition would be at the top of the political agenda, together with immigration, and the so-called “material improvements”, a catch-all designating investments in railways, central sugar mills and loans to the agricultural sector.¹⁵⁵ Accordingly, for the next fifteen years financial debates ceased to evolve around the “manufacture of money” and switched, instead, to mortgage banks and the accompanying

¹⁵⁴ Nabuco, *Um Estadista*, Vol. II, p. 789.

¹⁵⁵ For a discussion, see Colson, “The Destruction”; and Melo, *O Norte*.

legislation.¹⁵⁶ *Metalistas* and *papelistas* did not retire from the scene, though. They were just taking a long breath before resuming their battle in the late 1880s and throughout the 1890s.¹⁵⁷

* * *

To sum-up, the 1860 Law of Impediments had palpable effects on the activities of banks of issue. In the first two years following the Law, the Bank of Brazil and, to a lesser degree, the Banco do Maranhão and Banco da Bahia, were forced to scale down their note issues, in order to remain within the new ceiling stipulated by Decree 2685. Overall note circulation in this period was further reduced because of the ongoing process of retirement of Treasury notes. Nevertheless, the monetary contraction provoked by the Law was not as severe as figures for the volume of notes issued by incorporated banks might suggest. To begin with, private banks (*casas bancárias*) had long been operating in the major cities, especially in Rio. They engaged in the issue of *vales* and accepted deposits on current account, which could be drawn on short notice. Secondly, the growth in demand deposits in the joint-stock banks partly compensated the drop in high-powered money, so that the money supply, as measured by M1, fell by less than 5% between 1860 and 1863. By the first quarter of 1864, money supply was back at the same level as at the time of the Law of Impediments - 96,200 *contos*. A monetary crunch, therefore, is very unlikely to have caused the Souto crisis.

Loans made by private banks to the agricultural sector were a probable source of the 1864 commercial crisis. By lending long against dubious collateral, while maintaining large current accounts that could be drawn at any moment, *casas bancárias* built up unstable portfolios. Virtually unregulated by the authorities, their operations largely bypassed the restrictions on corporations introduced by the Law of Impediments. Their reckless operations probably helped trigger the Souto crisis. Yet,

¹⁵⁶ Mortgage legislation had been reformed in September 1864, under Law 1237. Yet, the creation, in 1866, of a specific department at the Bank of Brazil in charge of lending long-term funds to the agricultural sector did not produce the expected results. Six years on and the president of the Bank was still requesting alterations to the legislation governing the foreclosure of rural property, in an attempt to facilitate its support of agriculture. See *RMF* 1872, pp. 21-4.

¹⁵⁷ On the revival of monetary controversies at the end of the Empire, see G. H. B. Franco, *Reforma Monetária e Instabilidade Financeira na Transição Republicana* (Rio de Janeiro, BNDES, 1983).

response to the crisis from both the government and the Bank of Brazil was far superior to that in 1857. Convertibility was suspended, issuing limits relaxed, and heavy discounting pursued, at high interest rates. The exchange rate recovered rapidly, unhealthy banks were liquidated, and confidence restored. Even so, in bringing down some of the major commercial establishments in Rio, the Souto crisis strengthened the arguments against the private issue of banknotes and, ultimately, the privileges enjoyed by the Bank of Brazil. Criticism of the Bank was fuelled by its failure to resume convertibility after the turmoil caused by the 1864 crisis had died out. In defence, the Bank alleged that redemption of its notes into gold would not be possible as long as the government continued to demand that it discount Treasury bills. Opponents of the Bank were not convinced, and prepared to deliver the final blow to its issuing activities.

By the mid-1860s, the incapacity of the imperial government to finance its budget deficit in a non-inflationary way ultimately forced it to innovate its contract with the Bank of Brazil. Law 1349 not only stripped the Bank of its issuing powers, it also offered the government the chance to acquire much-needed specie. Financing of the war against Paraguay was made by means of exceptional legislation granting the Treasury permission to increase its issue of notes, *bilhetes* and *apólices*. Additionally, the government relied on a foreign loan in the amount of £5 million, contracted under very adverse terms. The subsequent monetary expansion notwithstanding, Law 1349 represented a compromise between soft money and hard money advocates, as it removed issuing powers from the Bank of Brazil, while allowing the government to indulge in inflationary financing. The re-establishment of the monopoly of issue in the hands of the Treasury signalled the failure of the system created in 1853 to provide stability to the monetary market.

Conclusions

Part II covered in detail the main events in the monetary and banking sphere in Brazil between 1850 and 1870. It began by pointing out one of the immediate consequences of the end of the trans-Atlantic slave trade, in the early 1850s - the search for alternative investment opportunities. It was argued that the financial market of the time was ill-prepared to “recycle” capital freed from this activity, while at the same time dealing with the expansion of the coffee business. Moreover, it was shown that the *vale*-issuing banks then in operation were not capable of averting the seasonal drain of currency from Rio to the provinces. In order to stem these flows while, at the same time, regulate the money supply, the government created a semi-official, note-issuing, bank in 1853 - the third Bank of Brazil.

The statutes of the Bank of Brazil contained both privileges and obligations, which the government hoped would allow for two objectives to be met. First, the gradual expansion of the money supply, in order to meet increasing demands for credit. Second, the “improvement” of the circulating medium. By this was meant the establishment of a gold-backed note circulation, capable of stabilising the rate of exchange at the legal parity of 27d/1\$000. Not only was a stable value of the *milréis* confirmation of a sound monetary regime, but also it precluded the income and wealth shifts that an oscillating rate of exchange would bring. The creation of the third Bank of Brazil, therefore, was a logical step in the same direction of the 1846 Law that established the notional parity of 27d, as well as Law 552, of 31 May 1850, which pledged to freeze the expansion of the fiduciary circulation in the Empire. This would be accomplished, it was hoped, by the progressive substitution of convertible Bank of Brazil paper for Treasury notes. The ambition of the government was dependent on the Bank of Brazil retaining its monopoly of note issue.

The creation, by government decree, of new note-issuing banks, in 1857-8, showed just how difficult it was to reconcile demands for money supply increases and maintenance of exchange-rate stability. The episode also served to qualify the belief that the Bank of Brazil somehow managed to direct government policy to suit its interests. By allowing new entrants into the market, the government gave an indication of the conflicting relationship it would have with the semi-official bank throughout the duration of its contract. The reaction to the 1857 crisis also made clear

the central dilemma involved in the relationship between Bank and government. The initial attempts by the Bank to sustain the rate of exchange quickly gave way to an autonomous policy of meeting domestic demand for discounts. In other words, when called to assist the government to prop up the currency, the Bank ended up adopting the policy it believed was in the interest of its shareholders. Without a doubt, this was an institution with a considerable degree of autonomy.

The analysis of the events that followed the recovery from the 1857 crisis has shown how advocates of hard money managed to take control over the conduct of economic policy. The dismissal of the *Conciliação* cabinet, replaced by a Conservative administration, opened the way for the introduction of new rules for corporations in general, and banks of issue in particular, the so-called “Law of Impediments” (Law 1083). It was seen that this law was directed at restoring a 100% gold-backed note circulation and, to that end, it imposed limits on the issue of fiduciary currency. It also regulated the operation of joint-stock companies, and provided for the replacement of copper coins in circulation. Finally, the Law of Impediments ensured the primacy of the Legislative power in chartering banks of issue.

The examination of the post-1860 period has revealed that the nature and extent of the Law of Impediments has been somewhat exaggerated by later commentators. First, it was seen that its provisions regarding legislative approval of joint-stock banks simply sought to dispel earlier confusion surrounding the chartering of banks. Second, it was shown that as regards the limits on note issues, the Law could not be imputed with causing a severe monetary contraction. In fact, as seen in Chapter 4, the Law of Impediments and Decree 2685 created limits on the issue of monetary base, or high-powered money. But they made no allowance for the operation of the monetary multiplier, so that the nominal money supply, as measured by M1, had recovered ground by 1864. More significantly, the existence of other forms of money provided by private banks (*casas bancárias*) meant that, in practice, it is likely that there was no contraction at all of the money supply in the aftermath of the Law of Impediments. The expansion of the real economy in the early 1860s lends support to this hypothesis.

It was argued that the 1860 Law should be blamed for what it did not impede, rather than its alleged impediments. Namely, the unchecked operation of the private banks, which engaged in the issue of *vales* and, also, accepted huge volumes of deposits. Lack of any official surveillance of their operations meant that prudential controls were conspicuous by their absence. As a result, in all likelihood it was due to their reckless operations that the Souto crisis of 1864 occurred, not on the supposedly severe monetary crunch brought about by the 1860 legislation.

It was also shown that the government and the Bank of Brazil reacted to the 1864 crisis in a fashion that helped ease its effects on the markets. The government, by adopting extraordinary bankruptcy legislation and by relaxing the rules that constrained the operations of the Bank; in particular, the requirement of convertibility and issuing limits. The Bank itself, by discounting heavily, and at a high interest rate, against good collateral. Nevertheless, its subsequent failure to resume redemption of notes into gold made for an intensification of attacks on its privileges. The Bank's position, in turn, was partly a result of its having to discount increasing amounts of Treasury bills. In other words, the government's fiscal imbalance was preventing the attainment of the ultimate goal of a stable currency. At the root of the problem was the massive increase in expenditures brought about by the outbreak of the Paraguayan War. The need to secure victory at all costs meant that the price to be paid would be a momentary departure from the principles of sound finance that the government never failed to profess. In practice, this meant the Treasury taking over from the Bank of Brazil the monopoly of issue of inconvertible notes. Additionally, it involved the issue of debt in all forms - *apólices*, *bilhetes*, and a foreign loan.

In examining the evolution of monetary and banking policies in the 1850-70 period, Chapters 3 and 4 have shown that the imperial government often displayed a predilection for hard money, as rightly stressed in the literature. This was the case, for example, when it cracked down on the illegal issue of *vales* by banks such as the Mauá, MacGregor. Also, when allowing the Bank of Brazil a mere 2:1 ratio for its gold-backed issues of notes. The Law of Impediments and Decree 2685, although not very effective in reducing the money supply, were nevertheless characterised by a generally conservative approach to monetary management. Finally, the conclusions

of the inquiries into the 1857 and 1864 crises reveal just how much banks of issue were generally disliked by government officials.

Nevertheless, contrary to the claims of most of the historiography, the imperial government was not always staunchly monetarist. For example, it created the third Bank of Brazil in part with an eye to providing the provinces with the necessary currency to finance genuine economic activity. Also, when it felt that the amount of money in circulation was not sufficient, the government gave the go-ahead for the creation of new banks of issue, in 1857-8. The reaction to the 1864 crisis, when the Bank of Brazil was allowed to lend liberally to the market, is further evidence of the government's frequent departure from monetary conservatism. Finally, and most prominently, the recourse to all forms of monetary expansion in which the government embarked during the Paraguayan War serves to show that it was willing to compromise on its ideological convictions for the sake of the survival of the Empire. Overall, then, instead of seeing the imperial government as invariably hostage to monetarist thought, it is more appropriate to portray it as displaying a remarkable degree of conservative pragmatism in monetary and banking policy.

PART III - THE STRUGGLE OVER MONEY AND BANKING

Introduction

Part III examines in detail the most salient elements which emerged from the examination of Brazilian monetary and banking history between 1850 and 1870, undertaken in Part II. Chapter 5 provides an analysis of the debates in the Chamber of Deputies, and in the Finance Standing Committee of the Council of State. It can be argued that debates in the Chamber reflected parochial interests, including those of the planter class, while the larger, “national”, perspective shaped discussions in the Council. Hence, it may be expected that a “soft” approach to monetary management appeared prominently in parliamentary discussions, while a more conservative tone was adopted in the Council of State. A comparison of the main elements in the debates held in both bodies should provide some indication as to the nature of the imperial State, as discussed in Part I. More specifically, it should shed light into the extent of the autonomy of the State from the dominant class (*fazendeiros*), when setting monetary and banking policy.

The questions of issuing rights and convertibility are the subject of Chapter 6. As already indicated, issuing rights were a hotly contested feature of nineteenth-century monetary debates, both in Brazil and elsewhere. Section 6.1 deals with the broader elements of the English monetary debates, which greatly influenced discussions in Brazil. The Brazilian experience is examined in section 6.2.1, which shows the extent of official regulation of issues of both *vales* and banknotes. Convertibility, in turn, is the topic of section 6.3. Adherence to gold, which was sought throughout the period under examination, would ultimately define the type of monetary policy and exchange-rate regime under which the Brazilian economy would operate. The research will bring out the finer details of Brazil’s peculiar gold standard system. Against this backdrop, the dispute between *metalistas* and *papelistas*, which figures prominently in the historiography, is analysed in detail.

Finally, Chapter 7 is dedicated to framing the discussion about the particular combinations of monetary policy and exchange-rate regime favoured by the major participants in the Brazilian monetary debates. As will be shown, this discussion was informed by different views concerning the role of banks in the economy. Three

perspectives are examined: the “developmental”, “statist” and “orthodox”. The polar cases - “developmental” and “orthodox” - derived from a different set of preferences about monetary and banking policy, and each implied competing approaches towards issuing rights and convertibility. Developmental considerations - which have dominated the historiography - emphasise the failure of the banking system to support economic development. The research will show how, more often than not, orthodox concerns with monetary restraint and exchange-rate stability would prevail over developmental demands for monetary expansion and cheaper credit. This implies that the “statist” perspective - meaning banks acting as financiers of the State - would not be considered as a valid policy option. Finally, it will be argued that disagreement over the duty of the Bank of Brazil to serve as guarantor of monetary stability prevented it from exercising a “proto-central bank” role in times of distress.

Chapter 5 - Contemporary Views on Money and Banking: the Chamber of Deputies and the Seção de Fazenda

In Chapter 1 it was argued that some of the major political actors in nineteenth-century Brazil entertained different preferences concerning monetary and exchange-rate policy. More specifically, it was seen that, in principle, *fazendeiros* and the central government stood at opposite poles when it came to their desired level for the exchange rate and the degree of monetary autonomy enjoyed by the issuing authorities. While exporters of primary products favoured the low/high scenario, comprising a depreciated *milréis* and an expansionist monetary policy, the government preferred the high/low combination.

The objective of this chapter is to see to what extent the preferences that *fazendeiros* and government were known to have a priori - and which were summarised in Figure 1.3 - were actually advanced by each group in two of the major political bodies where they were represented. This will be done by examining two sets of primary sources - the records of the debates of the Chamber of Deputies (*Annaes da Câmara dos Deputados*), and of the meetings of the Finance Standing Committee of the Council of State (*Imperiaes Resoluções do Conselho de Estado na Seção de Fazenda*).¹

Throughout, analysis of this material will be made against the backdrop of the policies in the monetary and banking sphere, as examined in Part II of the thesis. Ultimately, this chapter will assess the extent to which competing contemporary views on monetary matters - as expressed in the *Annaes* and *Imperiaes Resoluções* -

¹ The reason for choosing these sources is as follows. The nature of the political system in imperial Brazil can be understood by means of an analogy consisting of a target, that is, a set of concentric circles emanating from the Emperor. The circle closest to the centre included the elements that provided cohesiveness to the political edifice of the Empire. This circle could be thought of as a continuum, at the far end of which were national deputies, followed by presidents of provinces, ministers of state, senators and members of the Council of State. 'At the first extreme, the maximum of politics, understood as "partisan passions", uncontrollable, linked as they are to local, petty, immediate, interests; at the other extreme, the absence of politics, the predominance of reason, of general interests, which coalesce with the interests of the nation'. Cf. Mattos, *O Tempo*, p. 178. Deputies, of course, were involved in party politics. Additionally, they were representatives of local, "petty", interests, among which those of *fazendeiros*. Members of the Council of State, on the other hand, were the antithesis of deputies. Partisan politics was seldom present in the discussions in the Council. In this respect, council members were expected to be even more "apolitical" than senators. Like senators, though, they had life tenure. Council members were, by definition, "men of reason". And reason and the overall interests of the State were often seen as one. *Ibid.*, pp. 170 ff.

ended up being adopted and transformed into policy.² This, in turn, will be used to infer to what extent the imperial State was autonomous from the dominant class (*fazendeiros*) when implementing monetary and banking policy between 1850 and 1870.

5.1 - Monetary Debates in the Chamber of Deputies

In Chapter 2 it was said that it is not possible to establish the precise class origin of members of the General Assembly. Still, there is no question as to the Assembly's elitist composition, given the nature of the electoral system, which made it virtually impossible for members of the lower classes to win a seat in it. It seems therefore safe to state that the Chamber of Deputies - which tended to be a more open "club" than the imperial Senate - was composed of members of both the urban elite (merchants, lawyers, doctors, journalists etc.) and the rural sector, that is, landowners.³ In the absence of major organisations at the time representing the interests of planters, the Chamber of Deputies would have been a privileged location in which the rural class could make its views heard and indirectly influence government policy.⁴

² The *Annaes*, of course, do not exhaust the possible sources of information regarding demands from the planter class. Yet, they are an excellent means to grasp contemporary views on a host of subjects of national importance, and the banking question was certainly in this category. Moreover, prior to the 1870s *fazendeiros* had few organisations directed at advancing their interests. Commercial associations, although boasting planters amongst their members, tended to function mostly as ad hoc advisers to official policy. Similarly, another major class association of the time - the Sociedade Auxiliadora da Indústria Nacional - operated mostly in the provision of technical advice to planters, especially through its monthly bulletin, *O Auxiliador da Indústria Nacional*. Finally, demands from the planter class could circulate - with less impact on official policy - as pamphlets, and in the press. In the end, therefore, political demands, however diffuse, were brought to the Chamber of Deputies. On the history of the Sociedade Auxiliadora, see E. Carone, *O Centro Industrial do Rio de Janeiro e a Sua Importante Participação na Economia Nacional, 1827-1977* (Rio de Janeiro, Cátedra, 1978).

³ Unfortunately, secondary sources seldom provide information on either the occupation of national deputies or their party affiliation. Occasionally, however, there are references to deputies who were planters, although there are grounds to believe that many representatives identified as professionals were also landowners. In what follows, party affiliation will be given whenever information could be obtained. When this was lacking, only the province being represented by a particular deputy will be mentioned.

⁴ See footnote 2, above. Even though planters would also be represented in provincial assemblies, the national nature of legislation relating to money and banking made the Chamber of Deputies the logical place for *fazendeiros* to try to influence policy in that area.

The discussion that follows is based on a close examination of the bulk of monetary debates held in the Chamber between 1853 and 1866.⁵ In terms of the banking history of the Empire, this period is bounded by the debate over government support to the Banco Comercial do Rio de Janeiro and Mauá's Bank of Brazil, and the 1866 banking reform that restored note issuing rights to the Treasury. First, some general features of the discussion will be highlighted. Then, the main substantial elements of the monetary debates will be examined. The latter are organised under three broad themes: their political/partisan nature; the question of issuing rights and convertibility; and the competing perspectives on the role of banks in the economy.⁶

The legalistic spirit, typical of the Iberian tradition, was a general feature of the debates in the Chamber of Deputies. For example, from the moment the Bank of Brazil was created, deputies could not agree whether this implied a replacement of the 1846 "gold standard" law or not. In other words, it was not clear who was responsible for maintaining the stability of the currency, if the government (as mandated by the 1846 law), the Bank, or both. Attachment to legal questions was particularly felt in the 1858 and 1859 sessions, when the country experienced a dramatic shift both in banking policy and in the political arena.⁷ The period witnessed the introduction of plurality of note issue and the demise of the *Conciliação* experiment. At the time, legal discussions over whose competence it was to authorise banks to operate - the Executive's or the Legislative's - occupied many of the speeches, until it was finally settled in November 1860.⁸ Attempts by the government to reduce unilaterally the total amount of banknotes in circulation were also contested on legal grounds. As a final testament to the importance of legal aspects, it is worth noting that even deputies who sympathised with the restrictive spirit of the Torres Homem project objected to it as being in breach of banks' rights.⁹

Oddly, parochial interests were seldom defended openly, or at least registered in the transcription of the monetary debates in the Chamber. One of the rare instances where a deputy took to the tribune to defend his constituency was during the 1853

⁵ This comprised more than 600, two-column, pages of parliamentary papers.

⁶ The second and third points are the subject of Chapters 6 and 7, respectively.

⁷ The episodes referred to in this section were examined in detail in Chapters 3 and 4.

⁸ See, in particular, session of 22 May 1859, in *ACD*, Tome II.

⁹ See session of 1 July 1859, in *ACD*, Tome III, p. 8.

session. On the occasion, deputy Silveira da Mota (São Paulo) protested against the government's intention to confine to first-class commercial drafts the paper to be discounted by Rio banks. Bills of exchange drawn in Santos, with two known signatures, should deserve the same treatment, he argued.¹⁰ Also, in 1859, Martinho Campos (Liberal, Rio de Janeiro), criticised the Minister of Agriculture for disregarding two petitions sent by municipal councils located in the Paraíba Valley, against the Torres Homem banking reform.¹¹ They had been filed by planters from the coffee-growing municipalities of Valença and Vassouras, the latter being Campos' place of residence. The Minister replied that technically speaking municipal councils were not in a position to forward petitions on subjects that were outside their competence. The matter died there.

A final general feature of the monetary debates in the Chamber was the recurrent use of long quotations from English debates. Citing foreign authors invested deputies with the necessary credentials to take part in the discussions. The experience of other countries with banks of issue, or mortgage legislation, was also advanced.¹²

Unsurprisingly, the first major characteristic that transpires from the debates over the monetary question in the Chamber of Deputies is their partisan nature. This was particularly clear throughout the 1858-9 period, which saw a shift from the experiment with plurality of note issue, to the *metalista* backlash, that ultimately resulted in the 1860 Law of Impediments. At the start of the 1858 legislative year, Minister of Finance Souza Franco came under fire for his handling of the banking question in 1857. The chartering of six new banks of issue in 1857-8, and the operation undertaken to defend the rate of exchange from the effects of the 1857 crisis, were favourite targets of the opposition to the *Conciliação* cabinet. Teixeira Junior, the Conservative deputy from Rio, accused Souza Franco of opening the way for 'wanton speculation' after granting authorisation for the opening of the new banks

¹⁰ Session of 11 June 1853, in *ACD*, Tome II, pp. 162-5.

¹¹ Session of 23 July 1859, in *ACD*, Tome III, pp. 222-4.

¹² See, for example, speech by Bandeira de Mello, 13 June 1853, in *ACD*, Tome II, pp. 180-1; deputy Paula Santos, speaking in the session of 14 July 1859, in *ACD*, Tome III, p. 120; and Minister of Finance Zacarias, on 30 August 1866, in *ACD*, Tome IV, p. 161.

of issue.¹³ Five days later, Franco de Almeida, a Liberal deputy from Pará, (the same province as Souza Franco) came to the Minister's rescue, insisting on his dignity and the correctness of his banking policies.¹⁴ Souza Franco himself went to the stand and defended his acts. He claimed that the opposition's insistence on obtaining copies of the minutes of the meetings of the Council of State, convened to examine the events in the banking sphere in 1857, was unwarranted.¹⁵ Not only was this illegal, maintained the Minister, but it was no more than an oppositionist manoeuvre aimed at censuring the *Conciliação* experiment. In other words, Souza Franco suggested that underneath the apparently technical criticisms to his policies were deeper partisan objectives. In the end, the tactics of the opposition bore fruit, and the Olinda cabinet fell in December 1858, being replaced by the Conservative Abaeté ministry.

Party politics and “philosophical” convictions about monetary matters were often intermingled. For instance, plurality of note issue and economic and political freedom were often seen as part of the same liberal view of the world. In a debate held in 1859, Deputy Teixeira Junior, a Conservative representative from Rio de Janeiro province, referred to Souza Franco as the ‘chief of the economic school to which the honourable (opposition) deputies’ belonged.¹⁶ A deputy, discussing the 1866 banking reforms, urged the ‘liberal economic school, the historical Liberal party’, whose duty it was to come forward and fight the government bill which removed the issuing powers of the Bank of Brazil.¹⁷ Party affiliation, though, was not an automatic indication of preferences in monetary and banking matters. For example, in 1866, the then Prime Minister and Minister of Finance (Zacarias de Góis e Vasconcelos, a Liberal) defended his endorsement of the Senate bill spelling the end of the Bank's issuing rights, arguing:

I have always been inclined to the restrictive (banking) school; (...) I find more validity, more scientific rigour, more sense, in the restrictive school than in the

¹³ Session of 17 May 1858, in *ACD*, Tome I, pp. 32-5.

¹⁴ Session of 22 May 1858, *ibid.*, pp. 91-2.

¹⁵ Session of 17 June 1858, in *ACD*, Tome III, pp. 178-9.

¹⁶ See session of 8 July 1859, in *ACD*, Tome III, p. 66.

¹⁷ Session of 1 September 1866, in *ACD*, Tome IV, p. 182.

liberal one. I am a Liberal (...), very liberal, in politics, but there are topics in which liberty does not work well, and credit is, in my view, one of those topics.¹⁸

The voting process in monetary questions - like any other - involved instances of disagreement with party guidelines. For instance, in 1859 deputy Sá e Benevides (Alagoas), shortly after publicly announcing his support of the Conservative cabinet headed by Abaeté, claimed he was voting against the government-sponsored Torres Homem banking project, on the grounds that the measures contained therein were ‘extremely harmful to the public good’.¹⁹

Despite these few instances, it is fairly safe to argue that as far as their “philosophical” positions were concerned, Conservatives tended to support restrictive monetary and banking legislation, while Liberals usually sided with plurality of issue and expansionist monetary policies. It took an exceptional situation to bring both parties - and schools of thought - to agree on a set of measures in the monetary and banking realm. For example, the 1866 government project aimed at reforming the Bank of Brazil and providing the government with additional Treasury issues to finance the Paraguayan War. In reference to the long-lasting dispute between *metalistas* and *papelistas*, Prime Minister Zacarias claimed that the project did not imply ‘the defeat of one school and the triumph of the other’²⁰ He stressed that the bill had received the support from both Itaboraí (a Conservative) and Souza Franco (Liberal). In the end, it was approved with minor modifications, and became Law 1349, of 12 November 1866. In all likelihood, the blessing it received from the two financial experts in Parliament helped the government carry the vote.

From early days Itaboraí and Souza Franco were caught in the middle of parliamentary disputes. Their speeches in the Senate were closely followed by many national deputies, and were often used to attack their respective parties’ stance on particular topics. Thus, the decision by the government to come to the aid of the two Rio-based banks in 1853 - by allowing them an extraordinary increase in their *vale*

¹⁸ Ibid., p. 190. This is, of course, a statement of the major single exception to *laissez-faire* arguments made by modern market-oriented economists, and which leads them to advocate government command of monetary policy. For an elaboration, see M. Friedman and A. J. Schwartz, “Has Government Any Role in Money?”, *Journal of Monetary Economics*, Vol. 17, 1986, pp. 37-62.

¹⁹ Session of 15 July 1859, in *ACD*, Tome III, p. 133.

²⁰ These schools of monetary thought will be examined in Chapter 6.

issues, which would be considered legal tender in the city - was heavily criticised. Deputy Bandeira de Mello (Ceará) pointed to contradictions in the proposal, coming as it did from Itaboraí, a staunch opponent of banks of issue.²¹ During the 1857 crisis, on the other hand, deputy Sérgio de Macedo (Rio de Janeiro) criticised Souza Franco for asking the Bank of Brazil to ship gold to London, in order to honour drafts used to defend the exchange rate.²² According to him, this was a clear violation of the Bank's remit, which called for the importation of gold to bolster its reserve fund, and never for the export of bullion. Clearly, both Itaboraí and Souza Franco became convenient targets for the opposing parties.

Monetary debates, of course, did not take place in a vacuum. They were part of the specific context in which Conservatives and Liberals fought each other in the Chamber. This, in turn, depended on the particular nature of the cabinet then in power. An early example of this was the opposition to the government bill providing for emergency loans to the Rio-based banks, in 1853. At the time, the Chamber of Deputies was composed entirely up of Conservative deputies. Even so, throughout the debates there were references to the “majority” and the “minority”.²³ The minority, in this particular case, was composed of disgruntled Conservative deputies from Pernambuco, part of the so-called “parliamentary opposition”.²⁴ Their general antagonistic attitude towards the cabinet headed by Itaboraí, therefore, led to opposition to the banking bill which, nonetheless, was approved. In other words, an “unanimous Chamber” was no guarantee of a smooth ride for the ruling party.

Issuing rights and convertibility were perhaps the two major topics in the Brazilian monetary debates of the nineteenth century. In the early 1850s, Itaboraí emerged as the undisputed champion of a monopoly of issue. Even as the Chamber debated the need to help out the Banco Comercial do Rio de Janeiro and Mauá's Bank of Brazil, in 1853, he backed in the Senate a project creating a large, Rio-based, bank. Paula Batista, a deputy for Pernambuco, perceived the Minister's intentions. For him, the government bill providing assistance for the two banks was no more than a

²¹ Session of 13 June 1853, in *ACD*, Tome II, pp. 182-4.

²² Session of 29 May 1858, in *ACD*, Tome I, p. 150.

²³ See session of 15 June 1853, in *ACD*, Tome II, pp. 203-10.

²⁴ See Nabuco, *Um Estadista*, Vol. I, Chapter V.

palliative, while the “national bank” was not established.²⁵ Accordingly, in June 1853 Itaboraí went to the Chamber of Deputies, as Minister of Finance, to defend the Senate bill creating the third Bank of Brazil. His pro-monopoly views were clearly put: ‘competition amongst banks, gentlemen, has been the main cause of most commercial crises’.²⁶ Deputy Lisboa Serra (Conservative, Maranhão) backed the project. Competition amongst banks was indeed dangerous, he maintained, and the recent example of the two banks in Rio supported this view. Furthermore, by centralising issues in the hands of a single institution, convertibility would be truly possible.²⁷ Other deputies were not convinced. Only plurality of issue, claimed Bandeira de Mello (Ceará), could provide commerce and agriculture with the necessary resources.²⁸ The sheer Conservative majority, however, ensured the approval of the project and the momentary triumph of monopolists.

Still, pluralists were not easily defeated. Having had their hopes boosted by Souza Franco’s experiment with new banks of issue, in 1857-8, they remained adamant about the superiority of their views. For example, João da Silva Carrão (Liberal, São Paulo, and a future Minister of Finance), vehemently opposed the 1859 Torres Homem banking reform. For Carrão, freedom to issue notes, *vales*, and commercial paper in general was an essential component of Brazilian law since colonial times. An end to that freedom, therefore, was a breach of banks’ rights.²⁹ The Ferraz proposal, an amendment to the Torres Homem bill, was overwhelmingly endorsed by the Chamber, even though it effectively tightened control over the issue of all types of paper.

If issuing rights were hotly disputed in the debates in the Chamber, convertibility was surprisingly uncontroversial. Even Mauá - alongside Sebastião Ferreira Soares, one of the few contemporaries to question the usefulness of the gold standard for Brazil - at times seemed to agree with the view that banknotes should

²⁵ Session of 15 June 1853, in *ACD*, Tome II, p. 206.

²⁶ Session of 20 June 1853, *ibid.*, p. 259.

²⁷ Session of 21 June 1853, *ibid.*, pp. 270-1.

²⁸ Session of 22 June 1853, *ibid.*, p. 283.

²⁹ Session of 30 June 1859, in *ACD*, Tome II, pp. 236-40.

preferably be redeemed in gold.³⁰ Even opponents of the overwhelmingly *metalista* Torres Homem project of banking reform emphasised the need to resume convertibility of Bank of Brazil notes, in an effort to prevent a further depreciation of the *milréis*.³¹ Torres Homem himself thus summed-up the general view:

Gentlemen, on the question of unity and plurality of banks there are, as we all know, two opposing schools; but there is a fundamental point in which advocates of free competition find themselves in perfect agreement with their adversaries, and that is that free competition would entail the anarchy of credit and a turmoil in circulation, were it not for the check imposed by convertibility of notes into gold.³²

Convertibility should be seen as the rule, argued the Visconde de Uruguai, in 1859.³³ Inconvertible paper, therefore, was the exception, admissible only in extraordinary circumstances, such as wars.³⁴ The reasons put forward for defending convertibility were the usual ones. They referred to the desire to stabilise the rate of exchange - thus preventing the income and wealth shifts associated with oscillations of the currency³⁵ - and the related question of the “good housekeeping seal of approval” sought by foreign investors.³⁶

(...) in countries where the circulating medium is formed by paper money, the slightest disturbance, the smallest sinister event may give rise to the exportation of a great mass of capital. Capitalists become frightened, they fear that the fall of the exchange rate, the depreciation to which this type of currency is exposed, will cause them losses. They therefore seek to prevent it, promptly exporting their capital. This

³⁰ When debating the Torres Homem bill of banking reform, Mauá stated, to the surprise of Teixeira Junior, that the Bank of Brazil ‘should redeem (its notes) in metal whenever possible’. Session of 8 July 1859, in *ACD*, Tome III, p. 70. Indeed, at first sight this was a striking assertion, coming as it did from one of the most outspoken *papelistas*. Yet, on closer inspection, Mauá was simply affirming that, in principle, convertibility should be sought. This implicitly meant that in the impossibility of having a gold-backed circulation, temporary use of paper money should be considered. Mauá’s views on money and banking will be discussed further in Chapter 6.

³¹ See speech by deputy Franco de Almeida (Pará), in the session of 15 July 1859, *ibid.*, p. 144.

³² Session of 6 July 1859, *ibid.*, p. 42.

³³ Session of 2 July 1859, *ibid.*, p. 15.

³⁴ *Ibid.*

³⁵ On this point, see the report of the joint Justice, Finance and Commerce Committee of the Chamber of Deputies, on the Torres Homem project for banking reform, reproduced in the session of 22 June 1859, in *ACD*, Tome II, pp. 195-6.

³⁶ On the gold standard as a sign of macroeconomic policies deemed “appropriate” by foreign investors, see Bordo and Rockoff, “The Gold Standard”.

export brings, in turn, a further depreciation of the currency, the depreciation increases their fears, and this increased fear produces greater (capital) exports.³⁷

Although exchange-rate instability was generally regarded as an evil, there remained considerable disagreement amongst contemporaries as to the actual determinants of the external value of the *milréis*. The most widely accepted view was that the rate of exchange was determined exclusively by the volume of currency in circulation. This was the usual *metalista* claim that a monetary supply in excess of the needs of the economy resulted in a depreciation of the currency. As mentioned earlier, the Visconde de Uruguai was one of those who equated “too much” money with a depreciating *milréis*.³⁸ Against this majority view stood those who dismissed monetary influences on the exchange rate altogether. The trade balance, instead, was seen as the main force that determined the rate of exchange, a position which one *metalista* sympathiser suggested was a remnant of mercantilism.³⁹ Finally, a few perceived the role played by both monetary and balance of payments forces on the value of the *milréis*.⁴⁰ Regardless of more “heterodox” explanations, the *metalista* view was undoubtedly triumphant. Consequently, efforts to “improve” the quality of the circulating medium would always involve reducing the amount of notes in the economy.

National deputies, like other people of influence at the time, entertained conflicting views on the proper role of banks in the economy. Ultimately, their stance reflected predilections about monetary management. In terms of the framework introduced in Chapter 1, opinions concerning the role of banks derived from whether contemporaries favoured hard money or soft money. As already noted, hard money had in Torres Homem one of its staunchest supporters. For him, banks should act, first, with a view to preserving macroeconomic stability and, secondarily, in supporting economic activity. For example, Torres Homem insisted that the 1853 law creating the third Bank of Brazil had replaced the 1846 “gold standard” law and, as such, the Bank had taken over from the government the task of ensuring the stability

³⁷ Speech by Itaboraí, session of 20 June 1853, in *ACD*, Tome II, pp. 261-2.

³⁸ Session of 2 July 1859, in *ACD*, Tome III, p. 14.

³⁹ Speech by deputy Sampaio Vianna (Bahia) in the session of 19 July 1859, *ibid.*, pp. 177-9.

⁴⁰ Speech by deputy Coelho de Castro (Rio de Janeiro) in the session of 4 July 1859, in *ACD*, Tome V, Appendix, pp. 48-9.

of the currency.⁴¹ Basically, this meant retiring Treasury notes from circulation, until the country's currency consisted exclusively of gold-backed Bank paper. Ironically, the chief architect of the Bank, Visconde de Itaboraí, had stated in 1853 that the main objective of the institution was the 'development and expansion of credit' and, secondarily, the "improvement" of the circulating medium.⁴² Not exactly the stance expected from the chief ideologue of the *metalistas*.⁴³

Despite the high profile of advocates of hard money, soft money was also popular amongst deputies. For a number of members of Parliament, banks, especially those entrusted with issuing rights, were an essential engine of economic development. In the words of Bandeira de Mello (Ceará), they were 'ingenious constructions designed to pass capital, that otherwise would have remained unproductive, to the hands of men who will make it bear fruit'.⁴⁴ Advocates of liberal monetary and banking policies often realised the implicit trade-off involved in such an approach, which pitted developmental considerations against the desire to stabilise the currency. In attacking the Torres Homem project on banking reform, José Antonio Saraiva (Conservative, Bahia) stated that

the Minister wants the banks to survive, and to survive under the nightmare of the improvement of the circulating medium. He wants industry to wither, credit to stagnate, commerce not to develop, just in order that the oscillations in the currency

⁴¹ See session of 26 July 1859, *ibid.*, p. 66.

⁴² 'It has been said that the project submitted to the appreciation of this august Chamber aims at improving the circulating medium. This proposition is not correct. The main purpose of the project is to develop and expand credit, and by those means assist the operations of industry and commerce'. Session of 20 June 1853, in *ACD*, Tome II, p. 259. In fairness to Itaboraí, after claiming that the main objective of the projected new bank was not the "improvement of the circulating medium" he quickly added that 'given that this (improvement was) a public necessity, and (would) equally help the banking institutions to operate more freely and unimpeded, (he) deemed convenient to call the new institution to help in this improvement'. *Ibid.*

⁴³ Still, the view that the Bank had an important role to play in, amongst other things, fighting commercial crises was put forcefully in 1866. At the time, deputy Silva Ferreira (Mato Grosso) felt strongly that the government was wrong in terminating the Bank's right to issue notes, for this would have meant doing away with its role as lender of last resort: '(...) issuing banks constitute a permanently plentiful source of funds for discounting operations, especially in times of crisis, when credit dries up, and money is needed'. Session of 29 August 1866, in *ACD*, Tome IV, p. 150. The government, of course, was not moved by these arguments. At that time, war financing took precedence over any concern with the Bank's desired role in fighting commercial crises. The role of the Bank of Brazil as a lender of last resort will be explored in Chapter 7.

⁴⁴ Session of 18 June 1853, in *ACD*, Tome II, pp. 246-7.

are less frequent. He does not want to go forward, to navigate, because he does not want to feel the movement of the ship, the jolt of the odd torment.⁴⁵

In short, Saraiva acknowledged that the price to pay for banks' support for economic activity was a measure of instability in the currency. The problem, of course, was knowing how much oscillation and depreciation would result from expansionist monetary policies. And this no one could foresee.

The needs of agriculture were the main concern of pro-banking deputies. To the charge that the banks of issue brought little benefit to agriculture it was replied that, on the contrary, the sector had indirect access to credit.⁴⁶ But access via middlemen resulted in *fazendeiros* paying high rates of interest on their loans. For Luis Antonio Barbosa (Minas Gerais) - a member of the Justice commission that examined the Torres Homem project - factors (*comissários*) would have little to gain from the changes proposed by the government. Planters, on the other hand, would at least be spared the false illusion afforded by the successive renewal of their drafts.⁴⁷ Martinho Campos, a Liberal deputy from the coffee-growing Paraíba Valley region of Rio, insisted on the usefulness of factors, who 'provided a benefit to agriculture'.⁴⁸ Other deputies were not so sure.

Ferreira Aguiar (Pernambuco): The real benefit is for themselves.

Carneiro da Cunha (Pernambuco): It would be even worse without them.

Aguiar: Why?

Cunha: Because planters would not have the advantages they have today.

Aguiar: Yet, planters, (...) even when they offer the most secure collateral, are unable to obtain resources from existing banks!⁴⁹

In 1853, Joaquim Nebias (São Paulo) complained that the proposed "national bank" would do little to help the agricultural sector. Bills dealing specifically with rural property lay dormant in commissions in the Chamber, he claimed.⁵⁰ Nothing

⁴⁵ Session of 7 June 1859, in *ACD*, Tome III, p. 56.

⁴⁶ Deputy Francisco José Pacheco (São Paulo), in response to Francisco Athayde (Minas Gerais), session of 22 July 1859, *ibid.*, pp. 219-20. This point will be seen in greater detail in Section 7.1

⁴⁷ Session of 16 July 1859, *ibid.*, p. 159.

⁴⁸ Session of 14 July 1859, *ibid.*, p. 132.

⁴⁹ *Ibid.*

⁵⁰ Session of 21 June 1853, in *ACD*, Tome II, p. 265.

would change until agricultural property was delimited and properly defined, added Lisboa Serra.

How does the honourable deputy expect that an unknown, undefined, draft be accepted in the market? Would an unknown, mysterious, draft obtain money in any market in the world? Well, our agriculture is at present this undefined and mysterious draft (...). Planters would enjoy more trust than anyone else if only their property could be converted into values that would be accepted by commerce.⁵¹

Having agreed on the need to better define property rights in land, deputies nonetheless had second thoughts about the ability of issuing banks to help agriculture. The sheer imbalance between the short-term nature of issuing banks' note liabilities, and planters' drafts was all too real. João de Almeida Pereira Filho, a planter representing the province of Rio de Janeiro, put the question in precise terms when discussing the 1859 banking reform.

A lot has been said about agriculture, the great losses it will suffer with these measures, as well as the great benefit it currently receives from banks. But, have you ever seen issuing banks, having to renew drafts every four months, protect agriculture effectively? What we need in this country is mortgage credit, for issuing banks (...) are of little use to agriculture, whose products are by their own nature long-term (...).⁵²

In short, deputy Pereira Filho was echoing the opinion of many contemporaries, and clearly arguing for long-term lending to agriculture. The new mortgage department of the Bank of Brazil, created in 1866, was thought to address these demands. Hopes were soon dashed, though, as it became clear that the main objective of the banking reform had been to provide the government with resources to carry out the war with Paraguay.⁵³ 'Agriculture will go on paying 15% or more', claimed Silva Pereira (Mato Grosso).⁵⁴ Still, others went so far as stating that mortgage credit was not needed at all: 'agriculture has sufficient commercial credit; what it really needs is low

⁵¹ Ibid., pp. 272-3.

⁵² Session of 23 July 1859, in *ACD*, Tome III, pp. 233-4.

⁵³ 'Leave aside the commercial question, leave aside the financial question, do not attempt, under pretence of helping commerce, to deal with fiscal interests (...)'. Deputy Joaquim Nebias (Conservative, São Paulo), session of 12 June 1866, in *ACD*, Tome II, p. 102.

⁵⁴ Session of 29 August 1866, in *ACD*, Tome IV, p. 150.

interest rates (...).⁵⁵ Be that as it may, demand for cheaper credit for agriculture would persist, at least, until the end of the Empire.⁵⁶

5.2 - Monetary Debates in the Seção de Fazenda

As seen in Chapter 2, the Council of State was in itself an elite within the imperial elite. Its members, drawn from the ranks of the Senate, comprised some of the most experienced politicians in the land. The Emperor consulted their opinion when using his Moderating Power. The full, 12-member, Council (Conselho Pleno) usually dealt with political issues. The four standing committees (*Seções*), in turn, were consulted about technical questions pertaining to their respective areas of competence. The records of the meetings of the *Seções*, thus, provide an opportunity to examine the views of a select group of politicians on important questions of policy, expressed in dispassionate fashion.⁵⁷

The three-member Seção de Fazenda was consulted in connection with several subjects, some of which were not even remotely related to finance. Thus, it was called to give its opinion on questions linked to provincial laws, pensions, and inheritances, for example. Yet, and more importantly, it was consulted on matters of tariffs, taxation and banking. The usual procedure in cases relating to money and banking was as follows. Businessmen interested in opening up a bank, for instance, would get in touch with the president of their respective province, who would send a memorandum in support of their request to the Minister of Finance.⁵⁸ The Minister, in turn, forwarded this request to the Seção de Fazenda, which, after deliberation,

⁵⁵ Deputy Paula Santos (Minas Gerais), session of 30 August 1866, *ibid.*, p. 167.

⁵⁶ See Franco, *Reforma*.

⁵⁷ '(The records of the meetings of the Council of State) constitute a source with unique characteristics, not found elsewhere, which make it a valuable subject of analysis. One of these characteristics is the fact that they represent what could be termed the views of the elite within the elite'. Cf. Carvalho, "Conselho de Estado", p. 380.

⁵⁸ Requests could also originate with class organisations, such as commercial associations. This was the case of Consultation No. 491 (31 March 1858), when the Commercial Association of Pernambuco sought permission to issue promissory notes (*vales*), in order to address the shortage of small change in the province. See *SFCE*, Vol. IV, pp. 267-8.

would provide a resolution (*resolução*) in favour of, or against, the request.⁵⁹ Resolutions were then sent to the Emperor, with the following words: ‘(...) this is the Committee’s opinion, but Your Royal Highness will decide as He sees fit’. The Emperor normally, but not always, followed the Committee’s decision. If favourable to the request, a decree could follow.

Resolutions varied in length from half a page to, sometimes, almost 20 pages, containing long historical and theoretical digressions in support of the Committee’s final position. The *rapporteur* tried to summarise the opinion of all three members. Yet, whenever substantial divergence emerged, these opinions would also be included in the records, and be taken to the Emperor. Individual consultations could contain more than one request. For example, at times different people would seek permission to open up banks in different cities. Yet, this was rare, and consultations usually referred to a single request. Furthermore, a particular request could return to the *Seção de Fazenda*, for a new opinion.⁶⁰ Also, and depending on the nature of the request, the Emperor could seek the advice of more than one standing committee.⁶¹ On rare occasions, the matter originally brought to the Committee would be referred to the *Conselho Pleno*, so that other council members could be consulted.⁶² Finally, if the *Seção da Fazenda* thought that a particular request should be addressed to the Legislative, not the Executive, the proposal would be forwarded to the Assembly for examination.⁶³

Between 1850 and 1870, inclusive, the *Seção de Fazenda* was consulted 722 times, which gives an average of over 34 consultations per year. Of those, 164

⁵⁹ Technically speaking, the Committee gave “consultations”. However, in order to avoid confusion, in what follows “consultations” will refer to the issues brought to the Committee’s attention, and which, after deliberation, would result in “resolutions”.

⁶⁰ See, for example, Consultation No. 441, 1 November 1856. A João Baptista da Fonseca requested the approval of the statutes of a bank in Rio (*Sociedade de Comércio e Indústria*), but was refused. The same request, with some modifications, was later brought to the attention of the *Seção de Fazenda*, on 15 June 1857 (Consultation No. 471). Again, it was turned down. Finally, the bank was given the go-ahead in April 1859, by Minister of Finance Torres Homem. Still, it would never start operations. See *SFCE*, Vol. IV, pp. 92-106, and 186-7.

⁶¹ See, for example, Resolution No. 538, of 28 December 1859, when the Finance, Justice, and Empire (Interior) standing committees were consulted about the request by the Bank of Brazil to have its issuing limits increased. *Ibid.*, pp. 374-6.

⁶² See Resolution No. 708, 14 June 1862, in *SFCE*, Vol. V, pp. 284-8. The matter was later examined by the *Conselho Pleno*. See *ACE*, Vol. V, pp. 278-94.

⁶³ See Resolution No. 561, 21 April 1860, in *SFCE*, Vol. IV, pp. 438-40.

(22.7%) involved matters pertaining to money and banking. In 62 cases out of the 164 consultations on monetary and banking issues (37.8%) governmental decrees were issued in support of the application, which serves to show the importance of the Seção de Fazenda in advising Executive policy.

Table 5.1
Consultations Made to the Seção de Fazenda, 1850-70

Year	Total	Money and Banking	%	Year	Total	Money and Banking	%
1850	47	3	6.4	1861	81	20	24.7
1851	17	2	11.8	1862	37	8	21.6
1852	27	6	22.2	1863	29	9	31.0
1853	20	1	5.0	1864	30	7	23.3
1854	44	11	25.0	1865	46	11	23.9
1855	24	6	25.0	1866	34	9	26.5
1856	49	8	16.3	1867	21	5	23.8
1857	30	8	26.7	1868	14	2	14.3
1858	18	7	38.8	1869	32	13	40.6
1859	38	4	10.5	1870	19	5	26.3
1860	65	19	29.2	Total	722	164	22.7

Source: *Imperiaes Resoluções do Conselho de Estado na Seção de Fazenda, desde o anno em que começou a funcionar o mesmo conselho até o presente* (Rio de Janeiro, Typ. Nacional, 12 vols., various years).

In the twenty-one years for which resolutions were analysed, the Seção was consulted, on average, 7.8 times a year on matters related to money and banking. In absolute terms, the early 1860s saw the largest amount of consultations made to the Seção, as well as consultations dealing with monetary questions. The share of the latter during most of the years immediately after 1860 also exceeded the average proportion in the 1850-70 period (22.7%).

The entire 1850-70 period may be divided into four different sub-periods, in order to bring out the most salient points. The sub-periods are as follows: 1850-3, 1854-9, 1860-6, and 1867-70. The first one relates to the years between the adoption of the Commercial Code and the creation of the third Bank of Brazil. The second sub-period covers the initial years of operation of the Bank. The 1860-6 years span the period between the enactment of the Law of Impediments and the innovation of the government's contract with the Bank. Finally, the Paraguayan War and the Treasury's monopoly of note issue marked the 1867-70 years.

Table 5.2
Consultations Made to the Seção de Fazenda, selected periods

	Total	Money and Banking	Requests to Open Banks (*)	Requests Approved
1850-53	111	12	4	3
1854-59	203	44	31	13
1860-66	322	83	22	15
1867-70	86	25	7	5
Total	722	164	64	36

Note: (*) Often several requests to open banks would be included in one single consultation made to the Seção de Fazenda, so that the third and fourth columns of the table are not strictly comparable with the first two.

Source: *Imperiaes Resoluções do Conselho de Estado na Seção de Fazenda, desde o anno em que começou a funcionar o mesmo conselho até o presente* (Rio de Janeiro, Typ. Nacional, 12 vols., various years).

From Table 5.2 it is clear that the two intermediate sub-periods concentrate the bulk of both total consultations to the Seção de Fazenda, and those specifically dealing with monetary matters. Even allowing for the different length of the sub-periods, the first half of the 1860s (1860-66) stands out as the time of most activity for the Seção. On average, 46 consultations were made every year during this period, 12 of which dealt with money and banking.

Overall, four major topics occupied the attention of council members. In order of recurrence, these were issuing rights, the Bank of Brazil, savings banks (*caixas econômicas*), and foreign banks. Also, the Finance Standing Committee was consulted on general monetary topics, such as the origins of commercial crises or the legality of certain current practices in the banking sector.

The question of issuing rights appeared regularly in the consultations made to the Seção de Fazenda. These often involved requests to approve the statutes of new banks or open branches of existing establishments.⁶⁴ From Table 5.2 it emerges that the peak for those requests occurred between 1854 and 1859. Individually, 1855 and 1857 showed to be the years where most requests of this nature were filed - eight each. Even though the Seção de Fazenda was consulted whenever individuals, or

⁶⁴ Consultations could also cover changes in statutes, requests by deposit or mortgage banks to gain issuing powers and, in the case of the Bank of Brazil, permission to increase its issuing limits.

associations, sought permission to open banks, there remained some doubts as to who had the authority to allow banks to be set up, the Executive or the Legislative. On two occasions in 1855 Itaboraí and Jequitinhonha disagreed on this point.⁶⁵ However, there was no disputing the fact that provincial assemblies were not in a position to charter banks.⁶⁶

In Chapter 1 it was argued that planters tended to prefer soft money policies, consisting of a depreciated rate of exchange and an expanding money supply. This objective could be achieved, to some extent, by allowing a greater number of banks - including banks of issue - to operate in the Empire. If so, it might be interesting to contrast the pattern of requests for the setting up of new banks and the state of the rate of exchange. The idea is that, in principle, requests for opening banks would tend to occur in times when the rate of exchange was appreciated and, therefore, exporters' proceeds in *milréis* terms were at a disadvantage.⁶⁷ If that relationship could be established, then there would be additional supportive evidence to the effect that bank formation was, to some extent, the result of demands by the planter class for soft money.⁶⁸

The first sub-period, 1850-3, is relatively uneventful in this regard. Throughout, the rate of exchange remained close to par, and requests to open up banks were few (see Table 5.2). The 1854-9 sub-period, as already noted, concentrated the largest number of this type of request - 31 in all. Until the outbreak

⁶⁵ See Resolutions Nos. 398 and 404, in *SFCE*, Vol. II, pp. 446-50, and 464-71. This point will be examined in Chapter 6.

⁶⁶ This had been established in a consultation made in 1859, concerning the chartering of a Banco Rural e Hipotecário by the province of Rio Grande do Norte. Council members strongly opposed the move, stressing that the 1834 Additional Act explicitly forbade provincial assemblies from legislating on such matters. See Resolution No. 575, 11 August 1859, in *SFCE*, Vol. IV, pp. 486-9.

⁶⁷ Of course, even if the relationship between a high exchange and an increase in the number of requests for opening banks were established, other factors might be operating. For example, an appreciating *milréis* might be the result of booming exports and economic growth which, by themselves, should imply greater demand for resources, and, possibly, requests to open banks.

⁶⁸ From the outset, it must be acknowledged that this exercise is fraught with problems, not least by the fact that the rate of exchange tended to be volatile. Consequently, a request to open up a bank when the *milréis* was at a high level might only be examined by the Seção de Fazenda a few months later, when the exchange rate might have fallen. Still, the novelty of the data calls for the exercise, however tentative the conclusions may turn out to be. Indeed, some earlier works have used the records of the meetings of the Seção da Fazenda. Yet, they have only examined a subset of the resolutions in order to illustrate a specific point, rather than attempting a general analysis of all resolutions across a long period, as is the case here. Saes, for example, used the records dealing specifically with *paulista*

of the crisis of late 1857, the *milréis* remained near par, backed by the gold reserves of the Bank of Brazil. At first, it might be tempting to ascribe the high number of requests to open up banks in 1855 and 1857 (eight each) as a confirmation of the direct relationship between these very requests and an appreciated *milréis*. On closer inspection, though, it emerges that the figures are partly biased by the presence of the Bank of Brazil, which sought permission to open six provincial offices (*caixas filiais*) in 1855. In 1857, by contrast, requests to open banks did precede the financial crisis and, thus, the fall in the value of the *milréis*. It could be argued, therefore, that requests to open banks at that point - in this case, banks of issue - were influenced by the appreciated rate of exchange and its negative effects on the profitability of agriculture in the provinces. For the remainder of the 1854-9 sub-period the devaluation of the *milréis* was accompanied by few requests to open banks - only four in all. Again, this could vindicate the relationship exchange rate/banks of issue, but most likely it reflects the pessimistic state of expectations in the aftermath of the 1857 crisis.

1863 saw the *milréis* at its highest average level for the decade.⁶⁹ Also, there were six requests to open banks in that year, despite the admittedly stringent banking and corporate legislation introduced in the 1860 Law of Impediments. More than any other year, then, 1863 could be used as “proof” of the fact that when the *milréis* was at a high level there were greater demands for an expansion of the money supply, by means of the creation of new banks.⁷⁰ Alternatively, this might support the view that a high rate of exchange promoted confidence in the economy and, consequently, demand for more money/credit. Either way, in 1869, when the rate of exchange was fluctuating between 18 and 20 pence to the *milréis*, an equal number of applications were filed - six. Yet, it is likely that this was just a natural response to six years in which only five banks sought government approval of their statutes.

banks, while Guimarães was interested in the opinion of the Seção de Fazenda on matters pertaining to the Mauá, MacGregor Bank. See Saes, *Crédito*; and Guimarães, “Bancos”.

⁶⁹ See Table A7, in the Statistical Appendix.

⁷⁰ It is worth remarking that coffee prices were at an all-time peak in 1863 (at 12.3 cents/lb.), which, *ceteris paribus*, meant high profitability for the sector and, in principle, a slackening of requests for the opening of banks. Conversely, these high prices by themselves might have led to an expansion of production and, hence, demands for more credit. For data on the coffee sector, see the Statistical Appendix, in M. Martins and E. Johnson, *150 Anos de Café* (Rio de Janeiro, Salamandra, 1992).

All in all, as already suggested, the picture that emerges from comparing the level of the exchange rate and requests to open banks is patchy, at best. It is clear that many forces have a bearing on the decision to open a bank. The records of the meetings of the Seção de Fazenda do not offer any indication as to the authors of the requests, apart from, occasionally, the names of the applicants.⁷¹ Perhaps planters had little to do with these requests. From the above, it appears that only for 1857 and 1863 could a case be made about the relationship between the level of the exchange rate and decisions to open banks.

Issuing rights were linked to a broader debate pitting advocates of plurality of issue against proponents of monopoly. This, in turn, involved different views as to the role of banks in the economy and, ultimately, sympathy with soft money or hard money. On 14 June 1862, the Finance Standing Committee was consulted about a request from the Bank of Brazil, urging the government to stop new issuing banks from being created. On the occasion the Bank alleged that unless it was granted a monopoly of note issue for the next twenty years it would not be able to ensure the stability of the currency.⁷² After deliberation, the Committee concluded that it was unable to give a definitive answer to the Bank, for want of the necessary data. Still, Jequitinhonha, the *rapporteur*, was in favour of the request. Councillors Itaboraí and Abrantes, on the other hand, maintained that even without competition the Bank would not be capable of ensuring the stability of the currency. The matter was then referred to the General Assembly. On the same day, the Seção was consulted about the Bank's plans to merge with one of its two competitors in the capital.⁷³ Once again Jequitinhonha was in favour of a measure that would have ensured a monopoly of note issue for the Bank in Rio (which it eventually did). Itaboraí and Abrantes remained opposed. They deemed monopoly in Rio alone insufficient for the Bank to fulfil what amounted to a "proto-central bank" role.⁷⁴ Also, they believed the matter had to be judged by the Legislative, not the Executive, a view shared by the

⁷¹ Additionally, seldom, if at all, do the transcripts of resolutions provide much clue as to the motivations behind those requests.

⁷² Resolution No. 708, in *SFCE*, Vol. V, pp. 284-8.

⁷³ Resolution No. 709, *ibid.*, pp. 288-94. For the events leading to the merger, see Chapter 4.

⁷⁴ More on this in Chapter 7.

rapporteur, Jequitinhonha. Accordingly, the question was also referred to the General Assembly.⁷⁵

Earlier, the Seção had examined the alternative to monopoly - plurality of banks of issue. When analysing the requests for the establishment of several banks, in 1856, Itaboraí noted that ‘from an excessive number of banks operating in the same sphere of commercial transactions arise serious inconveniences (...), as well as commercial and monetary crises (...)’.⁷⁶ The supposed failure of the American experiment with free banking was used as an argument for turning down a request for the opening of a bank in the province of Ceará.⁷⁷

As already emphasised, issuing banks were seen as the natural way to provide the economy with an increasing supply of currency and, ultimately, lower rates of interest. The Seção de Fazenda was asked to give an opinion on the creation of banks of issue on thirteen different occasions.

Figure 5.1

Seção de Fazenda: requests for creation of banks of issue

Resolution/ Consultation	Date	Bank	Final Decision from the Seção de Fazenda
280	7 Jun 1851	“Second” Bank of Brazil (Mauá) (*)	Against

⁷⁵ If issuing rights were a contentious question among some council members, there was no disputing the need to ensure convertibility of banknotes. In four different consultations, in 1856 and 1857, the Seção de Fazenda examined requests for the establishment of issuing banks. In three cases - Caixa Comercial da Bahia, Banco do Maranhão and Banco da Bahia (see Figure 5.1) - the Committee was in favour of allowing the banks to be created, so long as they ensured redemption of their notes in gold or Treasury notes. These were the same conditions that applied to the Bank of Brazil. The fourth request, made by the Banco Comercial de Campos, was turned down, on the grounds that its statutes did not provide for the redemption of its notes for currency. Resolution No. 410, 16 January 1856, in *SFCE*, Vol. IV, pp. 16-9. Still, the bank was allowed to operate as a deposit and discount bank.

⁷⁶ Consultation No. 432, 20 October 1856, *ibid.*, pp. 68-79.

⁷⁷ ‘The doctrine contained in the first part of para 9 (of the statutes of the proposed bank) is a copy, or, rather, a travesty, of the system that evolved in New York State, known as “free banking”. The extent to which this system is inefficient and nugatory in ensuring convertibility of bank paper is borne out by the commercial incidents that took place in the United States in the latter months of last year (...)’. Consultation No. 492, 30 September 1858, *ibid.*, pp. 268-72. The question of free banking will be examined in Chapter 6. It is worth noting that on both occasions - as in virtually every case between 1855 and 1865 - Itaboraí’s hard money positions seemed to have been endorsed by fellow council member Abrantes. The latter, Minister of Finance on three occasions, was one of the founders, and long time president, of the Sociedade Auxiliadora da Indústria Nacional, at the time an organisation dedicated mostly to advancing the interests of the rural class. Either Abrantes did not deem soft money the most appropriate policy for planters, or preferred to vote exclusively based on the technical merits of the requests brought to the Seção de Fazenda.

317	8 Jan 1853	Banco Rural & Hipotecário (*)	Against
376	16 Dec 1854	Bank of Brazil - Ouro Preto branch	In favour
384	17 Mar 1855	Bank of Brazil - São Paulo branch	In favour
385	17 Mar 1855	Bank of Brazil - branches in Salvador, Recife, Belém, S. Luís, and Porto Alegre	In favour
404	25 Jul 1855	Banco da Paraíba (*)	Against
410	16 Jan 1856	Banco Comercial de Campos (*)	Against
476	8 Oct 1857	Caixa Comercial da Bahia	In favour
478	30 Nov 1857	Banco do Maranhão	In favour
483	3 Dec 1857	Banco da Bahia	In favour
573	23 Jun 1860	Bank of Brazil - Fortaleza branch	In favour
911	13 May 1869	Banco Industrial do Maranhão	Against
927	18 Dec 1869	Banco do Ceará (?) (*)	Against

Note: (*) Banks allowed to operate, but without the right to issue notes.

Source: *Imperiaes Resoluções do Conselho de Estado na Seção de Fazenda, desde o anno em que começou a funcionar o mesmo conselho até o presente* (Rio de Janeiro, Typ. Nacional, 12 vols., various years).

Prior to the law creating the Bank of Brazil, in July 1853, the Seção de Fazenda was opposed to granting (note) issuing rights to banking institutions. Both Mauá's Bank of Brazil and the Rural e Hipotecário were therefore denied this right, although the Committee had no objection to them being set up as deposit and discount banks with the right to issue *vales*. After July 1853, two more requests to open issuing banks were turned down.⁷⁸ It was only in 1857 that new note-issuing banks were allowed to compete with the Bank of Brazil. Interestingly, of the six new banks allowed to operate during Souza Franco's spell as Minister of Finance, only two (Banco do Maranhão and Banco da Bahia) had their applications examined by the Seção de Fazenda. The other four - Banco Comercial & Agrícola, Banco do Rio Grande do Sul, Banco de Pernambuco and Banco Rural & Hipotecário⁷⁹ were chartered by government decree without consultation with the Standing Committee.

In Chapter 4 the point was made about the confusion contemporaries often made about the operation of the monetary multiplier.⁸⁰ In other words, people often thought that banks of issue were the sole vehicle through which the money supply

⁷⁸ In the case of the Banco da Paraíba, the Seção concluded that issuing rights should be denied on the grounds that such permission was the prerogative of the Legislative. Resolution No. 404, 25 July 1855, in *SFCE*, Vol. III, p. 469. As to the Banco Comercial de Campos, opposition to granting it rights to issue derived from concerns over the bank's ability to ensure convertibility of its *vales*. Resolution No. 476, 16 January 1856, in *SFCE*, Vol. IV, p. 17.

⁷⁹ The Rural & Hipotecário had been operating as a deposit and discount bank and was given issuing rights in February 1858.

⁸⁰ This point will be taken up again in Chapters 6 and 7.

could be altered. As late as 1866, then, the Seção de Fazenda felt confident to state that ‘the multiplication of deposit and discount banks does not have the influence, attributed by some, on the rate of interest and the mass of commercial transactions’.⁸¹ Still, not all council members shared this view. When examining the application of an issuing bank to be established in the province of Paraíba, Jequitinhonha went against the opinion of the *rapporteur*, Itaboraí, and maintained that ‘banks increase wealth, and provide activity to circulation; be they discount or circulating (banks), the effects are exactly the same’.⁸²

Vales and other obligations issued by individuals, or associations, were also a matter about which the Seção de Fazenda was consulted. On 21 April 1860, the Committee considered the legality of commercial houses and, even, individuals, in the city of São Luís issuing *vales* of denominations of 1\$000, as a remedy for the shortage of small change in the province of Maranhão.⁸³ Once again Jequitinhonha, the *rapporteur*, and Itaboraí disagreed. For the former, there was nothing in the Commercial Code that banned private individuals from issuing *vales*. Itaboraí recognised this, but argued that the government should look after the stability of the currency, as mandated by Law 401, of 11 September 1846. He, therefore, called the government to ‘demand from the competent powers measures that will put an end to such a dangerous state of affairs, and will ensure the stability of the monetary standard’.⁸⁴ The Seção was clearly divided on this point. The matter would only be cleared up with Decree 2694, of 17 November 1860, which determined that issues of notes, bills, *vales*, or other obligations payable to bearer could only be made with prior approval of the Legislative.

As expected, the Bank of Brazil appeared regularly in the consultations made to the Seção de Fazenda. Of the 164 consultations dealing with monetary questions between 1850 and 1870, 30 were directly related to the Bank. In the beginning, there was a preoccupation on the part of the Committee to ensure that the Bank was capable of maintaining the stability of the currency. For example, a request to open a discount

⁸¹ Resolution No. 839, 6 April 1866, in *SFCE*, Vol. VI, p. 45.

⁸² Resolution No. 404, 25 July 1855, in *SFCE*, Vol. III, p. 469.

⁸³ Resolutions No. 559, 560, and 561, in *SFCE*, Vol. IV, pp. 425-32, 438-40, and 440-53.

⁸⁴ *Ibid.*, p. 431. This was official admission that *vales* were quasi-money. The competent powers in this case would be the President of the province and the local police authority.

and deposit bank in Porto Alegre, in 1854, was deferred, while the Seção consulted the Bank to enquire if it was interested in establishing a branch in that city.⁸⁵ From the text of the resolution, it is clear where Itaboraí stood.

The Committee believes that it would be preferable that the Bank of Brazil would open a branch in Porto Alegre, not only because it would provide more resources (...) to that city, but also because it is not in the interest of the State to reduce the sphere of action of the Bank, which must comply with the onerous contract celebrated with the government (...).⁸⁶

Support for the Bank by the Finance Standing Committee was most forthcoming with regard to the creation of new branches in the provinces.⁸⁷ The Seção de Fazenda was also very receptive to the Bank's request that foreign coins not be accepted in the tax offices of the province of Rio Grande do Sul, lest they compete with its own notes.⁸⁸ Finally, it agreed with the Bank that it should not be liable to the payment of taxes imposed by provincial assemblies.⁸⁹

Nevertheless, on many occasions the Seção denied the Bank important requests. For example, changes in the statutes of the Bank, which would have allowed it to discount paper of more than 90 days and with only one signature, were blocked, on the grounds that they would have resulted in a deterioration in the quality of the Bank's portfolio.⁹⁰ Similar proposals by the Bank were again turned down two years later.⁹¹ Crucially, requests to increase its leverage to three times the reserve fund were firmly rejected, first, in 1859, and again in 1863.⁹² In 1859, councillors argued that the Bank failed to provide them with enough clarifications in support of its request. Moreover, they believed that if, as the Bank claimed, issues were dangerously in excess of legal limits, then this was of the Bank's own making and, therefore, notes should be retired from circulation.⁹³ In the second of the

⁸⁵ Resolution No. 359, 24 August 1854, in *SFCE*, Vol. III, pp. 318-20.

⁸⁶ *Ibid.* In the end the Bank decided to open the branch.

⁸⁷ See Resolutions No. 376, 384, 385, in *SFCE*, Vol. III, pp. 355-7, 382-3, and 383-4.

⁸⁸ Resolution No. 396, 16 May 1855, *ibid.*, pp. 442-4.

⁸⁹ Resolution No. 690, 1 March 1862, in *SFCE*, Vol. V, pp. 255-6.

⁹⁰ Resolution No. 375, 16 December 1854, in *SFCE*, Vol. III, pp. 352-5.

⁹¹ Resolution No. 443, 8 November 1856, in *SFCE*, Vol. IV, pp. 109-14.

⁹² Resolutions No. 538 and 726, *ibid.*, pp. 374-6, and Vol. V, pp. 359-68.

⁹³ Resolution No. 538, 28 December 1859, in *SFCE*, Vol. IV, p. 375.

consultations, the Committee was split. Itaboraí, the *rapporteur*, believed that the Bank's request actually amounted to a wish to increase note issues to four times the reserve fund - the 3:1 ratio plus the amount of Treasury notes withdrawn from circulation.⁹⁴ Besides, he argued that it was up to the Legislative, not the government, to judge the request.⁹⁵ Jequitinhonha broadly agreed with the position of the *rapporteur*. The third member, Cândido Batista de Oliveira - who was also president of the Bank of Brazil at the time - positioned himself in favour of the request. Essentially, he argued that, unlike 1859, the Bank ensured convertibility of its notes. Alternatives, such as an increase of its capital - which would have permitted additional note issues - would take too long, argued Oliveira. Although in a minority, his position prevailed, as the government issued Decree 3054, 28 February 1863, authorising the Bank to increase its issuing limit to three times the reserve fund.

Deposit and discount, and issuing banks were not the only type of establishment seeking permission from the government to operate at the time. Savings banks (*caixas econômicas*) were also spreading in the Empire, eager to cater for the needs of small investors. As noted earlier, savings banks were mutual associations. In effect, depositors were shareholders. Profits made from investments - mainly in government bonds - were credited, net of administrative charges, in the accounts of depositors. Between 1850 and 1861, the Seção de Fazenda was consulted about requests to establish 15 savings banks.⁹⁶ Seven of them were allowed to operate. The Committee recognised the utility of savings banks, and often made this point based on moral, Christian, grounds.⁹⁷ Thrift among the poor was a value to be cherished, the Seção believed. Accordingly, it felt strongly about *caixas econômicas* that offered little protection for small investors. Bogus savings banks were one source of concern. The request placed by the Caixa Econômica de Nazareth was

⁹⁴ Resolution No. 726, 4 February 1863, in *SFCE*, Vol. V, p. 361.

⁹⁵ This was also the main reason why the Seção turned down two requests in which it was asked if the notes of the Bank of Brazil could be given *cours forcé* in the provinces. See Resolutions No. 777, 808 and 833, in *SFCE*, Vol. V, pp. 502-5, 586-8, and Vol. VI, pp. 31-2.

⁹⁶ Interestingly, no requests of this nature were filed between 1861 and 1870. This may have been a consequence of the changes in legislation introduced by the 1860 Law of Impediments (Art. 2, paras 14 to 18), which provided for government-appointed (and paid) directors, to oversee the operations of *caixas econômicas*. Still, many such institutions operated illegally, without government authorisation.

⁹⁷ Resolutions No. 485 and 490, in *SFCE*, Vol. IV, pp. 250-2, and 275-7. This moralist tone is also found in *Parecer Sobre Caixas Econômicas*.

typical, and was rejected as being incompatible with the rules set out by the Law of Impediments.⁹⁸ It was allowed to open, though, as long as it operated as a proper deposit and discount bank. Accordingly, it would have to alter to its statutes, including a change of name, from ‘Caixa Econômica’ to ‘Banco’. Requests rejected by the Seção de Fazenda also involved proposed statutes that gave excessive liberty to shareholders to withdraw their capital with little advance notice, and before formal liquidation of the establishments. Council members deemed such provisions too liberal, and an obvious threat to small, less informed, investors.

As seen in Chapter 4, foreign banks first arrived in Brazil in the early 1860s. On 27 September 1862, the Seção de Fazenda was consulted about the request made by the investors behind the London and Brazilian Bank. The *rapporteur*, Cândido Batista de Oliveira, could not have expressed a warmer welcome.

The majority of the Committee believes that the creation of this new bank (...) might be of considerable usefulness for the country, and of great use to foreign trade, for which it seems particularly suited. (...) The imperial government will be providing a real service to the industries of the country by allowing the London and Brazilian Bank to be set up in the capital of the Empire.⁹⁹

The majority of the Committee to which Oliveira referred included Itaboraí. Jequitinhonha, however, was not impressed. He maintained that the benefits expected from the bank could only come from local sources, through ‘an increase in national capital’.¹⁰⁰ Subsequently, the London and Brazilian Bank would find no problem in obtaining approval for their branches in five provincial cities.¹⁰¹ The same happened to a request to open the Brazilian and Portuguese Bank.¹⁰² Yet, plans to establish the London, Brazilian and Mauá Bank were only approved under certain conditions.¹⁰³

⁹⁸ Resolution No. 651, 19 June 1861, in *SFCE*, Vol. V, pp. 145-6. See also the plans for a *caixa econômica* in Recife, rejected on similar grounds (Resolution No. 352, 21 June 1854, in *SFCE*, Vol. III, pp. 276-9).

⁹⁹ Resolution No. 714, in *SFCE*, Vol. V, pp. 308-13. Interestingly, at the time Oliveira was also president of the Bank of Brazil. Apparently, he did not anticipate any harm to the Bank’s business from the arrival of foreign competitors.

¹⁰⁰ *Ibid.*, p. 312. Ironically, this view coincided with the practice of the English banks of relying on domestic sources for their funds, to the dismay of many in Brazil. On this point, see Jones, “Commercial Banks”.

¹⁰¹ Resolutions No. 730, 743 and 768, in *SFCE*, Vol. V, pp. 377-8, 399, and 482-3.

¹⁰² Resolution No. 751, 23 December 1863, *ibid.*, p. 417.

¹⁰³ Resolution No. 824, 13 December 1865, *ibid.*, pp. 619-24.

Essentially, these involved making the institution subject to Brazilian, not English, legislation, which would have involved, amongst other things, supervision by the Brazilian authorities.¹⁰⁴

From the above, it is possible to identify two different levels of ideology in the Seção de Fazenda - the collective and the individual. The first corresponded to the common ethos that underlined the opinion of council members, while individual preferences were more clearly reflected in the style of particular *rapporteurs*. Three broad elements of the collective ideology of the Seção stood out: respect for the law, a sense of fairness, and the desire to ensure the soundness of the banking system as a whole.¹⁰⁵ The legalistic approach was certainly influenced by the training that many council members had had in Law schools.¹⁰⁶ This stance surfaced, for instance, when the Committee condemned note, or *vale*, issues made by individuals, or with authorisation from local assemblies.

As to a sense of fairness, it underlined, for instance, the close scrutiny of statutes of *caixas econômicas*, where the Seção did its utmost to protect the interests of small investors. Privileges of any nature were also shunned, even if this meant going against personal predilections. For example, when examining the requests for the establishment of four new banks of issue, the *rapporteur* (Itaboraí) expressed his personal opposition to ‘competition between circulating banks’.¹⁰⁷ Nevertheless, he also pondered that in light of the recent approval of a bank of issue in Rio, there was ‘no reason that could justify denying these requests’.¹⁰⁸ Lastly, the Seção saw to it

¹⁰⁴ See Barman, “Business”, p. 259. Finally, the Seção de Fazenda was consulted about general topics relating to money and banking. For example, to judge whether establishments which had already applied for government permission to operate, but were still awaiting a decision, should be bound by the rules set out in the Law of Impediments. See Resolution No. 650, 19 June 1861, in *SFCE*, Vol. V, pp. 142-5. The Seção was also heard in connection with a bill establishing the weight and fineness of new coins (Resolution No. 754, 1 February 1864, *ibid.*, pp. 434-444).

¹⁰⁵ The first two characteristics serve to show the point made earlier about the “vision of the State” inherent to the Council, and which set it apart from other institutions.

¹⁰⁶ This was the case of three of the six longest serving members of the Committee in the 1850-70 period - Miguel Calmon du Pin e Almeida (Marquês de Abrantes, who sat at the Seção between 1855 and 1865), Manuel Alves Branco (Visconde de Caravelas, 1850-5), and Francisco Gê de Acaiba Montezuma (Jequitinhonha, 1853-6 and 1858-63). Itaboraí was a member of the Committee for the longest period, from 1853 to 1867, having returned in 1870. Both he and Cândido Batista de Oliveira (1862-5) held doctorates in Mathematics. Finally, Francisco de Salles Torres Homem, who served between 1866 and 1870, was a physician. See Tavares de Lyra, *Instituições*.

¹⁰⁷ Resolution No. 476, 8 October 1856, in *SFCE*, Vol. IV, pp. 207-16.

¹⁰⁸ *Ibid.*, pp. 208-9.

that banking establishments adopt prudent commercial practices. For example, by refusing them permission to discount bills of more than three months, or with just one signature.¹⁰⁹ Nowhere was this point made more strongly than when the Committee was consulted about requests to open mortgage banks. Between 1850 and 1870, the Seção examined eight such requests. Six were rejected, often because the Seção felt that the proposed mortgage operations were a pretence for the illegal issue of *vales*.¹¹⁰ Of the two requests that were approved, one was from the Banco Rural & Hipotecário, which, despite its name, never conducted a single mortgage operation. Alternatively, opposition could derive from concerns about the mismatch between long-term immobilisation of the resources of mortgage banks and the short-term liabilities they might have.¹¹¹ In the end, the term structure of banks' portfolios was a matter that occupied the attention of council members.¹¹²

The individual ideology within the Seção de Fazenda was felt especially in the drafting, by the *rapporteur*, of the summary opinion of all three council members. Although dissenting views were always expressed, there is no disputing that the *rapporteur*'s particular preferences carried more weight. In other words, even though the final draft of the resolutions summarised the view of all three members, it was heavily biased by the predilections of whoever was chosen as *rapporteur*. There is no indication of how this task was allocated, although expertise, however defined, might have played a part. Thus, Itaboraí, widely held as the foremost financial expert of the day, acted as *rapporteur* in almost every consultation made to the Seção de Fazenda during his tenure, i. e., from 1853 to 1867. Accordingly, his orthodox views clearly dominated the texts of the resolutions in the period. For example, in rejecting a request for the creation of a bank in Rio, the Seção argued that 'the principle of free competition, the advantages of which cannot be disregarded in other industries, does

¹⁰⁹ Resolution No. 839, 6 April 1866, in *SFCE*, Vol. VI, pp. 42-5. Also, insistence on convertibility of notes into gold was part of the overall concern with sound money. See, for example, the consultations made in connection with the banks approved by Souza Franco in 1857 and 1858, in *SFCE*, Vol. IV, pp. 217-24, and 238-43.

¹¹⁰ See, for example, Resolution No. 364, 28 October 1854, in *SFCE*, Vol. III, pp. 331-6.

¹¹¹ See Resolution No. 398, 26 May 1855, in *SFCE*, Vol. III, pp. 446-50; and Resolution No. 432, 20 October 1856, in *SFCE*, Vol. IV, pp. 68-79.

¹¹² As argued in Chapter 4, this concern did not extend to the operation of private banks, hence the problems leading to the Souto crisis.

not produce equally beneficial results when applied to credit establishments'.¹¹³ Also, when criticising the expansion of corporations, which were accused of being geared more to 'dealing in their own shares, rather than facilitating the production instruments for industrious men; (of being) the result of an immoral game fostered in this capital lately, by certain speculators, who thus reveal the easiest way to enrich a few at the expense of the misery of many'.¹¹⁴ These views sounded very much like those of Itaboraí, the most articulate advocate of orthodoxy.

Similar views were being expressed more than ten years later, in one of the most telling examples of the nature of the remit of the Finance Committee. On the occasion, the Seção was consulted in connection with a memorandum sent by the Bank of Brazil seeking guidance on how to proceed in the case of a large loan being requested by the Vergueiro Company.¹¹⁵ The Vergueiro Company belonged to the family of Nicolau Pereira Vergueiro, a former Minister of State and senator of the Empire, who had died in 1859. Vergueiro had pioneered the employment of free European labourers in his plantations in São Paulo and his family commanded considerable political and economic power in the province. The objective of the loan - requested in January - was to allow the company to liquidate its commercial ventures and concentrate exclusively in agriculture. As collateral, the Vergueiro Company offered a full mortgage on its Ibicaba plantation, in Limeira, together with its slaves. In support of the request for of 2,200 *contos* (£235,000), the company emphasised its ramifications in the *paulista* economy, which, should the company fail, would cause great damage to the region. Given the sheer size of the loan, Vergueiro argued, only the Bank would be in a position to help. In reply, the Bank's president - Cândido Batista de Oliveira, himself a member of the Seção de Fazenda - noted that the law barred the Bank from undertaking mortgage operations. Besides, even if that was not technically the case with the Vergueiro request, the Bank should never immobilise its resources on such a scale.¹¹⁶ Still, Oliveira thought best to hear the opinion of the Seção de Fazenda.

¹¹³ Resolution No. 353, 1 July 1854, in *SFCE*, Vol. III, pp. 298-85.

¹¹⁴ Resolution No. 364, 28 October 1854, *ibid.*, pp. 331-7.

¹¹⁵ Resolution No. 799, 23 June 1865, in *SFCE*, Vol. V, pp. 568-73. The matter was analysed by a joint Finance and Empire (Interior) Committee.

¹¹⁶ *Ibid.*, p. 571.

The Committee's report was scathing. First, it pointed out the prohibition on the Bank pursuing any mortgage loan. Second, even if legal, such an operation would be incompatible with an issuing bank, given the natural imbalance between lending long, while maintaining very short-term liabilities, in the shape of banknotes. Third, the Bank's own position against the loan, about which the government could do nothing. Finally, and most important, the Committee noted that the Vergueiro Company was not alone in

resorting to the government, from which it requested such a unique and extraordinary measure. Behold the majority, if not all, *fazendeiros* from the municipalities of Mar de Hespanha and Juiz de Fora, who demand the same thing, and allege similar reasons, in a petition addressed to Your Royal Highness. After them will come those from other municipalities in the province of Rio de Janeiro and, soon, those from São Paulo, Minas Gerais, etc.¹¹⁷

The request to which the *rapporteur* (Itaboraí) referred were examined on the same day.¹¹⁸ It had originated in the city council of Mar de Hespanha, which was relaying a petition made by the region's planters, who sought a loan from the Bank of Brazil in order to help them 'settle their onerous obligations'.¹¹⁹ This loan would be guaranteed by their assets, 'reasonably and properly evaluated'.¹²⁰ The request was accompanied by two other petitions, signed by the inhabitants of the town, and by planters of the Juiz de Fora. The Seção could not help noticing that both petitions were "signed" in block letters using the same handwriting, instead of bearing proper signatures. They were also turned down. There was nothing the government could do and, also, it could never suggest to institutions like the Bank of Brazil that they lend long against dubious collateral.

In essence, here were two requests, made by a very influential *fazendeiro* family from São Paulo and ordinary *mineiro* planters. On both occasions the Committee positioned itself against lending to agriculture. Its decision was both legalistic and ideological. Legalistic, because the statutes of the Bank of Brazil did not allow it to carry out that sort of operation. Also, the government could not interfere with the Bank's commercial practices, even if it were allowed to lend against

¹¹⁷ Ibid., pp. 571-2.

¹¹⁸ Resolution No. 801, 23 June 1865, *ibid.*, pp. 575-6.

¹¹⁹ Ibid., p. 575.

¹²⁰ Ibid.

mortgages. Ideological, because the Seção deemed mortgage operations naturally risky, and incompatible with issuing banks. And it was prepared to go against the demands from *fazendeiros*, in order to ensure the soundness of the banking system.

Still, “mainstream” opinions did not go unchallenged within the Seção. Throughout his mandate, Jequitinhonha maintained a position sympathetic to soft money. For example, in a consultation made in 1855, Itaboraí, as *rapporteur*, argued against granting issuing rights to a bank, to be created in the province of Paraíba. The reasons were the usual ones: the statutes did not provide sufficient guarantees for redemption of notes in gold, note circulation in the Empire was already excessive, and it was up to the Legislative to decide on such matters, not the government.¹²¹ Jequitinhonha disagreed. He maintained that issuing banks and deposit banks were essentially equal. He cited Gilbart, a notorious author of the Free Banking school,¹²² in order to demonstrate the operation of the multiplier mechanism.

Debtors draw against a bank, and creditors have the respective amounts deposited in their accounts. This system allows small sums of currency to perform great and important transactions. Money thus economised is employed by the bank in making advances, by means of discounts. This system, by providing additional efficiency to banking establishments, also increases the productive capital of the country.¹²³

Jequitinhonha’s pro-bank predilections extended to the question of *vales*. When analysing the existence of privately-issued promissory notes in Maranhão, he was the only member of the Committee to position himself in favour of allowing the practice to continue.¹²⁴ His view was that the shortage of small change in the province, and the problems arising from it, more than compensated any legal disposition in contrary. Yet, Itaboraí’s anti-*vale* stance prevailed once again.¹²⁵ But Jequitinhonha would not always be on the losing side. Opining in a different case, he supported minor changes in the statutes of a bank to be established in Rio, but insisted

¹²¹ Resolution No. 404, 25 July 1855, in *SFCE*, Vol. III, pp. 464-71.

¹²² More on the Free Banking monetary school in Chapter 6.

¹²³ Resolution No. 404, 25 July 1855, in *SFCE*, Vol. III, p. 470. Finally, Jequitinhonha argued that only a very narrow interpretation of the law would lead to the Legislative being responsible for authorising the establishment of banks of issue. In the end, Itaboraí’s position won and the government authorised the constitution of a deposit and discount bank, not an issuing one. *Ibid.*

¹²⁴ Resolution No. 561, 21 April 1860, in *SFCE*, Vol. IV, pp. 438-40.

¹²⁵ *Ibid.*

that it be allowed to issue notes.¹²⁶ He was in a minority position, against the opinions of Itaboraí and Abrantes. However, as *rapporteur*, his views held sway and the government authorised the creation of the Banco Industrial, Comercial e Territorial do Rio de Janeiro.

On the whole, then, the Seção de Fazenda favoured hard money policies in the 1850-70 period. This was part of its collective ideology in support of measures that would ensure the stability of the banking system and the soundness of the circulating medium. But, most significantly, hard money derived, to a large extent, from Itaboraí's position as *rapporteur* on most occasions. As the above examples show, the opinion of the *rapporteur* carried great weight in the final decisions of the Committee. Since throughout this crucial era Itaboraí was in charge of drafting the resolutions, his conservative views on monetary management ended up serving as "the view" of the Seção de Fazenda. Without pushing too far the argument about the importance of individuals in History, there is little doubt that Itaboraí's personal view of the world, his "ideology", had enormous influence in the conduct of monetary and banking policy at the time. At least in the Seção de Fazenda, Jequitinhonha appeared as the natural counterweight to orthodoxy. Planters would certainly have preferred him as leading ideologue of the Committee.

* * *

In sum, examination of the records of the monetary debates held in the Chamber of Deputies between 1853 and 1866 has revealed, as expected, their strong partisan nature. Often, political disputes determined the particular stance which a deputy, or party, would have in regard to policy proposals in the field of money and banking. There appears to have been a tendency for deputies from the Liberal party to support soft money policies, while Conservatives generally advocated hard money. The difficulty in ascribing party affiliation to most of the speakers, however, precludes any stronger assertion in this respect. Yet, overall, many deputies entertained soft

¹²⁶ See Resolution No. 524, 30 September 1859, *ibid.*, pp. 349-54.

money predilections, and this was certainly more conspicuous in the *Annaes* than in other contemporary sources.

The nature of the records of the meetings of the Seção de Fazenda is markedly different. Party politics played no visible part in reported discussions. Appraisal of the submissions brought to the attention of the Committee was done largely on a technical basis. Both general features and idiosyncrasies emerge from the examination of the resolutions issued by the Seção. General features included a legalistic approach to the topics, as well as a sense of public responsibility. These traits were revealed particularly when the Committee examined requests for the opening of banks or *caixas econômicas*. Unlike the Chamber of Deputies, the Seção de Fazenda tended to have a more orthodox view of monetary and banking matters. This combined with the legalistic approach to produce a trend towards rejecting requests that appeared to stimulate banking practices deemed too liberal. Yet, this general conservative mood in the Seção must be attributed, to a large extent, to the presence of Itaboraí. His role as *rapporteur* during most of the period definitely imbued resolutions with a generally orthodox message. This tendency would only be mitigated in the few instances when Jequitinhonha acted as *rapporteur*, and resolutions were, on the whole, more liberal.

Chapter 6 - The Battleground of the Struggle: issuing rights and convertibility

As seen in previous chapters, monetary management was a hotly disputed topic in mid nineteenth-century Brazil. Throughout the debates two broad camps could be identified, *metalistas* and *papelistas*. The former, as the name implied, advocated convertibility of note issue on demand, the imposition of strict limits on the money supply and, more generally, adherence to the principles of monetary virtue identified with the gold standard. In short, they favoured hard money policies. *Papelistas*, on the other hand, saw no obstacles to the issue of paper money, so long as in proportion to the amount of actual transactions undertaken in the economy. The sheer shortage of gold at the domestic level, coupled with pressing demands for credit expansion, they argued, precluded the pursuit of the more orthodox approach preferred by *metalistas*. Both groups entertained mixed, and often contradictory, views on many issues within the general debate, thus resembling the English monetary controversies of the first half of the nineteenth century.¹

The analysis of the discussions held in the Chamber of Deputies and the Seção de Fazenda revealed that two interrelated topics stood out in the Brazilian controversies: whether the right of issue should be granted to one or more institutions, and the question surrounding the type of backing that would be required of issuing banks. The first point concerned the establishment of a monopoly of note issue, in contrast with the plurality advocated by many. As to convertibility, disagreement surrounded the nature of the reserve fund that would back emissions. Should it be made up exclusively of gold, or a mixture of gold, Treasury notes and, eventually, financial assets. Also, the extent of issue as a multiple of reserves (in other words, the reserve requirements) was a matter of controversy. Both the “monopoly vs. plurality” and the “gold vs. paper” debates informed the larger discussions surrounding the origins and spread of financial crises, or panics, and exchange-rate stability.

6.1 - Monetary Controversies in Historical Perspective

¹ On the British monetary controversies, see J. Viner, *Studies in the Theory of International Trade* (London, George Allen & Unwin, 1937); F. W. Fetter, *Development of British Monetary Orthodoxy, 1797-1875* (Cambridge, Cambridge University Press, 1965); L. White, *Free Banking in Britain:*

When monetary debates were raging in Brazil, in the 1850s and 1860s, the equivalent controversies in Britain had subdued considerably.² Two major waves stand out in the history of these debates in Britain. The bullionist controversy, during the Napoleonic Wars, and the Banking school vs. Monetary school polemics from the 1820s onwards.³ The bullionist controversy concerned different interpretations for the depreciation of sterling after 1808, eleven years into the Restriction Act of 1797, which had suspended gold payments in Britain. In 1810, the Bullion Committee was set up by Parliament to investigate the matter, and opened the way for the fight between bullionists and antibullionists. The former argued in favour of immediate resumption of convertibility and blamed depreciation on monetary factors, that is, an overissue of banknotes. Antibullionists, on the other hand, claimed that depreciation of sterling should be ascribed to “real” (mainly balance of payments) disturbances, caused by war expenditures on the Continent, poor harvests at home, as well as hoarding of specie on account of increasing uncertainty. Accordingly, they argued that resumption of gold payments should be postponed until “normality” was restored.⁴ For all purposes, the controversy was resolved in 1819 in favour of the bullionists, when a Parliamentary Act determined the resumption of convertibility of Bank of England notes. Having established the overriding principle of convertibility

theory, experience, and debate, 1800-1845 (Cambridge, Cambridge University Press, 1984); and Collins, *Money and Banking*.

² Monetary debates were also present in other countries, of course. For the American experience, see B. Hammond, *Banks and Politics in America from the Revolution to the Civil War* (Princeton, Princeton University Press, 1957); L. Schweikart, *Banking in the American South from the Age of Jackson to Reconstruction* (Baton Rouge and London, Louisiana State University Press, 1987); and G. Ritter, *Goldbugs and Greenbacks: the antimonopoly tradition and the politics of finance in America, 1865-1896* (Cambridge, Cambridge University Press, 1997). Monetary debates in Europe are summarised in V. Smith, *The Rationale of Central Banking* (London, P. S. King & Son, 1936). For the debates in Chile, see G. Subercaseaux, *El Papel Moneda* (Santiago de Chile, Imprenta Cervantes, 1912); and P. J. Conoboy, “Money and Politics in Chile, 1878-1925” (unpublished Ph.D. thesis, University of Southampton, 1976).

³ For a selection of some of the major contemporary works written during the British monetary controversies, see F. Capie (ed.) *History of Banking, 1650-1850* (London, Pickering and Chatto, 1993, 10 vols.). At the time of the British monetary controversies its banking system was dominated by the Bank of England, a private institution incorporated in 1694. The Bank was granted the monopoly of note issue within a sixty-five mile radius from London, a position which would be confirmed by the 1844 Banking Charter Act, which banned new note issuers anywhere in Britain, as well as determining that lapsed note issues by the (outside of London) country banks could not be revived.

⁴ For an examination of the bullionist controversy, see Fetter, *Development*, Chapter 2; and W. Santiago-Valiente, “Historical Background to the Classical Monetary Theory and the ‘Real-Bills’ Banking Tradition”, *History of Political Economy* (hereafter, *HOPE*), Vol. 20, No. 1, Spring 1988, pp. 43-63.

of notes into gold, the debates that ensued would concentrate on the origins of the business cycle and attempts to mitigate it.⁵

Monetary controversies after the Resumption Act involved followers of two broad “schools” of thought, with different views on the business fluctuations that repeatedly hit the British economy. At the heart of the polemics - which pitted the Currency and Banking schools against each other - was the question of whether authorities should follow a set of rules or, to use a modern concept, be allowed discretion in the conduct of monetary policy.⁶ Adherents of the Currency school (prominent among whom were John McCulloch and Loyd Overstone) sought to define the means for achieving a price level which would be the same whether the money supply were one hundred percent metallic or part gold, part paper.⁷ Given that in practice a mixed currency was in place, then it would only operate properly if it were made to behave as gold. Hence the “currency principle”, which posited a mechanism whereby ‘any influx or efflux of gold (should result) in a corresponding (absolute, not proportional) decrease or increase in the quantity of the currency’.⁸

Banking school advocates (such as John Stuart Mill, Thomas Tooke and John Fullarton) did not share the view that the authorities should be bound by a rule which, in practice, imposed a constraint on monetary policy.⁹ Overissue (and, hence, inflation), they claimed, could not occur so long as convertibility was maintained. Consequently, there should be no “artificial” limit on the operation of the banking system, as reflected in the currency principle. In support of their arguments, adherents of the Banking school adopted three principles which they thought reflected the way in which banks actually operated: the “real bills” and “needs of trade”

⁵ White, *Free Banking*, p. 53.

⁶ See A. J. Schwartz, “Banking School, Currency School, Free Banking School”, in J. Eatwell *et al.* (eds.) *The New Palgrave Dictionary of Economics* (London, Macmillan, 1987), pp. 182-6.

⁷ *Ibid.*, p. 183.

⁸ Viner, *Studies*, p. 221.

⁹ It has been argued that in positioning itself in favour of discretion, i.e., of a measure of unbound authority, the Banking School could be likened to modern-day Keynesians, while Currency school advocates would resemble monetarists, in seeing as the government’s main task the setting of limits to the expansion of the money supply. For an elaboration of this point, see C. Kindleberger, “Keynesianism and Monetarism in Eighteenth- and Nineteenth-Century France, *HOPE*, Vol. 24, No. 4, Winter 1980, pp. 499-523.

doctrines and the law of reflux.¹⁰ The real bills (or commercial loan) theory of banking asserted that restricting bank loans to productive, self-liquidating purposes, ensured against their issuing too much money. The law of reflux, advanced by Tooke and Fullarton, modified the real bills doctrine slightly. According to them, overissue would be possible only in the short run. After that, notes would return to the issuer for repayment of loans, thus acting as a practical check on banks' discount policy. Finally, the needs of trade doctrine established that note circulation should be demand-driven, that is, expanded when business prospered and restricted in the downturn. In other words, it consisted of a pro-cyclical theory of monetary policy.

With regard to each group's views on the business cycle, both Banking and Currency school theorists generally considered them to originate in non-monetary factors. For them, "speculation" - broadly understood as the ebb and flow of optimism in the economy - was its root cause. Yet, the origin of the waves of optimism themselves was a moot point for both schools. Explanations differed, nevertheless, as to the transmission mechanism in operation. For the Currency school, banks - which responded to the ups and downs of the economy by expanding and contracting their issues - ensured the monetary spread of the cycle, although they were not behind the "original sin". The currency principle, therefore, did not insure against the occurrence of trade cycles but, rather, sought to prevent their amplification.¹¹ For the Banking school, nonmonetary factors lay behind both the origin and the spread of business cycles. The reason being that banks passively reacted to greater or lesser demand for credit, as the waves of optimism and pessimism alternated. The following table summarises the main points in the Currency school vs. Banking school controversy.

¹⁰ For a detailed discussion of these tenets of the Banking school, see Schwartz, "Banking School"; Santiago-Valiente, "Historical"; D. Glasner, "On Some Classical Monetary Controversies", *HOPE*, Vol. 21, No. 2, Summer 1989, pp. 201-229; and idem, "The Real Bills Doctrine in the Light of the Law of Reflux", *HOPE*, Vol. 24, No. 4, Winter 1992, pp. 867-94.

¹¹ Schwartz, "Banking School", p. 185.

Figure 6.1

Schema of the Currency School vs. Banking School Controversy

Issue	Currency School	Banking School
When is money stock self-regulating?	Only under an imposed rule (the currency principle)	Already
Who can overissue?	Single country banks; country banks in concert especially likely; Bank of England	No bank
Real bills doctrine	Anti	Pro
Law of reflux	Muddled, perverse, too slow	Instantaneous, via loan repayments
Needs of trade doctrine	Is bad; applies only to country banks, not to the Bank of England	Is good; applies to both country banks and the Bank of England
Trade Cycle: Origin Transmission	Nonmonetary Monetary	Nonmonetary Nonmonetary
System favoured	Rule-bound authority	Unbound authority (discretion)

Source: Adapted from Table 4.1, in L. White, *Free Banking in Britain* (Cambridge, Cambridge University Press, 1984), p. 135.

In spite of the considerable differences of opinion on the many issues outlined above, there was a crucial common thread to both schools of monetary thought (and also the Free Banking school, to be discussed later). It was the presupposition of convertibility of notes. In other words, their theoretical analyses implied an unequivocal endorsement of the gold standard in practice. Convertibility of notes into specie on demand, and the fixed exchange-rate regime that it implied, was the orthodoxy of the time, against which only a handful of people dared to stand out.

Gold was thought of as an ideal monetary standard, domestically and internationally, because of its unique qualities both as a store of value and a medium of exchange. Contemporaries were keen to contrast the (alleged) price stability that the gold standard afforded with the “evils” usually ascribed to inconvertible fiduciary money.¹² The well-functioning of the system would be ensured by means of the operation of the so-called price-specie-flow mechanism, originally proposed by Hume, in 1752. In this model, arbitrage in one commodity (gold) between nations served to maintain balance of payments equilibrium. Essentially, a country running a trade (or balance of payments) deficit lost gold. Domestically, the price of gold went up relative to those of other commodities. As a result, this country gained competitiveness, and

¹² See M. Bordo, “The Gold Standard: the traditional approach”, in M. Bordo and A. Schwartz (eds.) *A Retrospective of the Classical Gold Standard, 1821-1931* (Chicago and London, University of Chicago Press), p. 23.

increased its exports above its imports. Gold would flow back into the country and the balance of trade was restored.¹³

The sheer simplicity of Hume's model, in spite of its many underlying assumptions, made it attractive as an explanation for the supposed superiority of the gold standard vis-à-vis a fiduciary note circulation.¹⁴ When joining the gold standard, countries ensured a stable exchange rate and a balance of payments identically equal to zero. But, in the process, automatically relinquished control over their monetary policy. This was precisely why adherence to the gold standard was not unequivocally endorsed by all participants in the monetary controversies of the time. In effect, the ability to influence the money supply lay at the root of two of the major areas of conflict in the financial debates of the nineteenth century: who could issue what (issuing rights) and with what type of backing (convertibility).

6.2 - Issuing Rights

At the centre of the disputes over the right to issue notes was the latent conflict arising from its private and public dimensions. The private dimension was represented by the potential profits that accrued to a bank that issued its notes at virtually no cost, and which were then used in making loans. The public facet concerned the broader macroeconomic consequences of monetary expansion. The conflicts around issuing rights, and the legislation which eventually followed, were therefore linked to broader concerns about the overissue of notes. Overissue - understood as the creation of an excess supply of banknotes either by an individual bank or by the system as a whole - was perceived by the Currency school as a transient phenomenon, although with potentially damaging consequences. In the long run, and given the price-specie-flow mechanism, it argued, an excess stock of convertible currency would be eliminated through the export of specie. As Figure 6.1 shows, overissue was deemed likely by Currency school advocates, unless the "currency principle" was followed by a

¹³ Looked at from a different angle, after the initial gold loss, the country would suffer a currency and credit crunch, leading to price deflation, increased competitiveness and greater exports. This mechanism would be reinforced by changes in income, so that monetary contraction, by lowering domestic economic activity, brought about lower imports and an improvement in the country's balance of payments.

¹⁴ For a discussion, see W. M. Scammel, "The Working of the Gold Standard", in B. Eichengreen (ed.) *The Gold Standard in Theory and Practice* (New York, Methuen, 1985).

monopolist bank. Banking school theorists, meanwhile, dismissed that “principle” as an unnecessary constraint on the operation of banks. Instead, note issue would be naturally regulated by the “real bills” and “needs of trade” doctrines and the law of reflux.

The above discussion becomes more clear through the examination of the micro aspects of commercial banks’ issuing operations. These can be better understood by looking at a summary of the main items in a bank balance sheet.¹⁵

Figure 6.2

Summary of Commercial Banks’ Main Balance Sheet Items

ASSETS (claims by the bank against others)	LIABILITIES (claims on the bank)
bills discounted (B)	notes (N)
specie (S)	deposits (D)
	proprietors’ capital (K)

Source: Adapted from table in L. White, *Free Banking in Britain: theory, experience, and debate, 1800-1845* (Cambridge, Cambridge University Press, 1984), p. 3.

The main item on the assets side of the balance sheet of a nineteenth-century bank of issue consisted of discounted bills (B). This was the principal way in which short-term credit was provided to the market. The pre-eminence of bill discounting was a direct consequence of the expansion of trade and, in connection with it, the emergence of the commercial bill as the main financial instrument helping to bridge the lag between the purchase of merchandise and subsequent sale. This meant that instead of waiting for a client to pay for his merchandise only after it had arrived safely at its destination and been duly commercialised, a producer (the drawer) could draw a bill on the importer to whom he had sold goods. The drawee, by signing it, acknowledged his debt, which he promised to pay within (usually) three months. With this signed bill in his hands the producer could either wait until maturity for the full payment of his goods or take the bill to a discount house or bank. Discounting, thus, consisted basically of advancing money to clients (usually merchants) against a

¹⁵ The argument that follows is based on White, *Free Banking*, pp. 4 ff.

bill of exchange drawn on a third party, for a certain rate of interest, the “discount”. The rate depended on the reputation of the names on the bill of exchange.¹⁶

The second main item in the assets side of a bank balance sheet was cash in vault, mostly precious metal in coin form (S). On the side of liabilities, its outstanding notes (N) comprised the non-interest-bearing sight claims against its specie, while deposits (either demand or time) were claims against its stock of vault cash. Finally, proprietors’ capital (K) represented the liabilities of a bank to its owners, that is, the partners’ (or shareholders’, in the case of joint-stock banks) investments in the business, inclusive of accumulated net earnings (e.g., undistributed profits).

By definition, $S + B = N + D + K$. Taking the last item (proprietors’ capital) as given, it follows that a bank could not make additional loans - that is, discount more bills (B) - without either attracting additional deposits (increasing D), issuing more notes (N) or losing specie (reducing S). This equality highlights the delicate balance that issuing banks had to strike in their pursuit of business and profit opportunities. Their ability to increase discounting operations, which entailed a rise in the amount of outstanding notes and the volume of deposits, had to be judged against the greater strain put on its specie stock. The latter, unless it was expanded in proportion to the volume of discounts, could prove to be insufficient in case of a sudden demand for redemption.

It should be stressed that the business of issuing banknotes was not as costless as many contemporaries liked to portray it. Indeed, indulgence in overissue was far from a free exercise, given that issuing banks incurred costs both to initiate their operations and to maintain them. While the former costs may have been small - basically comprising those of printing notes - maintaining them in circulation in a competitive environment involved convincing the public of their superior qualities in respect to its competitors. More broadly, operating costs, i. e., the costs associated with holding and discounting commercial bills of exchange, were costs of

¹⁶ Banks of discount could re-sell the original bill to other intermediaries (at a new discount), by endorsing it. In so doing they became liable to payment in case the original drawee failed to honour his debt at maturity. The increasing sophistication of this market in short-term credit gave rise to a host of specialised players in London. For a discussion, see R. Roberts, “What’s in a Name? Merchants, Merchant Bankers, Accepting Houses, Issuing Houses, Industrial Bankers and Investment Bankers”, *Business History*, Vol. 35, No. 3, 1993, pp. 22-38.

information, transaction, and self-insurance. These were incurred ‘in ascertaining the credit-worthiness of bill issuers, enforcing the repayment of obligations upon maturation of the bills, and absorbing some percentage of bad debts’.¹⁷

A third school of thought in the nineteenth-century monetary debates in Britain - in many respects distinct from the Banking and Currency schools - has been identified in connection with the question of the costs of issuing banknotes. This Free Banking school, as the name suggests, favoured free trade in the issue of convertible notes.¹⁸ Accordingly, their attacks were centred on the monopoly of note issue exercised in the London area by the Bank of England.¹⁹ The Scottish experience, where since the seventeenth century the banking industry had developed very successfully, provided the major source of inspiration for advocates of free banking. During this period, the country had ‘no monetary policy, no central bank, and virtually no political regulation of the banking industry. Entry was completely free and the right of note issue universal’.²⁰

Scotland was not alone in boasting a free banking system at the time. In the United States, the free banking experience spanned the 1837-63 period. It was bounded by the expiry of the charter of the Second Bank of the United States and the passage of the National Banking Act, which created the (private) national banks.

¹⁷ Cf. White, *Free Banking*, p. 7.

¹⁸ Schwartz, “Banking School”, p. 184. The “rediscovery” of a third school in the English monetary debates is largely due to the works of White. For details, see White, *Free Banking*; and “Banking Without a Central Bank: Scotland before 1844 as a Free Banking system”, in F. Capie and E. Wood (eds.) *Unregulated Banking: chaos or order?* (London, Macmillan, 1991). For a review of several modern contributions to the debate, see M. Bordo, “Explorations in Monetary History: a survey of the literature”, *Explorations in Economic History*, Vol. 23, No. 4, October 1986, pp. 339-415.

¹⁹ As already noted, country banks were only allowed to issue notes outside a 65-mile radius from the capital. Additionally, an act of 1708 forbade English private joint-stock banks with more than six partners from issuing notes or any other obligations of maturities shorter than six months while the Bank of England existed, leaving supply of banknotes in the countryside to ‘a host of poorly capitalised, locally-based banks’, the so-called country banks. Cf. White, *Free Banking*, p. 38. The lack of both adequate capitalisation and diversification, in turn, lay at the origin of a spate of bank failures in the 1820s, leading to the repeal of the six-partner rule for country banks in 1826. Although allowing entry of joint-stock banks into London in 1833, Parliament still maintained the monopoly of note issue by the Bank of England in the metropolitan area. Finally, the Banking Charter Act of 1844 spelt the end of the Free Banking cause in Britain, having banned the creation of new note issuers anywhere in Britain (including Scotland), while also limiting the size of individual banknote issues to those existing in 1844. See Collins, *Money and Banking*, p. 70.

²⁰ Cf. White, *Free Banking*, p. 23. The Scottish experience with free banking had its admirers in the Brazilian Parliament, too. See the speech by deputy Joaquim Gomes de Souza, on 1 July 1859, in *ACD*, Tome V, Appendix, p. 32.

During this period, banking legislation was left entirely in the hands of the states, some of which passed free banking laws. Two main provisions underscored state-sponsored free banking legislation: entry into the industry and the type of note backing. Unlike the older system of chartered banks - where each bank required a separate charter by the state legislature - entry into banking was open to all, provided minimum requirements with respect to capital and other matters were complied with.²¹ The second point concerned the nature of the backing to note issue. In order to receive permission to circulate their notes freely, banks had to ensure their convertibility into specie. Additionally, a bond security provision applied, whereby designated government bonds had to be deposited with a state official as security for noteholders in case the bank failed to redeem notes on demand.²² Clearly, there were restrictions on who could undertake note issues and in what amount. In this sense, free banking in pre-Civil War United States was far from pure *laissez-faire*.²³ More appropriately, the period could be termed one of “decentralisation without freedom”.²⁴

Finally, it should be noted that, in practice, overissue could be greatly “self-policed”, through the operation of private bank monitoring arrangements. Clearing operations, whereby participating banks engaged in a daily settlement of accounts, was a typical market-based solution that imposed limits on banks’ issuing activities. In the presence of large institutions ready to demand immediate redemption of their

²¹ H. Rockoff, “Lessons from the American Experience With Free Banking”, in F. Capie and G. E. Wood (eds.) *Unregulated Banking*, Chapter 2.

²² See H. Rockoff, “The Free Banking Era: an examination”, *Journal of Money, Credit and Banking*, Vol. VI, No. 2, May 1974, pp. 141-67. Under New York state free banking legislation, ‘the bank regulator provided the bank with notes - bearing its name, etc. - in exchange for mortgages and government debt. Initially, the Comptroller’s office and later the state banking department had plates made for the production of each free bank’s notes and supervised/recorded the production of notes’. Cf. R. G. King, “On the Economics of Private Money”, *Journal of Monetary Economics*, Vol. 12, No. 1, July 1983, pp. 142-3.

²³ Rockoff, “Lessons”, p. 75.

²⁴ The expression is from Smith, *The Rationale*, p. 36. Traditional accounts of United States monetary history during the free banking era have emphasised the extent of “wildcat” banking, loosely understood as referring to banks, often located in isolated regions, that issued notes well in excess of their capacity to redeem them. However, recent research pioneered by Rockoff has demonstrated the existence of successful experiments with free banking in many states. In others, where wildcat banking effectively occurred, bank failures can be blamed on the type of bonds acting as security for note issue. Overall, and given the diverse record in the 1837-63 period in the United States, it seems inappropriate to refer to one American experience but, rather, to those of the different (19 in all) states that experimented with free banking.

notes in gold, issuing banks could ill-afford to indulge in the overissue feared by opponents of free banking. Clearing houses shortened the length of time a note circulated before it returned to the issuing bank, where it would pass under the tellers' scrutiny.²⁵ Examples of such schemes during the Free Banking era in the United States were the Suffolk System, centred around the Suffolk Bank of Boston, and the New York Clearing House. Successful arrangements of a similar sort had been operating in Scotland for some time and greatly reduced problems with counterfeit notes. More fundamentally, though, the Scottish experience with free banking provided what seemed to be a viable alternative to regulated, central banking.²⁶ On the whole, nineteenth-century Brazilian policymakers did not appear to share this view.²⁷

6.2.1 - Issuing Rights in Brazil

The rules that regulated issuing rights in nineteenth-century Brazil can be broadly separated into two sets: the right to issue proper and what could be issued. The first one involved general legislation regulating the issue of liabilities of some form, *vales* and notes being the more prominent. Furthermore, and related to corporate law, the type of organisation of the issuing establishments - for example, firms with limited liability or private partnerships - was a matter of concern for legislators. The second set of rules dealt with more technical aspects of the issuing process, such as denomination and extent of circulation. By themselves, matters pertaining to the first group were an object of often heated political disputes, while the finer, technical, aspects of legislation did not elicit as much controversy.

²⁵ On this point, see White, *Free Banking*, p. 40. The market mechanism - monitoring via note redemption - appears to have helped reduce the extent of wildcat banking in some parts of the United States, such as New York and Ohio. For details, see G. Gorton, "Reputation Formation in Early Bank Note Markets", *Journal of Political Economy*, Vol. 104, No. 2, April 1996, pp. 346-397. A similar point was made by Smith, *The Rationale*, p. 39.

²⁶ See C. Goodhart, *The Evolution of Central Banks* (Cambridge, MA, The MIT Press, 1988), Chapter 2; and G. Gorton, "Banking Theory and Free Banking History: a review essay", *Journal of Monetary Economics*, Vol. 16, No. 2, March 1985, pp. 267-76. More on the central banking question in Chapter 7.

²⁷ Yet, the clearing house mechanism employed in some countries served as the basis for Article 2, para 11, of the Law of Impediments, which made notes issued by other banks acceptable at the Bank of Brazil. The hope was that the 'supervision that each bank will be able to exercise over its competitors,

The question of issuing rights became central to the monetary debates in Brazil in 1829 when, following the *de facto* liquidation of the “first” Bank of Brazil, the Empire would be left without a single joint-stock banking establishment for seven years.²⁸ In 1836, with the creation of the Banco do Ceará, under the auspices of the provincial government and the authorisation of its legislative assembly, this long interregnum was broken. Two years later, in December 1838, the Banco Comercial do Rio de Janeiro (BCRJ) was founded, with a capital of 5,000 *contos* (£600,000). Its statutes would only be approved by the imperial government in June 1842! The successful experience of the BCRJ inspired a group of businessmen in Salvador to install the Banco Comercial da Bahia, in April 1845. This bank began its operations in May, although government authorisation only came in November. During the next four years, five other banks were later authorised to issue *vales*, the largest of which was the second Bank of Brazil, set up by Mauá. This period, dominated by *vale*-issuing banks, was Brazil’s first major experiment with government-supervised plurality of issue.

The lag between the start of operations of these banks and official recognition can be explained by the “trauma” caused by the failure of the first Bank of Brazil and the mismanagement which appears to have occasioned it. Crucially, though, it reflected the absence of specific legislation governing such an important matter as the establishment and operation of banks. In fact, the first pieces of banking legislation - but not a proper banking law - would only be passed on 10 January 1849 (Decree 575).²⁹ Still, the provisions of this decree did little to defuse uncertainty, and sheer confusion, regarding the rules applying to banks, which were just part of the broader category of corporations (*sociedades anônimas*), subsequently regulated by the 1850 Commercial Code.

by means of the exchange of their notes once a week’ would be of great service to the banks, ‘just as it had been in Scotland’. See speech by Ferraz, session of 8 August 1860, in *ACD*, Tome III, p. 99.

²⁸ The first Bank of Brazil was created in October 1808 and its operations started one year later. Throughout its 20-year life it was beset by demands from the State that, ultimately, led to its closure and a protracted process of liquidation, running from 1829 to 1835. For details, see Franco, *Os Bancos*, Chapter 1; C. M. Peláez, “The Establishment of Banking Institutions in a Backward Economy: Brazil, 1800-1851”, *Business History Review*, Vol. XLIX, No. 4, Winter 1975, pp. 446-72; and D. T. Vieira, *A Evolução do Sistema Monetário Brasileiro* (São Paulo, FCEA/USP, 1962).

²⁹ Articles 9 and 10 of the said decree determined that ‘the establishment of any corporation with the purpose of engaging in banking operations shall only be authorised once a quarter of its shares have

In 1853, after more than a decade of plurality of *vale*-issuing banks, monopoly of note issue was introduced. An act of the Legislative created the third Bank of Brazil. As seen in Chapter 4, Itaboraí proposed the bill establishing the new, semi-official, bank as a way to sabotage the Holanda Cavalcanti project for provincial banks of issue. Itaboraí's main concern, as expressed in Articles 16, 18, and 19 of the statutes of the Bank, was with the potential overissue which plurality could entail. The earlier experience in Rio, where competition between the Banco Comercial and Mauá's Bank of Brazil was blamed for a monetary pressure, only served to strengthen the resolve of the advocates of monopoly. Underpinning this conservative approach banks, was fear of the effects of excessive monetary expansion on prices and the rate of exchange. No one better than Itaboraí represented the dominant view at the time that a monopoly of note issue was one of the main pillars on which sound finance stood (the other being convertibility).

Competition among banks, gentlemen, has been the main cause of virtually every commercial crisis. It is the dispute in which everyone seeks to make more business, lure more customers, offer more dividends to their shareholders, which usually leads them to discount bills without the necessary guarantees; which forces interest rates down too much; which excites firms randomly; which makes real capital vanish from the market, and replaces it with fictional, imaginary, capital; it is the rivalry among banks which contributes greatly to produce failures, ruin, and despair in thousands of families, when the day comes in which this illusion fades away.³⁰

In short, monopoly of note issue was perceived by Itaboraí and his followers as the best way to ensure macroeconomic stability.³¹ Not everyone shared this opinion. There were those, like deputy Bandeira de Mello, who feared that with monopoly would come complacency and, ultimately, a deterioration in the quality of the paper being discounted.³² Others preferred a monopoly in the hands of the government, who would be allowed to issue inconvertible notes.³³ Be it as it may, it was shown

been subscribed; however, if this total has not been realised within the time marked by its statutes it shall be dissolved (...)' . Quoted in Pacheco, *Banco do Brasil*, Vol. II, p. 82.

³⁰ Speech delivered in the Chamber of Deputies on 20 June 1853, cited in Pacheco, *Banco do Brasil*, Vol. II, p. 106.

³¹ This point will be explored in greater detail in Section 7.3, in connection with the "orthodox" perspective on the role of banks.

³² Speech delivered in the Chamber of Deputies on 18 June 1853, cited in Pacheco, *Banco do Brasil*, Vol. II, pp. 101-2.

³³ This was the opinion expressed by a Mr. Robert Clinton Wright at the enquiry into the 1857 commercial crisis. See *Comissão de 1859*, pp. 111-2.

that the Bank of Brazil, and its *caixas filiais*, was unable to prevent the seasonal drain of currency to the provinces, a perennial problem at the time. The presence of Souza Franco at the Ministry of Finance in 1857 gave the pluralists the opportunity to see the creation of six new note-issuing banks, thus breaking the short-lived monopoly enjoyed by the Bank of Brazil. By chartering new banks of issue, it was hoped that the money supply would increase, and interest rates would be reduced. Developing economic activity was the main objective of those who supported plurality of issue.³⁴ Yet, some contemporaries entertained mixed feelings about the impact on the economy of the banks created by decree.

If this over-issue were exclusively employed in opening roads and facilitating the transport of the immense national (sic) riches of such provinces as Bahia and Minas Geraes (...), there would be little fear but than an ample amount of products would always be available for the legitimate purpose of trade. As matters stand, these banks of issue can only give rise to reckless and improvident speculations.³⁵

The apprehensions of the British Consul were never really put to the test. In late 1857, shortly after the first banks were chartered, the country was hit by the crisis which had originated in the United States. The financial panic that ensued delivered a deadly blow to the aspirations of supporters of plurality of note issue. Since it coincided with Souza Franco's decrees setting up the new banks, the crisis was said to have spread precisely because of the recently-established plurality of issue. In Chapter 3, it was seen that the new banks had not even engaged in the issue of notes when the panic spread in Brazil. Additionally, news of the creation of the banks had no impact on the rate of exchange, which eliminates the possibility of agents' expectations having contributed to the crisis. Nevertheless, it was shown that the operation needed to defend the rate of exchange proved very polemical, and attacks on it ultimately led to the fall of the *Conciliação* cabinet.

The incoming Conservatives went about reversing Souza Franco's policies. Yet, as pointed out in Chapter 3, the attempt by Torres Homem to modify radically banking and corporate legislation, in 1859, was initially rebuffed by Parliament. Even so, it was seen that although a staunch opponent of plurality of issue, Torres Homem

³⁴ This topic will be discussed in detail in Section 7.1.

³⁵ Parliamentary Papers 1860, LXV, *Report by Mr. Morgan, British Consul in Bahia, on the Trade of that Port for the year 1858*, p. 2.

saw no problem in chartering 17 new deposit and discount banks. This revealed a crucial misconception in the monetary debates in Brazil and, often, in other countries as well. Namely, the understanding that note issues were the sole means to increase the money supply.³⁶ Echoing the widely-held opinion that non-issuing banks could not “create” money, the Minister of Finance felt confident to stress in 1859 that

the needs of credit and the needs of circulation are two entirely different things. The sum of capital that industry seeks, through credit, is always well greater than the sum of the means of exchange supported by circulation. To distribute credit exclusively by way of new circulating notes is to disturb and depreciate the circulation, which does not admit but a given amount of currency (...) while, at the same time, it reduces the advantages of credit, for this paper in superabundance loses part of its purchasing power (...). Discount and deposit banks serve credit without exercising an influence on circulation and prices; in this regard they are harmless assistants to banks of issue.³⁷

Torres Homem’s convictions, of course, have no support in modern banking theory. With the development of deposit accounts, banks realised they could lend a percentage of those funds without compromising their ability to honour claims on them. Through this mechanism banks were capable of creating money independently of their note issues. Contemporaries either failed to perceive this or plainly considered notes and demand deposits as essentially distinct.³⁸ Although the multiplier never exceeded 1.2 times the monetary base in the 1860s,³⁹ it clearly represented one form of money expansion which the government was late in acknowledging.⁴⁰

³⁶ This idea was entertained by most Currency school members, as argued by Viner, *Studies*, pp. 249-50.

³⁷ Cf. *RMF* 1858, p. 7. The parallel with the earlier episode in which Souza Franco authorised the creation of new banks of issue without hearing the Legislative was clearly perceived by the British *Chargé d’Affaires*. ‘I shall have no means of estimating the effect of the above measure in time for the present mail (...). I may observe however that it is strange that in a constitutional country matters of such importance to its financial credit should be suddenly solved upon the simple advice given by the Minister of Finance to the Crown, and without reference to Parliament’. PRO, Foreign Office, 13/371, Stuart to the Earl of Malmesbury, Rio de Janeiro, No. 41, 7 April 1859.

³⁸ Still, there were some notable exceptions. Speaking in the Senate, Jequitinhonha cited Gilbert, in support of his position to the effect that ‘deposit banks can also alter the value of the circulating medium, through the swiftness of their notes, just like banks of issue’. Session of 5 August 1858, in *ASI*, Tome IV, p. 53. Earlier that year, deputy Teixeira Junior (Conservative, Rio de Janeiro) proposed that limits be imposed on bank deposits, which he rightly perceived as akin to money. See session of 22 May 1858, in *ACD*, Tome I, p. 85.

³⁹ See Table A1, in the Statistical Appendix.

⁴⁰ In fact, official recognition of the role of deposits as part of the money supply would only come about when the government passed Decree 3339 (10 November 1864), which stipulated that deposits

As a result of this oversight, policymakers saw no contradiction in closely controlling the activities of the banks of issue, while leaving deposit and discount banks, and *casas bancárias*, to carry out their business at will. This point was dramatically reflected in the discussion in Chapter 4 about the origins of the 1864 Souto crisis. It was then shown that, contrary to what many commentators have argued, the 1860 Law of Impediments did not lead to a major monetary crunch. The drop in the nominal money supply in the two years following the Law had all but been recovered by early 1864, a full nine months before Souto shut its doors. As such, it could not have been the major cause of the crisis. Still, it was pointed out that the restrictive banking and corporate legislation enacted in 1860 basically left untouched an important, although difficult to gauge, part of the financial sector. Private banks, it was argued, took demand deposits and issued their own, locally-circulating, *vales*.⁴¹ In this regard, they operated in a similar fashion to joint-stock banks, with the difference that they went largely unsupervised by the authorities. As a result, they took risky positions and, at the same time, provided the market with the liquidity which the government wanted to curtail through the Law of Impediments and Decree 2685.⁴²

The unchecked operation of private banks was Brazil's neglected experiment with free banking. Indeed, few controls existed on the creation of *casas bancárias*, and their subsequent activities. In this respect, their development loosely resembled

held in the Bank of Brazil in current account would henceforth count as part of its issues. The same rule would apply to three-fourths of total interest-bearing deposits. See Cavalcanti, *O Meio*, Vol. 2, p. 279. In the United States the procedure to include bank deposits with note issues when setting specie requirements was pioneered by the 1842 Louisiana banking act. See Hammond, *Banks and Politics*, p. 695.

⁴¹ 'In my opinion, receipts (...) issued by the bankers who failed represented an actual issue in disguise, one thousand times more dangerous and damaging to the public than those made by banks; because, although they acted as currency in commercial transactions, they had no limit whatsoever, except the individual credit of those who signed them; it was but an illicit means to circumvent the dispositions of the law of 22 August 1860'. Statement made by Sebastião Ferreira Soares for the inquiry into the 1864 crisis, in *Comissão de 1864*, Annex C, Part I, p. 51.

⁴² This point serves to highlight the fact that to focus exclusively on traditional monetary aggregates to gauge the degree of liquidity in the economy can be "myopic", as argued by Kindleberger, *Manias*, pp. 49-51. For example, Sweigart remarks that in 1865 'a Rio merchant had estimated that coffee factors had lent planters as much as 90,000 *contos*, a sum only slightly less than the total bank currency held by the public over the entire country. Not all of the planter drafts ended up in banks; drafts accepted by well known planters and factors circulated as currency throughout the coffee provinces'. Sweigart, *Coffee Factorage*, p. 135. It is difficult to assess the extent to which planter drafts behaved as "money", as well as the amount of outstanding obligations of this nature in other points in time. Still, their sheer volume in 1865 should add a measure of caution to any analysis of monetary trends based exclusively on aggregates such as M1 or M2.

the *laissez-faire* system which characterised Scotland, except for the absence of a local clearing arrangement. Strictly speaking, the periods of plurality of issue by joint-stock banks in Brazil would not qualify as free banking. Throughout, banks were required to obtain either governmental or legislative approval before starting their operations, even though at times this rule would be flaunted. *Casas bancárias*, by contrast, were broadly unencumbered by government controls and seem to have ignored, for the most part, basic prudential rules. Still, the growth in their discounts does not appear to have helped lower the rate of interest, as hoped by pluralists. Abundant money need not result in cheaper credit.⁴³ More important, the unsupervised operation of private banks helped trigger the major commercial crisis in the history of the Empire.

Monopoly of note issue was restored in 1866, when the contract signed between the government and the Bank of Brazil was reviewed. At the time, the reason given for this decision was the Bank's incapacity, or unwillingness, to resume convertibility of its notes. In reality, as argued in Chapter 4, the needs of the Treasury in connection with war expenditures determined the return of issuing rights to the hands of the government. Throughout the rest of the conflict, considerations of macroeconomic stability would have to be set aside. Monopoly of issue would momentarily be an instrument of national security, rather than a means to achieve a sound monetary system.⁴⁴

As argued in Chapter 3, the question of issuing rights in Brazil was directly related to the broader legislation governing incorporation. Brazilian corporate law, as detailed in the 1850 Commercial Code, laid down in Article 298 the institution of limited liability. In other words, unlike the usual *sociedades*, governed by unlimited liability, partners or shareholders in corporations (*sociedades anônimas*) would only be liable for the firm's debts up to the amount of shares they subscribed. A further set-up permitted by the Commercial Code, and which was modelled in its French counterpart, was the limited partnership (*sociedades em comanditas*). In this case, one or more controlling partners (*sócios solidários*) administered the firm, and were

⁴³ This point will be elaborated in Section 7.1.

⁴⁴ More on this in Chapter 7.

subject to unlimited liability, while other, non-controlling (or “sleeping”), partners retained limited liability.⁴⁵

Choice of liability for shareholders in a bank involved a trade-off. If, on the one hand, limited liability could make depositors wary of their chances of recovering their money in case of liquidation, unlimited liability from the outset restricted the pool of investors.⁴⁶ Joint-stock banks tended to be more stable than their private counterparts, given their ability to raise larger sums of capital. More capital meant more business volume, allowing greater economies of scale to be reaped, a feature which is crucial in the commercial banking industry.⁴⁷ Brazilian legislators seem to have sided with most nations of the time in deciding for limited liability for corporations.⁴⁸

The 1850 Commercial Code also determined in Art. 295 that *sociedades anônimas* could only be established ‘for a fixed period of time, and by means of Government authorisation, depending on legislative approval in case they benefit from any privilege (...)’.⁴⁹ In practice, this reiterated earlier jurisprudence in Brazilian legislation, dating back to the beginning of the nineteenth century, and deriving from Roman Law. As a result, in Brazilian law, incorporation was not a right, but a privilege.⁵⁰ Banks, if organised as corporations, had therefore to conform to the general provisions of Article 295 of the Commercial Code. As such, they had

⁴⁵ In Britain, ‘prior to 1857, bank shares (...) were subject to unlimited liability, that is, in event of the bank’s liquidation its shareholders were liable for all its debts, regardless of the value of each individual’s shareholding. A host of company law reforms in the 1857-62 period changed this and allowed banks to register as limited liability companies. Yet, it was only after the 1879 Companies Act that transition to limited liability status was eased, by retaining unlimited liability to note issues only, while shareholders were held responsible for the remaining liabilities and debts only up to a fixed amount’. Cf. Collins, *Money and Banking*, pp. 100-1.

⁴⁶ Ibid.

⁴⁷ Ibid., p. 66.

⁴⁸ It has been remarked that at that time ‘only in England and Scotland were joint-stock companies generally subject to unlimited liability. In America, as well as on the Continent, the principle of limited liability became the general rule right from the beginning’. Cf. Smith, *The Rationale*, p. 37, footnote 2.

⁴⁹ *Coleção das Leis do Império do Brasil*, Tome 11, Part 1, 1850, p. 107.

⁵⁰ Barman points out that Brazil was not alone at the time in making incorporation depend on official approval, as the same applied to France under its 1807 Commercial Code. See Barman, “Business”. Free incorporation was not introduced in the North German Confederation and Austria until 1870 and 1899, respectively. See “Introduction”, in R. Cameron (ed.), *Banking and Economic Development: some lessons from history* (New York, Oxford University Press, 1972), p. 17.

to seek government approval of their statutes before starting their operations. Nevertheless, as seen earlier, that determination was often not observed in practice. Furthermore - and this was the crucial point - should the issue of notes be interpreted as a “privilege”, official authorisation was definitely dependent on legislative approval.⁵¹ In spite of this interpretation, it was not until the 1860 Law of Impediments was enacted that the Legislative prerogative in authorising banks of issue was clearly established.⁵²

Art. 1, para 10: No bank, except those currently operating as a result of a decree from the Executive, corporation, or partnership of any kind, trader or individual in any position, shall be allowed to issue, without permission from the Legislative power, notes, bills, *vales*, paper or bond of any kind payable to bearer (...), liable to the payment of a fine of four times its value, to be borne fully by both issuer and bearer.⁵³

Technical aspects concerning bank issues varied over the years. Banks that were established in the pre-1853 period engaged in the issue of *vales*. This contrasted with the first Bank of Brazil, which issued banknotes that circulated nationally and had legal tender status. *Vales* were not accepted as payment of debts to the government (taxes, for instance) and could not be used outside the provinces in which they had been issued. Furthermore, the decrees approving banks’ statutes usually imposed a maximum limit on the issues of *vales*, which consisted of a multiple of paid-in capital.

⁵¹ In a way, then, joint-stock issuing banks were invested with a “double privilege”, that of limited liability - which benefited shareholders - and that of issuing notes.

⁵² As seen in Chapter 4, the 1860 Law of Impediments imposed restrictions not only on the operation of joint-stock banks, but on corporations in general. Additionally, it strengthened the provisions of the Commercial Code, by imposing for the first time clear penalties (in the shape of fines) on those responsible for failing to obtain official authorisation before embarking on commercial ventures (Art. 2, para 1).

⁵³ Restrictions on the operation of joint-stock companies in general would only be relaxed on 4 November 1882 (Law 3150), when free incorporation was introduced. Nevertheless, issuing banks remained required by law to seek legislative approval of their operations. It is worth noting the marked contrast between Brazil and Chile at the time, when a similar clash between *papeleros* and *oreros* helped shape most policies governing money and banking. In spite of the political power and intellectual influence of the latter group, the 1860 banking law in Chile placed few restrictions on the operation of those institutions, namely, a limit on (convertible) note issue of 150% of the bank’s paid-in capital and the requirement that denominations of bank notes be limited to 20, 50 and 500 pesos, in order to restrict their use. ‘There was no minimum capital requirement, no cash reserve requirements against deposits or note issue, no limit on loans to directors and no provision for government inspection or supervision. Nevertheless, the Banking Law of 1860 survived largely intact until 1925, except that the right of note issue was taken away in 1898 and some provision for the inspection of banks was made in 1912’. Cf. Conoboy, “Money and Politics in Chile”, p. 7.

Figure 6.3

Brazilian Banks: rules governing rights of issue, 1808-1851

Institution	Date Statutes Approved	Denomination of Notes and Issuing Limits
“First” Bank of Brazil	12 October 1808	.Notes with a denomination of 30\$000 or above .Unlimited issue with the sole proviso that it be done with ‘the necessary caution so as to ensure redemption (for metallic coins) on demand’
Banco Comercial do Rio de Janeiro	10 December 1838	. <i>Vales</i> with a denomination of 500\$000 or above, redeemable in gold or Treasury notes .Issues limited to 1/3 paid-in capital
Banco Comercial da Bahia	13 November 1845	. <i>Vales</i> with a denomination of 100\$000 or above, redeemable in gold or Treasury notes .Issues limited to ½ paid-in capital
Caixa de Economia da Província de Pernambuco	27 April 1847	. <i>Vales</i> with a denomination of 25\$000 to 500\$000, redeemable in gold or Treasury notes, and accepted at provincial tax offices .Issues limited to ½ paid-in capital
Banco Comercial do Pará	14 September 1847	. <i>Vales</i> redeemable in gold or Treasury notes .Issues limited to ½ paid-in capital
Banco Comercial do Maranhão	24 March 1849	. <i>Vales</i> redeemable in gold or Treasury notes .Issues limited to ½ paid-in capital
“Second” Bank of Brazil (Mauá)	2 July 1851	. <i>Vales</i> of no less than 5 days and lowest denomination of 200\$000, redeemable in gold or Treasury notes .Issues limited to 1/3 paid-in capital (*)
Banco de Pernambuco	22 December 1851	. <i>Vales</i> of no less than 5 days and lowest denomination of 100\$000 .Issues limited to ½ paid-in capital

Notes: (*) the same ratio applied to the branches of the second Bank of Brazil in São Paulo and Rio Grande do Sul, while the lowest denomination of *vales* was 100\$000.

Sources: B. de S. Franco, *Os Bancos do Brasil* (Brasília, Ed. da Universidade de Brasília, 1984); and A. Cavalcanti, *O Meio Circulante Nacional* (Rio de Janeiro, Imprensa Nacional, 1893, 2 vols.).

Notes of the third Bank of Brazil, unlike *vales*, were accepted in payment of taxes and debts to the government. But, like *vales*, they were not legal tender and could only circulate in the province where they had been issued. In time, this would come to include the markets formerly served by *vale*-issuing banks, such as Pernambuco, Bahia, São Paulo, Minas Gerais and Rio Grande do Sul.

Figure 6.4

“Third” Bank of Brazil: rules governing rights of issue

Arts. 12, 13, and 16: Bank allowed to issue notes in denominations of 20\$000 or more (head

office) and 10\$000 (branches), payable to bearer, redeemable in gold or Treasury notes (at the Bank's discretion) and accepted in payment of taxes and debts to the government

Art. 16, para 1: Issues limited to twice the Bank's <i>funido disponivel</i> , consisting of specie and 22-carat gold bars. Para 2: total issue cannot exceed the value of Bank's discount operations

Art. 18: Additionally, Bank can increase the issue set in Art. 16 by a sum equivalent to the total amount of Treasury notes withdrawn from circulation, but never exceeding thrice the <i>funido</i> (*)
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Art. 19: Finally, on top of the above limits, Bank can issue additional notes, so long as backed by gold at a 1:1 ratio, i. e., each extra unit of Bank of Brazil notes that is issued requires its equivalent in gold beyond the existing sum already in the <i>funido</i>

Note: (*) Art. 56, para 1 of the statutes of the Bank of Brazil determined that it gradually withdraw the Treasury notes in circulation.

Source: A. Cavalcanti, *O Meio Circulante Nacional* (Rio de Janeiro, Imprensa Nacional, 1893, 2 vols.), Vol. 2, pp. 198-201.

At first, total Bank issues were limited to an amount equivalent to twice its reserve fund (*funido disponivel*), comprised of both gold and Treasury notes. Redemption, accordingly, could be made in either of the two components of the reserve fund. As seen in Part II of the thesis, limits on the issue of Bank of Brazil notes were frequently relaxed, in order to accommodate additional demand for its notes, a sudden loss of gold, or both.

Banks created by decree in 1857-8 were all broadly governed by the same rules. They could only issue notes payable to bearer up to the value of paid-in capital.

Figure 6.5

Banks Created by Government Decree: rules governing rights of issue

Institution	Date Statutes Approved	Denomination of Notes and Issuing Limits
Banco Comercial & Agrícola	31 August 1857	.Notes with a denomination of 20\$000 or above (head office) and 10\$000 (branches), payable to bearer, without legal tender status, and redeemable in gold or Treasury notes (at the bank's discretion). .Total issue limited to an amount equivalent to bank's paid-in capital .At least 50% of issues to be guaranteed by an equivalent sum in bonds of the consolidated government debt (<i>apólices</i>) and railway shares with "profits" guaranteed by the imperial government; remaining 50% of note issues to be backed by reserve fund made up of Treasury notes and specie (*)
Banco do Rio Grande do Sul	24 October 1857	Same as above, except for the railway shares. Given the absence of railways in the province of Rio Grande do Sul at the time, shares of any business enjoying a minimum rate of return of 7% guaranteed by either the imperial or provincial governments
Banco de Pernambuco	11 November 1857	same as Comercial & Agrícola
Banco do Maranhão	25 November 1857	same as Comercial & Agrícola
Banco Rural & Hipotecário	27 February 1858 (**)	same as Comercial & Agrícola
Banco da Bahia	3 April 1858	same as the Comercial & Agrícola

Notes: (*) "Profit" guarantees referred to a minimum rate of return which the government ensured investors in railways and a few other infrastructure projects.

(**) The Rural & Hipotecário had been operating as a deposit bank since 1854. After doubling its capital from 8,000 to 16,000 *contos* it applied for, and obtained, permission to issue notes.

Source: A. Cavalcanti, *O Meio Circulante Nacional* (Rio de Janeiro, Imprensa Nacional, 1893, 2 vols.), Vol. 2, pp. 222-9.

Issues of the banks created by decree had to be partly guaranteed by an equal amount of *apólices* and railway shares, while the other half should correspond to a reserve fund made up of gold and Treasury notes. Their banknotes were not accepted in tax offices, a privilege which was held exclusively by the Bank of Brazil. They were not legal tender, either. In other words, private individuals were under no obligation to accept them in daily transactions.⁵⁴

Finally, the imposition of minimum limits on the face value of notes and *vales* issued by banks was an additional feature which Brazil shared with other nations at the time. Two main reasons accounted for this practice. First, given that notes of

⁵⁴ As expected, this provision could cause problems, as in the case of a respectable family from Rio, left stranded in a train station in the outskirts of the city, for want of legal tender currency to pay the fare. As it turned out, all they had in their pockets was a substantial amount of notes issued by the

small denomination tended to fall into the hands of the poorer and more ignorant classes - who, for the most part, were unable to discriminate between issuers - counterfeiting was discouraged.⁵⁵ Second, there was the fear that paper of small denomination would expel from circulation gold coins, used in day-to-day transactions.⁵⁶ In the end, requiring that banks issue notes the individual value of which could well be in excess of the average worker's weekly wages, led to the widespread counterfeiting of copper coins (the so-called *xenxéns*). Moreover, it resulted in the issue of private notes of very small denominations, as a means to introduce crucial small change into circulation.⁵⁷

6.3 - Convertibility

As noted in Chapter 1, one of the main reasons why countries sought to adhere to the gold standard system was the exchange-rate stability it provided. This stability, as argued, precluded the shifts in income and wealth that accompanied currency fluctuations, and which lay at the root of the political economy of monetary management. In practical terms, stability would be a direct result of the official commitment to the convertibility of domestic currency at a fixed weight of gold.

The importance of the exchange rate in an open economy like Brazil's in the second half of the nineteenth century cannot be exaggerated. This price had a bearing, to name only a few, on the amount of government revenue (which was highly dependent on import taxes) and foreign commitments. Other things equal, an appreciated rate of exchange meant higher imports and customs revenues. Moreover, it minimised the value in *milréis* terms of the expenses of the imperial government in foreign currency. The exchange also had an influence on the price of urban wage goods (many of which were

Banco Comercial & Agrícola, which the company refused to accept. See session of 29 May 1858, in *ACD*, Tome I, p. 149.

⁵⁵ Minister of Finance Ferraz criticised the banks' issues of notes of small denomination on the grounds that they fell into the hands of the lower classes, who used them in daily transactions. This subjected the paper to wear and tear, when not total loss, something which would ultimately benefit the issuing bank, who would be free from redeeming them. See *RMF* 1859, p. 69.

⁵⁶ This prompted the adoption of Art. 4 of Decree 2685 (10 November 1860), which imposed on the Bank of Brazil the requirement to withdraw from circulation notes of smaller denomination, should it fail to resume (gold) convertibility within six months.

⁵⁷ Similar problems arose in the South of the United States, where states struggled to regulate the private issue of so-called "shinplasters". For details, see Schweikart, *Banking*, p. 115.

imported), the profitability of the export sector and, more generally, the state of confidence in the economy as a whole.⁵⁸ Finally, exporters of commodities (*fazendeiros*) tended to favour a slipping exchange, which, *ceteris paribus*, increased the domestic value of their sales. Indeed, with most of their costs defrayed in *milréis*, a low rate of exchange meant a net transfer of resources from society as a whole to the export sector.

The first concrete step towards establishing a gold-backed currency in Brazil was taken on 11 September 1846, with Law 401.⁵⁹ This very succinct piece of legislation comprised two main articles.

Art. 1: From 1 January 1847 onwards, or earlier, if possible, the public stations (tax offices) shall accept 22-carat gold coins at the ratio of four *milréis* to the *oitava* (...)⁶⁰

Art. 2: The Government is authorised to retire from circulation the amount of paper money deemed necessary to raise and keep it at the value provided in the preceding Article; for this purpose it will be allowed to undertake the necessary credit operations.

The intentions of the government in advancing the 1846 Law were clear: the country should strive towards a convertible currency at the new 27d parity.⁶¹ Still, it must be emphasised that this exchange rate was more of a “notional” nature, given that monetary circulation at the time consisted mainly of Treasury notes, but also bank-issued *vales*, both of which were inconvertible. In practice, at that stage the country would still be under a regime of flexible exchange rates, given that no part of its note circulation was backed by gold, nor was it redeemable into it on demand. Convertibility, as seen in Chapter 3, would only come about after the creation of the third Bank of Brazil, in 1854.

Even though the spirit of the 1846 legislation would dominate most policy actions in the monetary and banking realm in the 1850-70 period, the 27d/1\$000 gold parity was effectively in force for fewer than six years: between April 1854 and November 1857, briefly between August 1858 and January 1859, and then again

⁵⁸ At the time, the degree of protection afforded to import-substituting industries by a depreciated *milréis*, as well as its influence on the imports of capital goods (and, hence, domestic investment) were not significant.

⁵⁹ The project for the 1846 Law had originated in the Senate, at the initiative of Bernardo de Vasconcelos. For a sample of the discussions in Parliament over the 1846 monetary reform, see A. Cavalcanti, *O Meio* Vol. 2, Chapter 2.

⁶⁰ An *oitava* corresponded to 1/8 of an ounce, or 3.586 grams.

⁶¹ This was the third time the legal parity of the *milréis* was changed. Historically, the par rate of exchange had been 67.5d, altered to 43.4d in 1833.

between October 1862 and the outbreak of the Souto crisis, in September 1864. These were the periods in which the Bank of Brazil - and, for a while, the smaller banks of issue - ensured convertibility of their notes and, as a result, the exchange rate remained near par. Still, this was a peculiar type of gold standard regime. Unlike a traditional gold standard, or the gold exchange standard, note issues in these periods were backed partly in gold, and partly in Treasury notes.⁶² Yet, Treasury notes were inconvertible, so that by giving them in return for its notes (as it usually did) the Bank was technically converting its own money into paper, not gold. Still, even with this peculiar system in place, exchange rate stability was observed. As it turned out, the simple pledge to redeem its notes into either gold or Treasury notes - in other words, “potential” convertibility - built credibility into the system, and ensured that the *milréis* remained around its par value. Indeed, it must be remembered that when a country is effectively under gold, its exchange rate can only vary within the narrow limits of the gold points. Outside this, specie will either flow into or out of its borders, thus redressing balance of payments surpluses or deficits. A look at the behaviour of the exchange rate in the period when Brazil was “potentially” under gold reveals little deviation from the 27d/1\$000 par value, when allowing for a cost for insurance and shipping of gold as high as 4% of its price.

⁶² Also, as shown in Figure 6.5, in the case of the smaller issuing banks note issues could be partly backed by blue chip shares of companies enjoying profit guarantees. For a summary of the main characteristics of the gold exchange standard, see P. Newman, M. Milgate, and J. Eatwell (eds.) *The New Palgrave Dictionary of Money and Finance*, Vol. 2 (London, Macmillan, 1992), pp. 256-7.

Table 6.1
Rate of Exchange Under Convertibility
of Bank of Brazil Notes: par 27d

(in pence *per milréis*)

Period	Exchange Rate	
	High	Low
10 Apr 1854 to 11 Nov 1857	28 3/4	26 3/4
24 Aug 1858 to 17 Jan 1859	27	26
23 Oct 1862 to 14 Sep 1864	27 5/8	26 5/8

Source: Daily quotations at the Rio Bolsa, in Junta dos Corretores de Fundos Públicos da Cidade do Rio de Janeiro, “Livro Oficial de Cotações de Títulos e Valores”, various vols.

Apart from the intervals displayed in Table 6.1, Brazil was under a fiduciary system and, therefore, could not possibly benefit from the same degree of exchange-rate stability as when it was under this peculiar type of gold standard regime. Still, monetary “virtue” was hailed as paramount and, accordingly, most policymakers and contemporary commentators favoured convertibility.

In the Brazilian historiography, individuals who proclaimed the virtues associated with hard money have been labelled *metalistas*, whose ideas would be broadly akin to those of the Currency school in England.⁶³ As should be clear by now, the Visconde de Itaboraí and Torres Homem were the main exponents of financial orthodoxy in the mid-nineteenth century. *Papelistas*, on the other hand, would be the Brazilian equivalent of the Banking school.⁶⁴ Bernardo de Souza Franco was the undisputed leader of this current.⁶⁵ The intellectual legitimacy for either camp was afforded by constant reference in the debates to foreign authors.⁶⁶

⁶³ See Saes, *Crédito*, p. 26.

⁶⁴ *Ibid.* See also Andrade, “1864”.

⁶⁵ Major politicians identified with the *metalistas* were Angelo Muniz da Silva Ferraz (President of the Council of Ministers and Minister of Finance from August 1859 to March 1861), Paulino José Soares de Sousa (Visconde de Uruguai) and José Maria da Silva Paranhos (Visconde de Rio Branco). With Souza Franco’s ideas sided Irineu Evangelista de Souza (Barão de Mauá), João Lustosa da Cunha Paranaguá and José Antonio Saraiva, to name the most important. See Andrada, *Bancos de Emissão*, p. 112.

⁶⁶ The practice of displaying authority on monetary issues by citing British authors was at times ridiculed by contemporary satirists. See, for instance, the play “Os Financistas, ou Trabalhos Político-Economicos de Huma Assembleia de Cidadãos Que Movidos do Mais Puro Patriotismo se Reunirão para Discutir Entre Si Hum Plano Conducente e Efficaz para Melhorar o Meio Circulante do Imperio do Brasil” (Rio de Janeiro, undated). The *dramatis personae* in this play were all animals, trees and vegetables. The elements of a project for the improvement of the circulating medium in the Empire

Gilbart, an English author identified with the Free Banking school, was a favourite, having had one of his works translated into Portuguese.⁶⁷ Hume, Smith, Ricardo, Mill, and other key participants in the English monetary controversies, were cited with varying degrees of familiarity. Additionally, some of the major tenets of the Currency school vs. Banking school controversy - such as the currency principle and the needs of trade doctrine - were repeated as undisputed truths.

Apart from the guarantee arising from the prompt redemption of banknotes, the total sum of paper-money in each country must vary in amount and value in a similar manner as it would vary (...) if replaced by a metallic currency.⁶⁸

(It is) an undeniable principle that the circulation of banknotes, redeemable in gold on demand, is always determined by the needs of the market, or of the circulation, and cannot go beyond (those needs).⁶⁹

A cursory look at the introductory section to most of the reports of the Minister of Finance in the 1850-70 period provides as good a summary as any of the dominant orthodox credo on financial matters. A typical claim by a *metalista* would read as follows:

(...) the essential condition which industry everywhere needs in order to grow and prosper is the stability of the value of the instrument used in the circulation of its products. This condition is met by a metallic currency, which, on account of the precious material from which it is made, is the universal equivalent, the uniform and almost invariable unit of all other values, the basic product to which they are reduced, as into a common denominator. Bank paper - a mere promise to pay - cannot replace it in circulation unless under the condition of it being converted into this real object (...).⁷⁰

Souza Franco's views on the subject of convertibility, as expounded in his 1848 book, were:

consisted of a few articles, the first one being: "The circulating medium in the Empire will comprise, as presently, noble species, less noble species and very crumpled ones. Paragraph 1: noble species are gold and silver; less noble species is copper; very crumpled species is paper-money of any sort". Ibid., p. 2.

⁶⁷ J. W. Gilbart, *A Practical Treatise on Banking* (London, Brown, Green and Longmans, 1856, 2 vols., 1st edn. 1827), translated by L. J. de Oliveira e Castro as *Tractado Practico de Bancos* (Rio de Janeiro, Garnier, 1859, 3 vols.). I am indebted to Carlos Gabriel Guimarães for drawing my attention to the Brazilian edition of the Gilbart book.

⁶⁸ Cf. *Comissão de 1859*, p. 53.

⁶⁹ Cf. *Comissão de 1864*, p. 76.

⁷⁰ Minister Torres Homem, in *RMF* 1858, p. 2.

Of itself (...) metallic circulation, or (circulation) under a metallic base and bank paper redeemable on demand, is preferable to non-redeemable Treasury notes (...). And the main reason for this is that precious metals are for general use and, being independent of the credit of public or private establishments, the circulating medium is not subject to repeated oscillations in value, which is totally lost as a result of fortuitous and unforeseen events. The same can be said of the notes of well-organised banks of issue, for they will always retain in reserve metal and bonds representing good debt in order to ensure convertibility (of their notes) into metal on request.⁷¹

Quite clearly, Souza Franco, the champion of the *papelistas*, was not so distant from his fierce opponent Torres Homem as far as support of a gold-backed currency was concerned.⁷² In this respect, both men were in tune with the “sound” monetary principles of their time. Like Currency school and Banking school advocates, both *papelistas* and *metalistas* maintained that adherence to the gold standard was paramount. This point is most important. It suggests the need for caution when interpreting the term *papelista*, which might convey the false impression of a supporter of a purely paper circulation, in clear opposition to the gold standard dogma of the day. The broad *metalista* vs. *papelista* dichotomy found in the literature usually fails to grasp this crucial point in the debate, namely, the defence (or opposition to) the gold standard.⁷³ There is no doubt, for instance, that Souza Franco was in favour of exercising strict government supervision of the six new banks of issue which he authorised as Minister of Finance in 1857 and 1858. Proof of this, he imposed limits to their issue of (partly) gold-backed notes (see Figure 6.5).⁷⁴

According to some, the strength of the gold standard doctrine at the time was actually part of a broader defence of the monopoly of note issue by the Bank of Brazil, which was broken when Souza Franco extended this privilege to other banks.⁷⁵ For this reason, Andrade uses the term “pluralist” in her work, instead of *papelista*, while arguing that it would be equally valid to refer to *metalista*-monopolists.⁷⁶ As

⁷¹ Franco, *Os Bancos*, p. 87.

⁷² This similarity was not lost on a contemporary, who remarked that ‘every one of our Ministers of Finance (...), advocates of monopoly or plurality of banks, from Torres Homem to Souza Franco, all of them are blind admirers of gold’. Cf. Milet, *O Meio Circulante*, p. 25.

⁷³ See, for example, Saes, *Crédito*, Part I; and Andrade, “1864”.

⁷⁴ For a similar contemporary defence of plurality of issue with convertibility of (non-legal tender) banknotes, see M. Hoyer, *Estudos Sobre a Reforma do Meio Circulante* (Maranhão, Typ. do Payz, 1880), pp. 38-40.

⁷⁵ See Andrade, “1864”.

⁷⁶ *Ibid.*, p. 168.

already suggested, this taxonomy can be misleading. Indeed, a *metalista* should, in theory, be in favour of metal (gold). Yet, as noted, Souza Franco, a *papelista* and pluralist, supported a gold-backed circulation as well. In this sense, his position was in fact similar to the Banking school's, which, like the Currency school, never questioned the idea of convertibility itself. This point is worth emphasising, for the term *papelista* has often been used in a derogatory sense, as depicting irresponsible inflationists. Souza Franco's influential book, written in 1848, contains ample evidence of how mindful he was of the need to combine a banking system which would simultaneously meet two objectives: to foster the economic development of Brazil while maintaining the stability of the currency. Moreover, this would be attained, he argued, through convertible notes, not by means of a fiduciary circulation.

Contemporary references to the two schools of thought are very scarce, the terms *papelista* and *metalista* apparently having been disseminated by twentieth-century writers.⁷⁷ Yet, the research has unearthed a rare, and comprehensive, definition of *papelistas*, given in the Senate by Itaboraí, when asked by Souza Franco.

They are those who proclaim that bank paper is capital, that it is desirable to create many banks, so as to have a larger circulating medium, for the greater the sum, the greater the number of transactions, and the greater the public wealth. They are those who create banks without imposing on them the indispensable conditions that will guarantee the redemption of their notes in gold (...), those who believe that banks, when under extraordinary circumstances, in which the gold reserve tends to fall and the portfolio to increase, should expand their operations (...). Those are the *papelistas*.⁷⁸

In Itaboraí's definition, then, *papelistas* were advocates of plurality of issue, who paid little attention to prudential rules, and advocated counter-cyclical monetary policies in the event of panics. Yet, like *metalistas*, they were supporters of gold-backed issues. Now, who were the "true" *papelistas*, in the sense of advocates of a purely fiduciary circulation? One needs to look no further than to Irineu Evangelista de Souza, Barão (later Visconde) de Mauá. He was a close friend of Souza Franco's, whose thoughts and policies on money and banking he strongly supported.⁷⁹ Nevertheless, Mauá

⁷⁷ An early example is J. F. Normano, *Brazil: a study of economic types* (Chapel Hill, NC, The University of North Carolina Press, 1935), p. 190.

⁷⁸ Debate held on 2 June 1858, in *ASI*, Tome II, p. 14.

⁷⁹ His participation in the efforts to defend the rate of exchange in the wake of the 1857 crisis bear witness to this. For details, see Chapter 3.

entertained ideas on the subject that were in essence much more radical. Throughout his prolific trajectory as the most important businessman in the Empire, he advocated the virtues of the “spirit of association”. In terms of banking legislation, this translated into a much bolder approach to the question of plurality of issue than Souza Franco’s. His stance against convertibility of banknotes into gold was heretic at the time, and clearly set him apart from his illustrious *papelista* friend.⁸⁰ The chapter on the “Circulating Medium in Brazil”, published in his 1878 autobiography, summarises Mauá’s view on the question of convertibility:

If metallic currency, and banknotes convertible on demand, constitute the engine *par excellence* of the monetary transactions of most countries, on account of their not being just orders on the capital of the country but (of their) having the advantage of being accepted (...) by the value conveyed by their mint price (...), it does not follow that these superlative conditions of an *excellent circulating medium* (...) could not be replaced *at a gain, at a substantial gain even*, by temporary, non-convertible paper from banks (...) which may be led by special circumstances (...) to keep in their portfolios not gold, but private and State paper of good credit (...).⁸¹

Mauá admitted that issuing banks had committed excesses. ‘To the *use* of bank notes, followed *misuse*: the mission of the statesmen was to curtail the latter by means of restrictive legislation (...)’.⁸² Nevertheless, as a rule, he opposed the straitjacket that a gold-backed circulation would impose on the credit system. Nor was he an irresponsible inflationist either, as the above remarks testify to. His hand is clearly seen in the text of the commission set up by the Bank of Brazil in reaction to the 1860 Law of Impediments.⁸³ On that occasion, the commissioners criticised both the currency principle and the real bills doctrine. They argued that there did not exist a “magic” relationship between the amount of currency in circulation and the number of transactions carried out in the economy. Instead, they suggested that the velocity of circulation depended on the state of confidence at a given point in time.⁸⁴ Finally, the

⁸⁰ Yet, as seen in Chapter 5, even Mauá was caught in a debate in the Chamber of Deputies, perhaps unwittingly, defending convertibility.

⁸¹ Emphasis added. Cf. Mauá, “O Meio Circulante”, p. 316. For an examination of Mauá’s ideas on the gold standard, see S. Fernandes, “Mauá, o Economista do Império: análise de sua crítica científica ao padrão-ouro”, *RBE*, Vol. 28, No. 2, April/June 1974, pp. 3-28.

⁸² Mauá, “O Meio Circulante”, p. 319. Mauá’s defence of inconvertible banknotes had already been made public much earlier, in his testimony to the enquiry into the 1857 commercial crisis. See *Comissão de 1859*, Annex A, p. 96.

⁸³ See Banco do Brasil, *Parecer Apresentado à Assembléa*.

⁸⁴ *Ibid.*, pp. 14-5.

report remarked on the adverse effects which the supposedly “natural” adjustment mechanisms of the gold standard had had in places like Great Britain, stressing that they would be even greater if a capital-importing nation like Brazil followed the desideratum of the 1860 Law.⁸⁵

Mauá was not alone in perceiving the potential damaging effects which the operation of the gold standard could have on Brazil. For Sebastião Ferreira Soares, a contemporary statistician,

Everything that has been said in the chambers and outside about the metallic circulating medium are nice theories, which fail completely in practice, for no State will succeed in retaining gold and silver coins in circulation unless the value of production and exports is greater than imports and consumption (...). Brazil will not achieve a stable circulating medium in gold and silver, as desired, unless its exports exceed its imports, and the most advantageous medium will be the one that we had earlier, with very few changes.⁸⁶

These remarks were made at the same time as the government’s determination to impose limits on the banks of issue was at its highest, namely, on the eve of the enactment of the 1860 Law of Impediments.⁸⁷ As seen in Chapter 4, with the Law,

⁸⁵ *Ibid.*, pp. 16-7. As noted by many authors, the gold standard operated differently in the countries at the centre and those in the periphery of the world economy, the latter being frequently hit by convertibility crises, devaluations and internal dislocations. In effect, borrowing countries were not as capable as “core” ones to control the rate of their capital imports. For the periphery, buoyant economic activity led to merchandise imports picking-up and, eventually, to a trade deficit. In the early stages of the cycle, this trade deficit would be financed by (foreign) capital inflows which, by their inherent volatility, were bound to return to their countries of origin at news of panics and the subsequent increases in Bank (of England) Rate. Given the lagged response of import demand to credit conditions, this capital flight could result in severe reserve losses which, under the gold standard, would bring about an equally strong monetary contraction. Depending on the magnitudes involved, that is, the size of the gold drain relative to the domestic monetary base, the ensuing deflation could be considerable. In short, capital flows tended to be pro-cyclical, that is, they would increase in boom times and as soon as the slump set in (but merchandise imports were still on the rise), they would return to the centres from where they had originated. This would aggravate the “natural” instability which derived from the periphery’s frequent reliance on the exports of one or two primary products. See A. G. Ford, *The Gold Standard: 1880-1914, Britain and Argentina* (Oxford, Clarendon Press, 1962). For a discussion of these issues as applied to Brazil, see Fritsch, *External Constraints*. Furtado had made a similar point earlier, when describing the economy of nineteenth-century Brazil and its incapacity to adapt to the rules of the gold standard in the period. See Furtado, *Formação*, Chapter 27.

⁸⁶ Cf. Soares, *Notas Estatísticas*, p. 312. Soares’ reference to “exports in excess of imports” (a trade surplus), as he himself elaborates in his book, would refer in modern parlance to the need for a balance of payments surplus if gold and silver coins were to be retained domestically.

⁸⁷ Mauá’s and Soares’ advocacy of paper currency, as already noted, was highly atypical in a world convinced of the superiority of the gold standard. In this respect, they were close to the Birmingham economists of the nineteenth century, who favoured inconvertible paper money as a means to enhance employment in times of distress in their city. In a debate in the Senate, Jequitinhonha stated that Souza Franco’s opinions in favour of plurality of issue were akin to those of the Birmingham school, ‘whose

banks created by decree in 1857-8 were barred from issuing notes in excess of their average outstanding issues in the previous semester, until they could ensure convertibility into gold. As for the Bank of Brazil, unless it also resumed convertibility, its note issue could not exceed the quarterly average of its outstanding issues counting from the day it began operating, until March 1860. Three of the seven banks of issue (the Bank of Brazil, Banco de Pernambuco, and Banco do Maranhão) were immediately forced to contract their issues as a result of the new legislation. In 1861, the Banco do Rio Grande do Sul relinquished its issuing rights, and was joined in the following year by the Rural & Hipotecário. As to the Comercial & Agrícola, it merged with the Bank of Brazil in September 1862, transferring to the latter its issuing rights. One month later, the Bank resumed convertibility of its notes, after almost four years in which they were redeemed in Treasury paper.⁸⁸

This new phase of convertibility would only last until the outbreak of the Souto Crisis, in September 1864, when the Bank sought (and received) government approval to suspend the obligation to redeem notes in gold. Conceived as an exceptional measure to protect its metallic fund, this new episode in suspension of convertibility of the notes of the Bank of Brazil would prove to be the last. Two years later, in September 1866, financial needs arising from the Paraguayan War led the government to announce a radical review of its agreement with the Bank. As a result of this innovation, the Bank lost its issuing powers, which were transferred back to the Treasury. The government would once again be in charge of the printing press. Massive issues of fiat money followed and return to the gold standard would have to wait until bold financial reforms were introduced in 1888.⁸⁹ After more than two decades of monetary struggle, financial conservatives had obtained a half-victory. If, on the one hand, they were unable to impose a fully gold-backed currency - the ultimate goal of every *metalista* - they succeeded in restoring centralisation of note issue. This would prove crucial for the war effort.⁹⁰

theories had been proven false'. See *ASI*, Tome I, 1858, p. 244. On the opposition of the Birmingham economists to deflation and the gold standard, see Fetter, *Development*, pp. 177-80.

⁸⁸ These events were examined in detail in Chapters 3 and 4.

⁸⁹ For details, see Franco, *Reforma*, Chapter 3.

⁹⁰ This point will be taken up again in Section 7.2.

* * *

To sum up, it was seen that monetary debates raged in many countries in the nineteenth century. In England, once the bullionist controversy was over, Currency and Banking school supporters fought over the type of rules which should be imposed on the operation of banks issuing gold-backed notes. Meanwhile, monetary controversies in Brazil were still at an earlier stage. Adherence to the gold standard, while advocated by the majority, was not unequivocally endorsed. Two major questions underlined monetary debates in nineteenth-century Brazil - issuing rights and convertibility. The right to issue notes or, sometimes, *vales*, was sought as a way to provide the economy with much-needed liquidity. Advocates of plurality of note issue in Brazil saw no reason for the imposition of strict rules on the operation of banks and corporations in general. Developmental considerations informed their positions. Policymakers, on the contrary, feared that widespread issuing powers were conducive to overissue. Their concern with macroeconomic stability generally led to a conservative approach to the whole question of issuing rights, which culminated in the 1860 Law of Impediments. Yet, it was seen that the Law, and Decree 2685, left private banks largely untouched. Over-extension of credit by these banks helped spark the Souto crisis of 1864, thus marring Brazil's only real experiment with free banking.

It was also shown that throughout most of the 1850-70 period Brazil operated a fiduciary system. Convertibility was in force for less than a quarter of the time. Nevertheless, it was shown that most policymakers - even those, like Souza Franco, identified with liberal banking policies - supported adherence to the gold standard, a point ignored in the existing literature. This was then seen as the most effective means to ensure a stable macroeconomic environment. A fixed and, preferably, appreciated rate of exchange, would avoid income and wealth shifts, while it provided the sound money credentials that attracted foreign praise and capital. It was shown that despite Brazil's failure to adopt a gold-backed circulation during most of the period, monetary virtue was pursued almost relentlessly. Nevertheless, once the security of the Empire was threatened by the war with Paraguay prudence gave way to pragmatism, and return to gold was postponed.

Chapter 7 - Three Perspectives on the Role of Banks: “developmental”, “statist”, and “orthodox”

Interest in the role of banks in the economy is not a recent phenomenon. The theme would receive increasing and systematic treatment in the heyday of development economics, after the Second World War, with the works of Gerschenkron and Cameron.¹ The literature spawned by these authors lay great emphasis in the role of banks as instruments of economic change. In this respect, banks were portrayed alongside other social institutions which, combined with a country’s (or region’s) factor endowments, population and technology, interacted to shape the process of economic development.² Although this “developmental” view of the role of banks has attracted most of the attention of economic historians, it is by no means the only one that exists. Two other perspectives stand out, the “statist” and the “orthodox”.³ The first one is concerned with banks’ role in financing profligate governments - in this case, the economic role of banks is seen as neutral or, at best, facilitatory.⁴ On the other hand, the “orthodox” perspective on the role of banks in the economy deals with their capacity to provide stability to the money market. It emphasises the ‘ordered evolution of a stable (financial) system’, which starts out amid recurrent crises and finally develops into a ‘more or less stable monopoly’, but one that serves the public interest. This outcome will ideally be guaranteed by an independent central bank.⁵ In what follows, each of these three approaches to the role of banks - “developmental”, “statist” and “orthodox” - will be analysed in connection with the evolution of the banking system in the Brazilian Second Reign. It will be shown that

¹ Their approaches to the role of banks are markedly distinct. While Gerschenkron sees banks as possible substitutes for “pre-requisites” to economic growth, Cameron prefers to make no *a priori* claim as to the relationship between a country’s financial structure and economic performance. See A. Gerschenkron, *Economic Backwardness in Historical Perspective: a book of essays* (Cambridge, Mass., Harvard University Press, 1966); R. Cameron *et al.* (eds.), *Banking in the Early Stages of Industrialization* (New York, Oxford University Press, 1967); and Cameron (ed.) *Banking and Economic Development*.

² Cameron (ed.) *Banking and Economic Development*, p. 5. Indeed, the development process may be viewed as constrained by factor endowments, and influenced by technology and the institutions that derive from these endowments. For an elaboration of this point with reference to the Latin American experience, see the contributions in Haber (ed.) *How Latin America Fell Behind*.

³ The taxonomy is borrowed from C. Jones, “The Fiscal Motive for Monetary and Banking Legislation in Argentina, Australia and Canada Before 1914”, in D. C. M. Platt and G. di Tella (eds.) *Argentina, Australia and Canada: studies in comparative development, 1870-1965* (London, Macmillan, 1985).

⁴ *Ibid.*, p. 125.

much of the controversies examined in the previous chapters derived from individuals' particular views as to the role of banks in the economy.

7.1 - The “Developmental” Perspective

Arguably the paramount function of any banking system is to provide a “bridge” between savers and persons or institutions able and willing to borrow.⁶ In this sense, banks act as a means through which idle resources are re-allocated towards more productive uses, allowing for an increase in society's capital stock and, ultimately, economic development.⁷ The “developmental” perspective has featured prominently in recent writing on nineteenth-century Brazil. Essentially, works in this strand have emphasised how government policy, by closely controlling the expansion of the banking system, greatly curtailed its capacity to foster economic growth.⁸ The emphasis of the “developmental” perspective on the role of banks implicitly assumes that monetary policy or, more specifically, monetary expansion, will bring about growth in output. The underlying mechanism would be some type of “Keynes effect” of monetary growth which, through lower rates of interest, would allow an increase in investments and, ultimately, in economic activity.⁹

During most of the nineteenth century, the Brazilian capital market was dominated by commercial credit, used to finance the planting and later shipment of

⁵ Ibid., p. 124.

⁶ One of the first systematic treatments of this “developmental” function of banks is J. A. Schumpeter, *The Theory of Economic Development* (Cambridge, Mass., Harvard University Press, 1959, 6th printing), especially Chapter III.

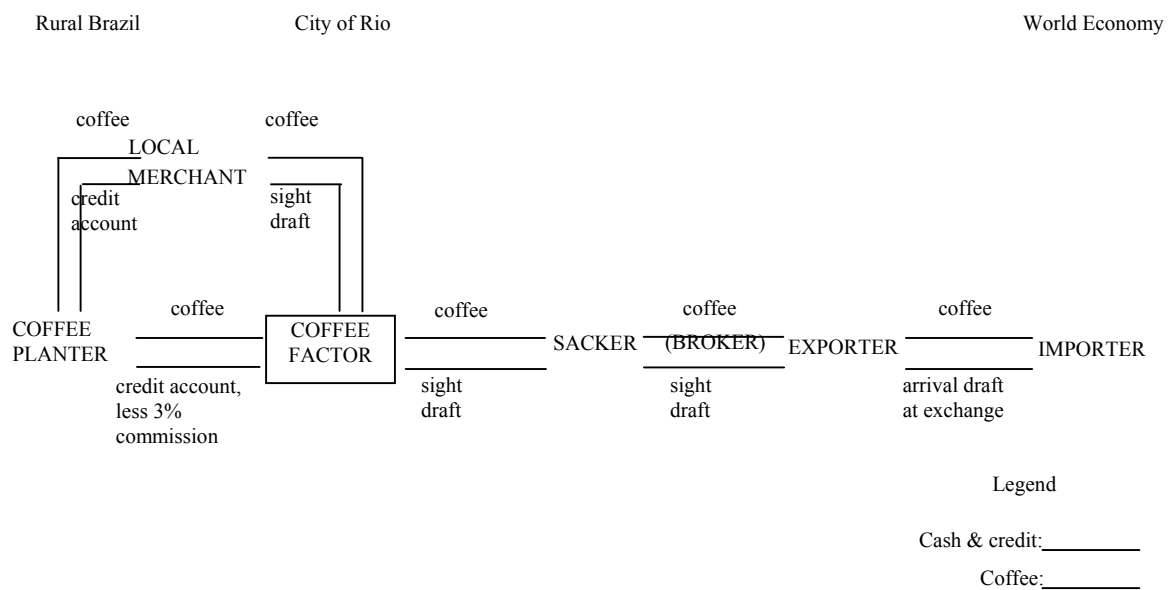
⁷ There are, of course, alternative ways to mobilise the economic surplus, such as taxation, inflation, foreign loans and gifts etc. For an elaboration, see J. G. Gurley and E. S. Shaw, “Financial Structure and Economic Development”, *Economic Development and Cultural Change*, Vol. 15, No. 3, April 1967, pp. 257-268.

⁸ See, for example, L. C. Soares, “A Manufatura na Sociedade Escravista: o surto manufatureiro no Rio de Janeiro e nas suas circunvizinhanças (1840-1870)”, in F. Mauro (ed.) *La Préindustrialization du Brésil: essais sur une économie en transition* (Paris, CNRS, 1984); Levy, *Bolsa de Valores*; Levy and Andrade, “Fundamentos”; and Prado, “Commercial”.

⁹ An additional way in which monetary expansion could have aided growth in nineteenth-century Brazil was by substituting money transactions for payments in kind in the non-monetised part of the economy. The lack of more detailed research on the sectors not directly linked to the import/export economy precludes any firmer assertion as to the impact of money growth in this case. On the importance of the nonexport economy, see C. Prado Jr., *Formação do Brasil Contemporâneo* (São Paulo, Brasiliense, 1948, 3rd edn.); A. Martins Filho and R. B. Martins, “Slavery in a Nonexport

commodities such as sugar, cotton, and coffee. In a relatively complex marketing chain, factors (*comissários*) provided the link between planters in the interior and, ultimately, the importing countries. Figure 7.1 depicts the flow of coffee from the plantation to the international market, highlighting the main agents involved in the commercialisation of the crop.¹⁰

Figure 1 –The Rio Coffee Factor as Commodity Middleman



Source: J. E. Sweigart, *Coffee Factorage and the Emergence of a Brazilian Capital Market, 1850-1888*. New York and London, Garland, 1987, p. 113.

Coffee factors arranged for the transportation of the crop from *fazendas* in the interior to a port, usually Rio de Janeiro. Shipments took place throughout the year, peaking in the August-November period. *Comissários* would then get in touch with sackers, a second class of middlemen, who purchased coffee in bulk and, then, blended the beans in accordance with the needs of the market. Brokers intermediated the sale of coffee from sackers to exporting houses, who acted as agents for foreign importers. Both factors and sackers were usually Brazilian or Portuguese, while brokers, by law,

Economy: nineteenth-century Minas Gerais revisited”, *HAHR*, Vol. 63, No. 3, August 1983, pp. 537-68, and comments by R. Slenes, E. Genovese, S. Engerman and W. Dean.

¹⁰ *Mutatis mutandis* the following summary description of the process of commercialisation of the coffee crop applied to sugar and cotton as well.

had to be Brazilian. Foreign merchants dominated the export/import end of the trade.¹¹

In addition to arranging for the shipment of coffee to Rio, where it would ultimately be bought and exported, factors would be responsible for forwarding goods from the port cities of Brazil to their planter-clients upland. Credits and debits would accordingly be registered in their clients' current accounts and interest charged on outstanding balances. This last point serves to highlight the fact that *comissários* first and foremost advanced credit to finance production, in an era when commercial banking was in its infancy. Since colonial times planters and merchants had relied on the Rio money market for short-term credit, defined as credit of up to six months. This was the minimum period necessary for a planter to meet his current demands - both personal and in the coffee activity itself - while he awaited the commercialisation of his crop.

Until the 1850s factors tapped credit from numerous sources, most prominently, from sackers, who were required to settle their coffee purchases within 20 days. Additionally, factors could count on trade credit extended by manufacturers and exporters overseas, through importers in Rio, with a time draft. In this way, merchandise purchased for their planter clients could be paid up to one year later. Similar arrangements existed between factors and domestic merchants.¹² Yet, with the economic growth of the 1850s demand for capital expanded as well. This prompted factors to push for a swifter settlement of accounts. Whereas previously factors would often grant to their clients grace periods of up to one year, the acceleration in the pace of commercial transactions increased their need for a liquid credit instrument. As a result, if a planter client required large advances, or if at the end of six months the planter's current account was in the red, the factor had the *fazendeiro* sign, or accept, a draft, which the factor drew up.¹³ This bill of exchange, to be paid within four to six months, would be drawn to the amount of the outstanding balance in the planter's current account, plus interest. Once accepted and signed by the planter, the factor would endorse it (thus sharing liability in the event of default)

¹¹ See Sweigart, *Coffee Factorage*, Chapter 2.

¹² *Ibid.*, pp. 115-6.

¹³ *Ibid.*, p. 117.

in order to discount it at one of several commercial establishments that accepted this type of financial instrument.¹⁴

As noted in Chapter 3, despite the onset of the coffee boom in the mid-nineteenth century, as late as 1850 Rio boasted just a single joint-stock bank, the Banco Comercial do Rio de Janeiro.¹⁵ Two other institutions operated in the provinces of Bahia and Maranhão. By the end of the decade there were three commercial joint-stock banks in the capital (the Bank of Brazil, the Rural & Hipotecário and the head office of the Comercial & Agrícola). Other, usually smaller, credit institutions were also present, such as commercial houses (*casas comerciais*), discount houses (*casas de desconto*) and private banks (*casas bancárias*).¹⁶ Commercial banks usually required a second endorsement on planters' drafts, apart from that of coffee factors, before accepting them in their portfolios. This could come either from another merchant or *casas bancárias*, which would charge 2% commission for this service.¹⁷ In the end, therefore, planters faced annual rates of interest on their drafts of between 2% and 4% above the market rate, that is, from 8% to 14%, at least, between the 1850s and 1880s. Figure 7.2 summarises the financial-intermediation role of the coffee factor in mid-nineteenth century Rio:

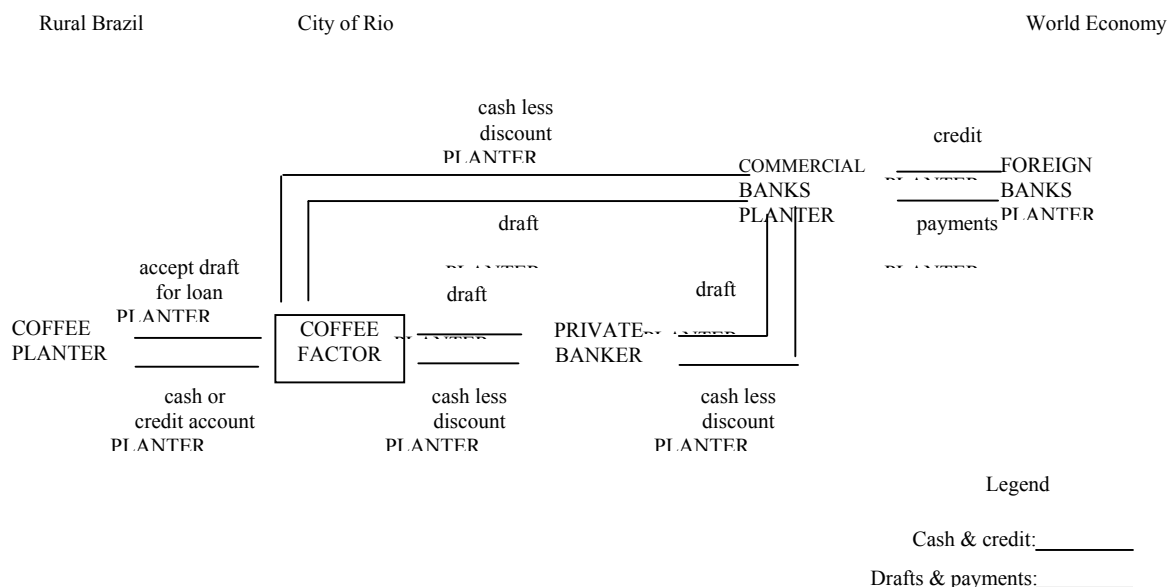
¹⁴ This pattern of financing a crop via commercial credit is remarkably similar to the one that was organised around the cotton economy of the US South, which suggests that it was the most adequate for commodity-exporting economies at the time. For a vivid description, see H. D. Woodman, *King Cotton and His Retainers: financing and marketing the cotton crop of the South, 1800-1925* (Lexington, University of Kentucky Press, 1968).

¹⁵ Souza Franco remarked that the Banco Comercial was incapable by itself to adequately serve a commercial centre the size of Rio de Janeiro at the time. In an interesting (although possibly inaccurate) comparison with New York City (whose volume of commerce he estimated as being approximately 4-5 times larger than that of Rio), he noted the existence of twenty-four joint-stock banks, with a disproportionately larger capital base and note issue, as opposed to Rio's single bank. See Franco, *Os Bancos*, pp. 30-31.

¹⁶ Commercial houses advanced credit to retailers, in payment of which they would receive commercial bills. In order to provide liquidity for this type of paper, discount houses would be set up, allowing commercial houses access to capital they had advanced before bills matured. See Levy and Andrade, "Fundamentos", pp. 20-1.

¹⁷ Sweigart, *Coffee Factorage*, p. 120. This was in line with similar services provided in the cotton trade in the US South, where commission charges 'for drawing, accepting, negotiating or endorsing notes or drafts (...)' usually ran at 2.5%. Cf. Woodman, *King Cotton*, p. 53.

Figure 2 – The Rio Coffee Factor as Financial Intermediary



Source: J. E. Sweigart, *Coffee Factorage and the Emergence of a Brazilian Capital Market, 1850-1888*. New York and London, Garland, 1987, p. 119.

The figure shows how commercial banks, although loath to involve themselves directly with rural loans, nevertheless often had an indirect participation in providing credit to the coffee economy. In fact, as already pointed out, planters' drafts, when endorsed by their factors and an additional reputable merchant, provided the necessary guarantees for commercial banks to discount them. Yet, as emphasised by Sweigart, for most of the nineteenth century banks did not entirely replace factors and commercial houses in the provision of short-term commercial credit.¹⁸

Short-term credit alone would never suffice to allow for the four to five years needed before a coffee grove bore its first commercial crop. Yet, banks were reluctant to extend longer term financing (six months to three years) to coffee producers. This resulted to a great extent from the uncertainty that surrounded the coffee business. The erratic nature of coffee production - subject as it was to weather conditions, plagues and, ultimately, varying crop yields - meant that this type of credit was essential to planters' medium and long-term prospects. Still, sheer uncertainty

¹⁸ See Sweigart, *Coffee Factorage*.

normally kept commercial banks from financing planters directly. Although in the 1850s properties in the coffee province of Rio de Janeiro were given as collateral to mortgage loans, hardly any long-term debt was to be found in bank portfolios. The Bank of Brazil, for example, was not allowed to provide mortgage-based loans before 1866. Meanwhile, institutions such as the Comercial & Agrícola (Commercial and Agricultural Bank) and the Rural & Hipotecário (Rural and Mortgage Bank), despite their names, had their operations almost exclusively confined to the short term. Planters, therefore, had to rely on either factors or their neighbours to obtain crucial longer-term credit.¹⁹

To a large extent the above discussion amounts to examining the role of banks in providing the productive sector of the economy with credit of different maturities. In a debate reminiscent of the one surrounding the alleged unwillingness of the British banking system to extend long-term capital to industry, it has sometimes been suggested that Brazilian banks in the mid-nineteenth century failed to support the agricultural sector.²⁰ More specifically, the whole financial system has been accused of short-termism, and deliberate withholding of longer-term credit from the countryside. This line of argument equates bill discounting with failure to provide medium and long-term capital. Contemporaries voiced this view, noting that ‘historically, commerce (...) had access to credit, unlike agriculture, which lived in penury’.²¹ Others observed that the existing system of banks of issue was incapable of providing the type of credit most suited to the needs of the rural sector. It was

¹⁹ In fact, although overwhelmingly dominant, factors were not the sole source of funds to planters. Inventories of nineteenth-century “capitalists”, often merchants and planters themselves, reveal the presence of money lending outside the strictly commercial channels where *comissários* operated. See, for example, the accounts of the influential Prado family, in D. E. Levi, *The Prados of São Paulo, Brazil: an elite family and social change, 1840-1930* (Athens, GA, The University of Georgia Press, 1987), p. 196, Appendix B; and Z. M. C. de Mello, *Metamorfoses da Riqueza: São Paulo, 1845-1895* (São Paulo, Hucitec, 1985), Chapter II.

²⁰ This is what appears to be implied by Levy and Andrade, when they contend that financing of the agricultural sector via factors ‘reasserted the dominance of circulation over production, ensuring the control of the latter by mercantile capital’. Cf. Levy and Andrade, “Fundamentos”, p. 25. For a critical summary of the debate about the relationship between banks and industry in Britain, see F. Capie and M. Collins, *Have Banks Failed British Industry?* (London, Institute of Economic Affairs, 1992).

²¹ Cf. A. da Silva Netto, *Formula Mais Effectiva para a Solução dos Nossos Bancos de Emissão* (Rio de Janeiro, Typ. Perseverança, 1865), Introduction.

argued that they could not afford to be exposed very long term, while at the same time issuing instant liabilities, that is, banknotes.²²

Recent research on the banking system in nineteenth-century São Paulo tends to confirm the bias towards short-term operations, mainly discounting of bills.²³ Although concerned specifically with the provision of capital to the manufacturing sector, its conclusions equally apply to the agricultural business, which also desired longer-term credit.

(...) few banks from 1850 to 1889 were strictly commercial ventures which offered short-term credit to the businesses already in place. The majority of their activities involved buying bills of trade from merchants and extending them a credit line secured by assets. In short, the early banking sector was geared toward providing the economy with liquidity, not capital for investment.²⁴

The predominance of short-term lending in nineteenth-century Brazil has led to claims that ‘commercial and financial capital at the time, linked to unfettered speculation, (was) of a “parasitic” nature, sucking the subsistence out of the old mercantile slave system, while unable to transform it and promote profound economic changes’.²⁵ Apart from the blatantly teleological nature of this assertion, it is clearly at odds with Sweigart’s detailed research on the financing of the coffee industry, summarised above. The picture that emerges from Sweigart’s work, far from portraying coffee factors as “parasites”, establishes them as crucial agents bringing together commercial and financial capital at the time. As shown, factors were the lifeline that linked, financially and materially, the *fazendas* in the interior to Rio and, ultimately, to the international economy.

²² Speech given by Minister of Finance Torres Homem in 1859, cited in Andrada, *Bancos de Emissão*, p. 90.

²³ See Hanley, “Capital Markets”.

²⁴ *Ibid.*, p. 6. Nineteenth-century Brazilian banks were not alone in their prudence. The 1842 Louisiana banking act, for example, established that two-thirds of banks’ funds arising from deposits and note issues should be invested in short-term assets maturing in ninety days or less, the other one-third being in specie. See Hammond, *Banks and Politics*, pp. 681-4. Unsurprisingly, states where banking practices were more conservative (such as in the Carolinas, Virginia, Georgia and Louisiana), emphasising high reserve ratios and short-term lending, displayed much sounder systems than the more aggressive banks prevalent in Florida and Mississippi, where failures were widespread. For details, see L. Schweikart, “Southern Banks and Economic Growth in the Antebellum Period: a reassessment”, *The Journal of Southern History*, Vol. LIII, No. 1, February 1987, pp. 19-36.

²⁵ Cf. Soares, “A Manufatura”, p. 15.

According to their detractors, the degree of “parasitism” on the part of coffee factors seems to lie in the level of the interest rate (commission) charged. It must be stressed that, in the end, interest rates planters faced depended on the general cost of credit in the Rio market. This, in turn, was affected by macroeconomic conditions and, crucially, the number of intermediaries who discounted planters’ bills. As such, the issue should not be presented as a moral one, pitting “greedy” *comissários* against “helpless” *fazendeiros*. Rather, and in the absence of major shocks to the economy, the cost of credit was conditioned by institutional characteristics. And, at the time, none was more important than the peculiar framework that regulated the foreclosure of rural property.

Since colonial times, landowners had been sheltered from their creditors by the practice of forced adjudication, which was also embedded in commercial and mortgage legislation enacted in the 1850s and 1860s. The basic mechanism around this practice is neatly summarised by Sweigart:

(...) if a creditor wanted to foreclosure on a mortgage, he called for a judge to establish an open auction in the county in which the property was located. The judge first appointed appraisers to establish the property’s value, yet the appraisal could never be less than the value of the original loan. If bids were not high enough to cover the appraised value, the creditor had to buy the property at four-fifths of the appraised value. Control over the appraisal lay with the judge who appointed the evaluators, often landowners and evaluators themselves, sympathetic and easily influenced by the debtor, who was often a relative. Planters arranged for their properties to be appraised well above their true value, and came out ahead in the settlement, after reimbursing their creditor for the original loan and any penalties assessed for late payments. (...) Since the creditor lost control over the adjudication process as soon as he initiated proceedings, coffee factors and mortgage banks avoided foreclosure altogether, and preferred to refinance the debtor’s original loan indefinitely, in hopes of retrieving their initial investment through the proceeds of future coffee sales.²⁶

It is no wonder, then, that the credit system did in fact “fail” the rural sector. But, again, this had much more to do with ill-defined property rights in land than to the greed of financial agents.²⁷ In the end, excessive legal protection given to rural property had dire consequences for the quality of collateral offered to creditors, hampering the financial-intermediation role of the banking system. Slaves, whose

²⁶ Sweigart, *Coffee Factorage*, pp. 194-5. The forced adjudication clause was finally revoked in 1885. See Saes, *Crédito*, p. 71.

²⁷ This major obstacle in the way of the development of a long-term market for rural loans had been clearly diagnosed by a contemporary. See the chapter “Do Crédito Rural e Sistema Hipotecário” (“On Rural Credit and the Mortgage System”), in Franco, *Os Bancos*, pp. 111-7.

value could amount to close to one-half the total value of an average plantation, were an alternative. Indeed, they were often given as collateral in credit operations. Yet, they were not the ideal type of guarantee either, in view of the risk of flight or death.

Clearly, there were instances of misconduct on the part of coffee factors. However, the credit-intermediation market was highly competitive, with between 100 and 200 coffee factorage and sacking firms operating in Rio in the third quarter of the nineteenth century.²⁸ In this context, monopolistic behaviour could hardly have flourished, all the more so since planters managed to monitor their creditors by hiring the services of more than one factor at a time. In the end, therefore, it was in the interest of both *fazendeiros* and *comissários* to retain a good reputation, for failure to do so could certainly lead to loss of future businesses for either party.

It was remarked above that premia charged on loans to the rural sector ultimately reflected the existence of an extended credit chain composed of several intermediaries, each of whom took part in the process of discounting planters' drafts. These commission charges built up into a heavy burden on *fazendeiros*. The obvious question, therefore, is why bankers did not lend directly to planters, bypassing factors altogether? Two interrelated features militated against such an arrangement: contemporary banking practice and informational problems. The general prudence in bank procedures at the time - i. e., the need to maintain as liquid a portfolio as possible, in view of the risk of a run on their reserves - kept bankers away from commitments in excess of one to three months.²⁹ By discounting a planter's draft only after it had received the endorsement of the factor (and possibly of an additional merchant), bankers engaged on a wholly different operation from what would have been the case had they loaned directly to the planter himself. In the first case, they would be lending against the liquid assets of a city merchant. A direct loan to a planter, by contrast, would ultimately have to be guaranteed by land, slaves or coffee, hardly the type of collateral that would meet banker preferences for liquidity.

²⁸ Sweigart, *Coffee Factorage*, p. 31.

²⁹ This "liquidity consciousness" was reinforced by the recurrent panics and crises which characterised the nineteenth century. Fears of a potential mismatch between the maturities of bank assets and liabilities has also been identified as a source of the short-termism of which British banks have often been accused. See M. Collins, *Banks and Industrial Finance in Britain, 1800-1939* (Cambridge, Cambridge University Press, 1991), pp. 16-7.

The other major reason why banks were reluctant to lend directly to planters stemmed from informational problems associated with rural credit operations. It was much easier for a factor than for commercial bankers to know the creditworthiness of a planter. The close ties which *comissários* developed with *fazendeiros* enabled them to have a good idea of the quality of their productive methods, the state of their coffee trees and slaves and, ultimately, their capacity to honour debts. It was only natural, then, that *comissários* should be best suited to gauge the risks involved in particular credit operations. Interest charged on loans granted to planters - a premium on the going market rate - reflected, therefore, both the risk of the operation itself and the service factors provided in assessing their clients' creditworthiness. In short, the high cost of credit to rural producers derived from a combination of three inter-related factors: i) mortgage legislation; ii) banks' fears of tying up their portfolios with risky, long-term, planter bills; and iii) the costs of monitoring *fazendeiros'* creditworthiness. Ultimately, ill-defined property rights meant contracts signed with planters were potentially harder to enforce. This implied high transaction costs and, as such, an obstacle to the development of the capital market.³⁰

At the beginning of this section it was noted that many economic historians working on nineteenth-century Brazil have espoused the “developmental” perspective. Perhaps more importantly, this view of the role of banks was also widely held at the time. Indeed, as seen in previous chapters, it served as the ideology behind demands for cheaper credit in the economy. Advocates of soft money, a low exchange rate, a fiduciary circulation, and plurality of issue, essentially subscribed to the view that banks were a crucial component of the development process. These were the aspirations entertained by agents in the low/high quadrant in Figure 1.3, including *papelistas*, *fazendeiros* and import-competing producers.³¹

Given the small importance of domestic manufactures at the time, rural producers were the single most important economic and political group in favour of soft money. Nevertheless, as already noted, *fazendeiros* were rarely organised in those days,

³⁰ On the importance of transaction costs in economic development, see D. North, “Economic Development Through Time”, *American Economic Review*, Vol. 84, No. 3, June 1994, pp. 359-68.

³¹ In a debate in the Senate, Souza Franco accused Itaboraí of wanting to ‘conserve a low rate of exchange, for farmers would benefit from it’, to which Itaboraí replied that ‘no one said a similar heresy’. Session of 15 May 1858, in *ASI*, Tome II, p. 72.

perhaps because they thought their representatives in Parliament or, even, in the Executive, would look after their needs. Despite the few instances of organised demands on the part of *fazendeiros* before the 1870s, there were occasions when they felt the need to make their voices heard. As seen in Chapter 4, when the government showed signs of losing patience with the Bank of Brazil over its failure to resume convertibility, in 1866, it received two petitions from interest groups. One came from the Bank itself, which was opposed to a review of its contract with the government. The other, from *fazendeiros* from the province of Rio de Janeiro.³² Although very short in details, planters basically called the Bank of Brazil to reduce the rate of interest it charged *comissários*. *Fazendeiros* even got factors to sign a document committing them to lowering the rates charged to the agricultural sector to 9%, as long as the Bank lowered its rate to 6%. Planters were clearly dissatisfied with the cost of credit.

The Bank of Brazil stopped being an essentially private association from the day it sought shelter in the shadow of the government, from whom it has received very important favours. It is only just that such profitable support also revert in benefit of the most important class in our country, which, more than any other, should be the first to receive the favours of the State.³³

Landowners had no doubt as to the legitimacy of their claim for government largesse. And cheaper credit was what they sought. The establishment of mortgage banks, it was argued, would free agriculture from the stranglehold applied by commerce. In a pamphlet published to convince *fazendeiros* to subscribe the capital needed to seek legislative authorisation to create a mortgage bank, its author stressed the need to make commerce depend on agriculture, and not the other way around.³⁴ Also, and tellingly, he condemned the adoption of a gold-backed note issue, on the grounds that “excessive imports” would lead to loss of gold, and a monetary contraction.³⁵ The *papelista* case could not have been made more clearly. Plurality of issue and a fiduciary circulation were best suited to the needs of agriculture.³⁶ As already noted,

³² See “Representação dos Lavradores”, in *Proposta do Poder Executivo*, pp. 46 ff.

³³ *Ibid.*, p. 46.

³⁴ See Silva Netto, *Formula*.

³⁵ *Ibid.*, pp. 10-11.

³⁶ This theme would again be taken up in the agricultural congress held in Rio in 1878. On the occasion, *fazendeiros* argued in favour of plurality of issue. Yet, they entertained the wrong idea that notes issued by private banks were not currency, but only promissory notes. Also, they claimed that

Mauá was arguably the greatest champion of the idea that banks were central to the economic development of the Empire.³⁷ His repeated exhortations in favour of the “spirit of association” reflected the view that banks were essential in pooling idle resources and channelling them into productive ventures.

There is no disputing the importance of banks for latecomers in the development process (let alone late, latecomers, like Brazil), as the French and German experiences have demonstrated.³⁸ In this connection, financial institutions have been shown to perform some important functions, such as (i) serving as intermediaries between savers and investors; (ii) supplying means of payments, through deposit creation; and (iii), in a Schumpeterian vein, providing ‘initiative and enterprise, as well as finance, for the creation, transformation, and expansion of industrial and other ventures’.³⁹ Yet, this list should serve as the basis of a general defence of banks, and not necessarily of banks of issue. Some contemporaries perceived this point.

Issuing banks do not do very much beyond substituting their notes for part of the metallic circulation, thus converting an expensive instrument into one which costs virtually nothing (...). Issuing banks, as such, do not go beyond this. In order to centralise credit, to bring together scattered capital, and entrust it to those who can employ it productively, thus promoting the interests of commerce and industry, banks of deposit are all that is needed. For in the countries where there are no issuing banks, is there not credit, loans, discounts of titles of private debt? No, (...) no one believes Brazil would be deprived of the advantages which credit produces if we did not have banks of issue.⁴⁰

Jequitinhonha had already made a related point a few days earlier in the Senate. Although himself a member of the same party as the then Minister of Finance, Souza Franco, Jequitinhonha did not agree with the decision to allow the incorporation of six new banks of issue in 1857-8.

The Minister sustained (...) another error, namely, the need and usefulness of having several banks of issue. To this day he seems not to perceive that the utility that may result for the country of banking establishments, especially banks of issue, does not

issues of banknotes could not have any impact on the rate of exchange. See *Anais do Congresso Agrícola*, pp. 112 ff.

³⁷ See Mauá, “O Meio Circulante”.

³⁸ The original argument is from Gerschenkron, *Backwardness*, pp. 13 ff.

³⁹ Cameron *et al.* (eds.), *Banking in the Early Stages*, pp. 7-8.

⁴⁰ Itaboraí, speaking in the Senate. Session of 5 June 1858, in *ASI*, Tome II, p. 16.

depend on their number, but rather on the number of people who deal and make transactions with them.⁴¹

Jequitinhonha had gone to the crux of the matter. Banking establishments were important, this was undisputed. Even advocates of monopoly of issue favoured a plurality of non-issuing establishments, as exemplified by Torres Homem's decision to allow 17 new deposit and discount banks to be incorporated, in 1859. Yet, the need to have many banks of issue, and not just deposit and discount banks, was controversial. More important was Jequitinhonha's perception that banks could only go so far in creating investment opportunities. In other words, that money and credit were, and are, distinct things.⁴² It was not enough to increase the money supply and expect viable investments to materialise instantly. In the specific case of agriculture, it has already been shown that business opportunities were greatly constrained by ill-defined property rights and legislation protecting rural property from foreclosure.

7.2 - The "Statist" Perspective

The "statist" view of banks concentrates on their operation as financial agents of governments. This was certainly the case with the first Bank of Brazil, which functioned between 1808 and 1828 as the financier of the State. During this period, the Bank financed the expenditures of the central government and, eventually, of the royal family itself. Yet, in the previous chapters it was argued that from 1846 onwards considerations of sound finance would underlie most government decisions in the area of money and banking. In effect, 1845 and 1846 saw the last issues of Treasury notes (totalling around 1,200 *contos*), in anticipation of future revenues. For the remaining twenty years the government would not issue notes at all.⁴³ It was also seen that the privilege to issue notes was accorded to the third Bank of Brazil in 1853, and extended to six new banks in 1857-8. In 1866, monopoly of note issue was once

⁴¹ Session of 21 May 1858, in *ASI*, Tome I, pp. 244-5.

⁴² Indeed, this was perfectly understood by some contemporaries. Commenting on the government's plans to allow the Banco Comercial do Rio de Janeiro and Mauá's Bank of Brazil to increase their issue of *vales*, in order to alleviate the monetary pressure felt in 1853, deputy Bandeira de Mello noted that the measure was fruitless: 'if the bills offered for discount do not have credit, if they are not sufficiently guaranteed, banks will not discount them, for banks cannot compensate for the lack of credit'. Session of 13 June 1853, in *ACD*, Tome II, p. 181.

⁴³ See Table A13, in the Statistical Appendix.

again in the hands of the Treasury. As seen in Chapter 4, for the duration of the Paraguayan War the government would make extensive use of the printing press and debt instruments to finance its expenditures.

In the end, the extent of inflationary financing of the public deficit depended on who was responsible for issuing notes. Although the Treasury itself did not issue banknotes for two decades, between 1846 and 1866, there remains the possibility that private banks, especially the Bank of Brazil, acted as a vehicle for financing government deficits. Despite pledges to the contrary made in the Speech from the Throne at the beginning of each legislative year, the central government only succeeded in obtaining a budget surplus twice between 1850 and 1870.⁴⁴ One way to finance this gap was by recourse to the issue of short-term (less than one year) Treasury bills (*bilhetes*), which paid interest of up to 6%, and were issued in anticipation of future ordinary revenues.⁴⁵ The public at large, as well as banks, took up these issues, the stock of which throughout the 1850s averaged only 3,000 *contos*.⁴⁶ *Apólices*, or bonds of the consolidated imperial debt, were also used to some extent in financing the deficit. Nevertheless, the last issue of *apólices* for that purpose took place in 1853, only recurring in 1865, when the Treasury would find itself in the midst of the demands emanating from the military campaign against Paraguay.⁴⁷ Here, too, banks played a modest role in financing the government. In fact, as of 1876, banks accounted for just over 11% of the total outstanding volume of *apólices*, most of which was in the hands of the non-banking sector (see Table 7.1).⁴⁸ Finally, foreign loans contracted to cover the fiscal deficit would only take place in

⁴⁴ See Table A10, in the Statistical Appendix.

⁴⁵ It must be noted that *bilhetes* circulated in the capital only. See speech by deputy Silva Pereira, quoted in Pacheco, *Banco do Brasil*, Vol. IV, p. 255.

⁴⁶ See Table A14, in the Statistical Appendix.

⁴⁷ See Table A15, in the Statistical Appendix.

⁴⁸ As seen in Chapter 6, bonds of the consolidated imperial debt served to back part of the issues of the provincial banks. Sparse balance sheet data for the Bank of Brazil reveal that between 1861 and 1864 it held in its portfolio, on average, 2,700 *contos* in Treasury *bilhetes*. This amounted to less than 10% of bills in its portfolio, and approximately 10% of total outstanding *bilhetes* in the economy. See Banco do Brasil, *Relatório*, various issues; and *RMF*, various issues. This proportion increased to 20% in 1866, when the Bank of Brazil had in its portfolio 6,000 *contos* in Treasury bills, out of a total of approximately 30,000 *contos* in circulation. See session of 1 September 1866, in *ACD*, Tome IV, p. 186.

1863. At the time, the imperial government borrowed £3.3 million in London, some of which was used for the consolidation of part of the floating Treasury debt.

Table 7.1
Consolidated Imperial Debt: amount outstanding in
November 1876, by type of holder
(in *contos*)

Holders	Amount	% of Total
Brazilian citizens	165,764.1	62.2
Banks	29,747.2	11.2
Provinces	25,437.4	9.6
British citizens	14,097.5	5.3
Other nations	16,597.6	6.2
Charitable organisations	11,827.4	4.4
Corporations	2,823.5	1.1
TOTAL	266,294.7	100.0

Notes: Figures refer to *apólices* of 4%, 5%, and 6%.

Source: Brasil, Ministério da Fazenda, *Proposta e Relatório Apresentados à Assembléa Geral Legislativa pelo Ministro e Secretário d'Estado dos Negócios da Fazenda* - 1878, Table 23, Annex.

For most of the twenty years up to the mid-1860s, then, the government made modest use of note issues or debt instruments to finance its deficits. Still, it could be argued that the 10,000 *contos* in Treasury notes that the Bank of Brazil retired from circulation between October 1856 and April 1861, as mandated by Article 56 of its statutes, amounted to a form of government financing. In a way it was, given that the Treasury would only repay the Bank after its 30-year contract had expired, and, even then, without interest. Nevertheless, these notes had been issued in the 1830s and 1840s, partly in replacement of the outstanding issues of the first Bank of Brazil. As such, they did not constitute liabilities issued by post-1850 administrations.

In short, unlike many other countries at the time, as well as the earlier Brazilian experience, policymakers in the post-1846 period did not see inflationary financing of the budget deficit as a valid option. Monetary “virtue” at that juncture was part of a broader context that included the denunciation of the trade treaties with Britain and the passing of the fairly protectionist Alves Branco tariff, in 1844. At that point, a firm commitment to monetary rectitude served as an indication to foreign

creditors of the country's "sound finance" credentials. Consequently, debt instruments were preferred to seigniorage. The recourse, however modest, to the issue of debt was certainly helped by the value of bonds of the imperial debt, which remained close to par between the early 1850s and mid 1860s.⁴⁹ Moderate deficits and debt financing, then, were the norm, until the inescapable demands of the Paraguayan War finally led the government to take over issuing rights from the Bank of Brazil, in 1866.

In Chapter 4 it was shown that the government relied on a variety of instruments to finance the expenditure associated with the War. Domestic and foreign loans, as well as tax increases, were used to meet the deficit, which ballooned from an average of 3,000 *contos* in the 1850s to more than 50,000 *contos* during the conflict.⁵⁰ It was also seen that printing Treasury notes was considered less desirable than the use of interest-paying instruments, such as *apólices* and *bilhetes*. Presumably, policymakers deemed the latter as a lesser evil when compared to fiat money. In effect, Minister of Finance Itaboraí emphasised in his report to the General Assembly in May 1869 that recourse to the issue of *apólices*, instead of paper money, had given 'the creditors of the State and the Peoples with whom we trade the solemn testimonial that we do not intend to resort to new alterations to the monetary standard'.⁵¹ In short, issues of the consolidated imperial debt would henceforth take precedence over inflationary financing of the deficit. The latter, as pointed out by a contemporary, far from an interest-free loan, was a 'very onerous way to raise money', suggesting the deleterious effects of the subsequent increase in the price level.⁵²

Shortly after the War, Minister of Finance Paranhos studied the nature of the issues of government paper that had been made in the previous years. Rather tellingly, Paranhos presented a table in the annual report to Parliament, in which Treasury bills were listed alongside government notes and banknotes as part of total circulation in the Empire. Contemporary records provide some indication of the

⁴⁹ See Bouças, *Finanças*, Vol. XIX, p. 146.

⁵⁰ Between the 1864/5 and 1869/70 financial years, the government deficit amounted, on average, to close to half of total expenditure. See Table A9, in the Statistical Appendix.

⁵¹ Cf. *RMF* 1869, p. 8.

⁵² See J. R. Dunlop, *Estudo para a Solução das Questões do Cambio e do Papel-Moeda no Brazil* (London, T. Brettell & Co., 1879), p. 14.

extent of the acceptance of short-term *bilhetes* in daily transactions in Rio, the only place where they circulated.

Treasury bills cannot completely perform the role of currency, either because they are not accepted in payment of most debts at tax offices, or because they are not legal tender for private transactions, or, finally, due to their high individual face value (...).⁵³

Still, the Minister's decision to publish the figures for these bills alongside notes issued by the Treasury and banks suggests that they could be deemed close substitutes for other, more liquid, forms of money.

⁵³ See debate in the Chamber of Deputies, session of 9 June 1853, in *ACD*, Tome II, p. 129.

Table 7.2⁵⁴
Brazil: monetary circulation, 1866-71
 (in *contos*)

	Treasury Notes	%	Banknotes	%	Treasury Bills	%	Total
1866	33,255.8	22.5	84,590.4	53.9	38,986.8	23.6	156,823.0
1867	60,164.8	33.0	62,357.8	34.2	59,572.7	32.8	182,095.2
1868	120,629.7	48.3	56,511.9	22.6	72,705.6	29.1	249,847.2
1869	150,687.4	58.3	43,133.3	16.7	64,575.3	25.0	258,396.0
1870	151,916.2	64.6	40,727.6	17.3	42,586.1	18.1	235,229.8
1871	150,893.5	72.6	38,329.5	18.4	18,632.5	9.0	207,795.5

Source: Brasil, Ministério da Fazenda, *Proposta e Relatório Apresentados à Assembléa Geral Legislativa pelo Ministro e Secretário d'Estado dos Negócios da Fazenda* - 1872, p. 47.

As Table 7.2 indicates, despite Itaboraí's desire to substitute debt issue for monetisation of the deficit, the volume of Treasury notes in circulation would account for the bulk of the currency in circulation in the late 1860s. It stabilised at around 150,000 *contos* in 1869. Meanwhile, banknotes outstanding decreased after the Bank of Brazil lost its issuing rights, in 1866. Finally, the drop in the stock of Treasury bills owed to the issue of *apólices*, which were then used to retire *bilhetes* from circulation, thus extending the maturity of the government debt.

As expected, the huge fiscal deficits engendered by the Paraguayan War were incompatible with gold standard orthodoxy. The goal of restoring convertibility - which had been suspended since the Souto crisis - was postponed as a result of the conflict. This failure to ensure adherence to gold, due to the inflationary financing of the imperial deficit, has been designated as the single major "trap" inherent in the *metalista* project.⁵⁵ Essentially, Teixeira points out the few alternatives open to the imperial government to increase its tax base. Taxes on rural property were politically unacceptable. Also, the dependence on import taxes for the better part of revenues

⁵⁴ It should be noted that the data in this table do not coincide with those in Tables 4.6 and 4.7, as they were drawn from different sources. Tables 4.6 and 4.7 are based on the monetary series estimated by Peláez and Suzigan, and reproduced in IBGE, *Estatísticas Históricas*. Table 7.2, instead, replicates a table presented by Minister Paranhos in *RMF* 1872, and is being employed here in order to advance a specific point regarding the importance of *bilhetes* as substitutes for money, as seen by contemporaries. Apart from this, the thesis relied heavily on the estimates produced by Peláez and Suzigan, which, despite some shortcomings, are still the most consistent available, and offer the longest coverage.

⁵⁵ See Teixeira, "Determinantes", especially Chapter 3.

indicated a saturation of that source. Consequently, inflationary financing, that is, the outright issue of notes, was pursued. Given the impact of monetary expansion on the exchange rate, adherence to the gold standard was compromised, argues Teixeira. A stable and appreciated rate of exchange would never come, as long as the government had to rely on the printing press. This was, in short, the conundrum facing hard money advocates at the time.⁵⁶

Although essentially correct from the theoretical point of view, Teixeira's argument fails to consider some crucial historical facts. First of all, between 1853 and 1866 the government was not directly in charge of monetary policy. Therefore, it could not automatically monetise its fiscal deficit. Note issues, as already stressed, were in the hands of the Bank of Brazil and, to a lesser extent, of other issuing banks. There remains the possibility that private banks acted as financiers of the government. Yet, it was seen above that banks played a subsidiary role in financing the public deficit, through the purchase of either *apólices* or *bilhetes*. Crucially, though, Teixeira suggests that the government's fiscal imbalance in the 1850s was as serious as it was in the 1860s.⁵⁷ Clearly, it was not. As already mentioned, the fiscal deficit deteriorated dramatically only after the outbreak of the Paraguayan War. Before then, it was still manageable, and was covered via the issue of *bilhetes*. Yet, from 1864 onwards there is no disputing the extent of the "trap" in which the government found itself in. And, as shown, it was clearly aware of it. So much so that it never entertained the idea of resuming convertibility while its fiscal position was so precarious.

In short, during the Second Reign there was indeed a constraint on the adoption of the *metalista* programme of adherence to the gold standard. Still, this constraint would only be effectively binding in the second half of the 1860s. Before that, as seen in previous chapters, there had been periods of partial convertibility of notes into gold. Even then, decisions to leave gold before the 1860s did not result from fiscal considerations. Instead, they followed the emergence of panics, or the drying up of gold reserves at the Bank of Brazil. These reasons, in turn, are closely

⁵⁶ Ibid.

⁵⁷ Ibid., pp. 87 ff.

linked to the stabilising function sometimes expected of banks. This is the subject of the next section.

7.3 - The “Orthodox” Perspective

The final view on the role of banks will be designated as “orthodox”, and is related to the progressive development of a central bank. The premise of this approach is that the success of any effort at regulating the currency depends on the existence of a monopoly of note issue.⁵⁸ The “orthodox” perspective was favoured by *metalistas* (or Currency school advocates), as well as early twentieth-century Brazilian monetary historians.

Before examining the considerable influence of the “orthodox” perspective amongst nineteenth-century Brazilian policymakers, it is worth re-emphasising two peculiarities that characterised the operation of the gold standard in the country. The first one referred to the fact that although Bank of Brazil notes were declared convertible into gold they only comprised one part of the total outstanding issues in the Empire. Except for 1857 and 1863-4, the volume of outstanding Bank notes was less than either Treasury paper, or the sum of Treasury notes and the notes of other banks of issue.⁵⁹ In other words, the Bank of Brazil did not always dominate the monetary market in the period under examination here, even though it was the single most important banking institution in the country. The other peculiar feature of Brazil’s flirtation with the gold standard in the mid-nineteenth century referred to the rule which limited Bank issues to a multiple of its reserve fund. In times of distress, then, even if convertibility were to be suspended, discretion would still be limited by the monetary rule which bound Bank issues to a multiple of an often dwindling reserve, consisting of specie and Treasury paper. The uniqueness of the Brazilian case, thus, suggests two things. First, that the Bank of Brazil was not as powerful as would be desired if it were to perform the stabilising role that many expected.

⁵⁸ As seen in Chapter 6, this view is challenged by advocates of free banking. See, for example, White, *Free Banking*; and, for an extreme defence of the private sector’s right to issue notes, F. Hayek, *Denationalisation of Money, An Analysis of the Theory and Practices of Concurrent Currencies* (London, Institute of International Affairs, Hobart Special Paper, No. 70, 1976).

⁵⁹ See Table A2, in the Statistical Appendix. The data in this table do not coincide with the series on high-powered money in Table A1. Nonetheless, unlike the data in IBGE, *Estatísticas Históricas*, from which Table A1 was constructed, it offers a breakdown of total notes outstanding by issuer.

Second, even if it did attempt to behave as a lender of last resort in times of distress its hands were tied by rules limiting note issues to a multiple of its reserves. Before dealing with the implications of both these features for the “orthodox” desideratum of ensuring a stable currency, it is necessary to look closer at the origins of the often-tumultuous relationship between Bank and government.

The 1846 “gold standard” law that established the 27d/1\$000 parity stated that ‘the Government is authorised to retire from circulation the amount of paper money necessary to increase its value (to 27d) and keep it there (...)’.⁶⁰ When the third Bank of Brazil was created, in 1853, the government included in Art. 56 of its statutes the provision that the Bank be required to ‘withdraw from circulation the paper which presently serves as *numéraire*, at the rate of 2,000 *contos* each year (...)’.⁶¹ In the eyes of many commentators and, crucially, most government policymakers, articles 2 of the 1846 law, and 56 of the decree laying down the statutes of the Bank of Brazil, could only mean one thing. When read in conjunction, they implied that the Bank had taken over from the government the role of ensuring the stability of the exchange rate at close to its notional par value of 27d/1\$000. This interpretation was clearly stated by Minister of Finance Torres Homem in his report of 1858. According to him, as a result of the monopoly of note issue granted the Bank in 1853, ‘the responsibility for maintaining the ratio between gold and Treasury notes (...), which the Law of 11 September 1846 had given to the government, was virtually transferred to the Bank of Brazil’.⁶² Few in the Bank of Brazil would dispute this interpretation either, so long as the institution retained the capacity to influence the money supply, as the sole issuer of banknotes in the Empire. The Bank, then, did accept its role of regulator of the currency and, indirectly, the rate of exchange. This was part of the duties it had inherited together with the note-issuing privilege, in 1853.

Nevertheless, not everyone believed that the Bank alone should regulate the currency. Many at the time adopted the view that it was up to both the Bank and the government to ensure the stability of the circulating medium.

⁶⁰ Art. 2, Law 401, 11 September 1846. Emphasis added.

⁶¹ Decree 1223, 31 August 1853.

⁶² *RMF* 1858, p. 4. Revealingly, in 1858 the Chamber of Deputies rejected an amendment proposed by Torres Homem which would have meant that Art. 2 of the 1846 “gold standard” law had been revoked

There are those who entertain the absurd (position) that it is up to the bank to maintain the value of the circulating medium on a par with the monetary standard fixed by the law of 11 September 1846. But they do not deign to point out the article in our statutes in which such an obligation is designated (...) It is admissible, and no one can deny the fact that with the organisation of this bank not only the strengthening of the credit of the country was sought (...) but also that this establishment assist the government in the great task of providing stability to the circulating medium'.⁶³

The above comment clearly suggests that the Bank had at least some part to play in maintaining the stability of the currency. That was the view at the time of the Bank's creation, when it was the sole institution in the Empire allowed to issue notes accepted in the public offices. Yet, there were those who maintained that it was strictly the government's duty to ensure that the *milréis* remained at close to its par value. In discussing the Torres Homem project, which ultimately served as the basis for the 1860 Law of Impediments, deputies Souza Dantas and Paula Santos insisted that it was up to the government (as expressed in Law 401, 11 September 1846), and not the Bank of Brazil, to ensure the maintenance of the parity of the *milréis* at 27d.⁶⁴ And they could always fall back on the words of Itaboraí himself, when defending in the Chamber of Deputies his project for the new bank.⁶⁵

Contemporaries clearly disagreed on what exactly the Bank's responsibilities were. A few years after its creation the Bank would be confronted by the confusion surrounding its remit. As new banks of issue were chartered, in late 1857, it found itself incapable of affecting as before the amount of money in the economy. From then on, its actions could always be (and, indeed, often were) countered by the remaining banks.⁶⁶ The end of the Bank's monopoly of note issue had undoubtedly compromised its stabilising role. Torres Homem acknowledged that fact, claiming that with plurality 'the plan of the Law of 1853 had changed fundamentally, both in

by the 1853 law that created the Bank of Brazil. See session of 26 July 1859, in *ACD*, Tome V, Appendix, p. 66.

⁶³ *Parecer Apresentado à Assembléa*, pp. 6-7. Souza Franco broadly shared this opinion. See *ASI*, session of 15 May 1858, Tome I, p. 71.

⁶⁴ Cavalcanti, *O Meio*, Vol. 2, p. 240. On the occasion, the authors criticised the whole idea of attempting to create a 100% gold-backed circulation in the country as a means to prevent the depreciation of the currency. According to them, defence of a fixed exchange rate during crises would necessitate massive increases in the rate of interest, with little impact on the outflow of gold, but with devastating consequences to domestic economy activity. *Ibid.*

⁶⁵ See footnote 42, Chapter 5.

⁶⁶ The episodes briefly summarised here are examined in much fuller detail in Chapters 3 and 4.

reference to the reform of the circulating medium and as regards the provision of credit to the economy'.⁶⁷ The real watershed came with the panic of 1857. As seen in Chapter 3, the government initially sought the Bank's assistance in staving off what amounted to a momentary balance of payments crisis. In this regard, it asked the Bank to intervene in the foreign exchange market, in order to prop up the value of the *milréis*. The Bank initially complied with the government's request but, a few weeks later, decided to retreat from the operation. The loss of gold from its reserves added to fears that its core business - bill discounting - would be affected, given the obligation to remain within the assigned ratio between reserves and note issue. The government, then, resorted to the services of the Mauá, MacGregor Bank, which succeeded in re-establishing the value of the currency at close to par. Mutual recrimination amongst government, Bank and members of the opposition in Parliament soon followed. The nature of the operation conducted by Mauá was challenged on both technical and ethical grounds. Many were unconvinced about the desirability of artificially sustaining the rate of exchange. Still others attacked Souza Franco for relying on Mauá, a personal friend, and not the Bank, to stave off the panic.⁶⁸

From then on, relations between the Bank of Brazil and the government would be soured. At the root of this lay the failure to agree on a "proto-central-bank" role for the institution.⁶⁹ Although the expression was seldom used at the time,⁷⁰ contemporaries were aware of the Bank's position as an agency at least partly responsible for seeing to the soundness of the currency. This was its "macro" function, to be achieved via convertibility and a rule that bound its note issues to gold reserves. An interrelated, "micro", function for this proto-central bank existed as

⁶⁷ *RMF* 1858, p. 5.

⁶⁸ The theme would occupy most of the debates in the Senate at the beginning of the 1858 legislative year. See *ASI*, Tome I, 1858.

⁶⁹ The prefix "proto" is used to distinguish institutions such as the Bank of Brazil from modern-day central banks, which, amongst other things, regulate the money supply via control over commercial banks' reserve levels, and open market operations.

⁷⁰ A major exception was the discussion by Souza Franco of the desirability of a "central bank", in his 1848 book. After some consideration of its pros and cons, with reference to the failed experience of the Second Bank of the United States, Souza Franco concludes against the idea, on the grounds that such an institution would be liable 'to great financial and political abuse'. Cf. Franco, *Os Bancos*, p. 84.

well. It concerned the role of the Bank as a lender of last resort in times of crisis.⁷¹ In practice, this meant abiding by what later came to be known as “Bagehot’s rule” in case of market distress: (i) to lend freely; (ii) to banks that are distressed, but solvent; (iii) against collateral; and (iv) at a penal rate of interest. Insolvent banks should be allowed to fail, and help should be confined to banks facing a temporary lack of liquidity.⁷²

Though muddled by conflicting legislation, the Bank of Brazil was still expected to perform proto-central bank functions. On part this was due to the sheer weight of the Bank in the banking sector and the size of its gold reserves. Nevertheless, years after its creation, it was still not clear how exactly the Bank was to exercise both its micro and macro functions. This was borne out by the events that followed the 1857 crisis. Still, there was a degree of learning by doing in action, as seen when the Souto crisis broke out, on 10 September 1864. On the occasion, the Bank clearly perceived its role as a lender of last resort to the market:

The retraction that many banks make, and the safety measures taken in moments of danger, render the situation even worse, just when, on the contrary, the expansion of (note) issues would be the only healthy and efficacious remedy. The most notable crises can only be dominated, and overcome, when banks facilitate their resources, for in these circumstances the sole element of life is the circulating medium, which momentarily fills the void left by vanishing capital. The Bank of Brazil understood this and, in order to provide the necessary assistance to commerce, had to increase its issues considerably.⁷³

In 1864, unlike 1857, the institutions needed to deal with the crisis were partly present, in the shape of a Bank of Brazil that was much more aware of its potential

⁷¹ Goodhart, *Central Banks*, “Introduction”.

⁷² Souza Franco would praise the role of the Bank of England as a lender of last resort to the London market in similar circumstances: ‘In times of crisis (...) bankruptcies befall not only those who are lost beyond hope, but also those with assets in excess of liabilities, but which are employed in such a way that they cannot make use of them in an emergency. In these cases (...), bankruptcies extend to businesses often held as very solid and which in other times would not run the slightest risk. Why is that so? Because there is no confidence. Men with considerable funds, houses amongst the richest in London came to the point of bankruptcy (...) and would have invariably failed had it not been for the help from the Bank of England’. Session of 15 May 1858, in *ASI*, Tome I, p. 67. Souza Franco was quick to point out that help should only be offered to houses that were illiquid, but solvent. ‘The government and the bank should only help businessmen who are in a position to benefit from assistance, and not those who are bankrupt beyond repair.’ Yet, surprisingly, three days later Souza Franco would attack the handling of the 1857 crisis by the Bank of Brazil, claiming that ‘(its) issue at three times (the reserve fund), four times, and, especially, five times, is, clearly, an attempt to evade resumption of its notes (in gold)’. Session of 18 May 1858, *ibid.*, p. 94.

⁷³ Cf. “Representação da Directoria do Banco do Brasil”, in *Proposta do Poder Executivo*, p. 31.

role as a lender of last resort and, accordingly, acted swiftly. True, on the part of the government there was vacillation, as evidenced by the Council of State's initial dismissal of the need for extraordinary measures to deal with the crisis. However, after just a few days the government reconsidered its initial position and issued Decrees 3306 and 3307 granting the Bank, respectively, permission to increase its issues and suspend convertibility. Between 10 and 20 September the Bank of Brazil provided advances in the order of 30,000 *contos* (£3.3 million) to the banking system, both to domestic and foreign institutions.⁷⁴ For its part, the government finally enacted legislation mandating a moratorium on the initiation of bankruptcy procedures, as well as on the payment of bills, *vales* and obligations in general. However arbitrary (and illegal), these measures - in conjunction with the lender of last resort role of the Bank - helped shelter the market from even more dire consequences. A summary table reveals the different underlying behaviour of agents and the contrasting effects of the 1857 and 1864 crises.

⁷⁴ Figures presented by the president of the Bank, Cândido Batista de Oliveira, in a meeting of the Council of State, on 9 November 1864. See *ACE*, Vol. V, p. 401. A contemporary criticised some of the major *casas bancárias* in Rio (Gomes & Filhos, Montenegro, Lima & Cia., Oliveira & Bello) for their timid efforts at fighting the run, which they abandoned just after three days and the discount of titles worth 7,000 *contos*. See Soares, *Esboço*, p. 82. All three institutions were later liquidated, which suggests that they were not in a position to offer much help in fighting the crisis.

Table 7.3
Brazil: the 1857 and 1864 crises compared

1857					1864				
Origin: “imported”					Origin: domestic				
Start: 13 November (arrival of news of the crisis in the United States)					Start: 10 September (Souto & Cia. shuts its doors)				
Treasury Notes in Circulation: approx. 43,000 <i>contos</i> and declining					Treasury Notes in Circulation: approx. 28,000 <i>contos</i> and stable				
Bank of Brazil Outstanding Note Issues: averaged 50,000 <i>contos</i> in the six months prior to the crisis; reduced to 40,000 <i>contos</i> at the end, in August 1858 Issuing Limit: at three times the reserve fund since April 1855 Suspension of Convertibility: 27 November 1857 (at the initiative of the Bank, not the government) Rate of Discount: raised from 8% to 10% on 15/12/57 increased to 11% on 23/12/57 lowered to 10% on 27/1/58 lowered to 9% on 19/2/58					Bank of Brazil Outstanding Note Issues: averaged 47,000 <i>contos</i> in the six months prior to the crisis; increased to more than 72,000 <i>contos</i> by April 1865 Issuing Limit: increased to three times the reserve fund on 13 September 1864 Suspension of Convertibility: 14 September 1864 (by government decree) Rate of Discount: raised from 8% to 9% on 20/9/64 increased to 10% on 8/10/64				
Monetary Indicators (% change on previous quarter)					Monetary Indicators (% change on previous quarter)				
period	H	M1	R/D	C/M1	period	H	M1	R/D	C/M1
1857 I	6.4	8.1	-1.1	1.1	1864 I	2.7	1.2	-9.7	8.8
1857 II	3.1	6.6	-34.2	-0.9	1864 II	0.0	1.9	1.9	-4.9
1857 III	2.3	7.9	-50.6	-4.4	1864 III	15.2	11.0	21.2	0.0
1857 IV	2.0	2.3	-28.1	-3.7	1864 IV	3.4	3.6	-14.6	7.5
1858 I	-10.1	-11.6	25.3	-1.6	1865 I	2.0	4.3	-23.4	2.3
1858 II	9.4	11.3	-12.4	-0.1	1865 II	3.3	-0.6	21.3	3.4
1858 III	-6.8	-3.5	-8.4	-7.0	1865 III	0.6	4.1	-10.8	-4.2
1858 IV	6.2	1.0	28.8	4.1	1865 IV	4.1	4.5	-21.3	3.7
Rate of Exchange (in pence per <i>milréis</i>) Oct-Nov 1857: above par (27d) Dec 1857: 26 ¼ (high) 23 ½ (low) Jan 1858: 25 ¼ (high) 24 (low) Feb 1858: 25 (high) 24 (low) Mar 1858: 25 ½ (high) 22 ¾ (low) Apr-May 1858: 25 ½ June 1858: 27 (high) 25 ½ (low) July 1858: 27 (high) 25 ½ (low)					Rate of Exchange (in pence per <i>milréis</i>) Jul-Sep 1864: above par (27d) Oct 1864: 27 ¼ (high) 26 (low) Nov 1864: 26 ¾ (high) 25 7/8 (low) Dec 1864: 26 ½ (high) 26 (low) Jan 1865: 26 1/8 (high) 25 ¾ (low) Feb 1865: 26 (high) 25 5/8 (low) Mar 1865: 26 (high) 25 ¾ (low) April 1865: 26 (high) 25 (low)				

Notes: Monetary indicators are as follows: H = high-powered money (monetary base); M1 = currency held by the public + demand deposits; R/D = bank reserves as a proportion of demand deposits; and C/M1 = currency held by the public as a proportion of money supply.

Sources: Monetary data from IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987). Bank of Brazil figures from Banco do Brasil, *Relatório Apresentado à Assembléa Geral dos Accionistas pelo Presidente do Banco* - 1858 and 1865. Exchange rates from Junta de Corretores de Fundos Públicos da Cidade do Rio de Janeiro, “Livro de Registro Oficial de Cotações de Títulos e Valores”, various volumes.

The reaction to the 1857 and 1864 crises was clearly different, not only on the part of the government, but also of the Bank of Brazil and the public at large. To begin with, suspension of convertibility in 1857 was decided unilaterally by the Bank of Brazil, and implemented a full two weeks after the initial run on banks in Rio. Continued depletion of its reserve fund, in an attempt to defend the (now floating) rate of exchange by selling drafts in the market, forced the Bank (specially its head office) to

contract its note issue sharply.⁷⁵ This serves to highlight the point made earlier about some of the peculiarities of the rules that governed note issues in Brazil. The statutes of the Bank of Brazil stipulated a ratio between its note issues and the amount of gold and Treasury paper in its reserve fund. The ratio itself varied over time, from 2:1 to 4:1, depending on the desire to increase or decrease liquidity in the market. Yet, the requirement that issues of the Bank maintain some proportion to its reserves was never abandoned altogether. Not even during times of crisis, as the 3:1 limit was not relaxed in 1857. Consequently, the Bank was constrained in its efforts to tackle the crisis. Indeed, although loss of gold from redemption was precluded via suspension of convertibility, it would continue to occur as a result of the sale of drafts, used to defend the rate of exchange. Therefore, the rules under which the Bank was forced to operate placed it in an awkward position. If it used its gold reserves to defend the currency - as the government expected it to do - it would necessarily have to reduce its issues, which were a proportion of these (dwindling) reserves. Bill discounting would therefore suffer, damaging the Bank's core business. Macroeconomic considerations (defence of the *milréis*) and its private interests (note issues) were clearly at odds.

Meanwhile, withdrawal of Treasury notes from circulation proceeded as usual, reducing liquidity even further. As a result, both the monetary base and M1 declined sharply in the first quarter of 1858. Throughout, the Bank's discount policy was erratic. In November and December 1857, it initially increased both discounting operations and interest rates, which rose from 8% to 11%. Nevertheless, soon after negotiations with the government collapsed, the Bank changed policy, charging a lower rate of interest on a shrinking volume of discounts. The reserve/deposits ratio increased in the first quarter of 1858, reflecting the cautious mood on the part of the banking system as a whole. The parallel decrease in the public's liquid holdings - as captured by the drop in the C/M1 ratio - was not enough to compensate the actions of the banking system, rendering the monetary contraction inevitable. Finally, it was only after the rescue operation undertaken by Mauá bore fruit, in mid-1858, that the rate of exchange returned to par.

⁷⁵ See PRO, Foreign Office 13/362, Scarlett to the Earl of Clarendon, Rio de Janeiro, No. 7, 13 January 1858.

The lessons appear to have been learned when the Souto crisis erupted, in September 1864. After the initial indecision as to the powers to be allowed the Bank, the government raised the Bank's issuing limit. Suspension of convertibility followed almost immediately, as decreed by the government. Contrary to its course of action in 1857, this time the Bank of Brazil increased its discounting activities massively. It provided much-needed liquidity to the market, at high interest rates. In sum, it acted as a true lender of last resort, fulfilling the role expected of it by the "orthodox" approach. Increases in high-powered money in the wake of the Souto crisis were sufficient not to be annulled by both the greater reserve ratio at the banks and the public's preference for holding cash, which could have dampened the monetary expansion. Also, the extent of the assistance furnished by the Bank, combined with the extraordinary bankruptcy legislation enacted by the government, helped to calm the market.⁷⁶ The reaction was seen to be unequivocally counter-cyclical, and consistent, unlike the mixed signals sent out by both government and Bank in 1857. The fall in the exchange was correspondingly much milder than in the previous crisis, and volatility was greatly reduced.⁷⁷ In spite of this, losses due to the Souto Crisis at the end of March 1865 were put at 65 to 70 thousand *contos* (£7.5 million) in the city of Rio, where twenty-five businesses went bankrupt.⁷⁸

As seen above, in both 1857 and 1864 suspension of convertibility was opted for. This has been portrayed as amounting to an exercise in conscious counter-cyclical policies.⁷⁹ Yet, it was shown that in 1857 the decision to discontinue redemption of notes for gold was taken unilaterally by the Bank of Brazil, not the government. The latter actually blamed this move for the subsequent depreciation of the *milréis*.⁸⁰ Suspension was strictly a protective measure employed to safeguard the Bank's reserve fund, not a deliberate effort to shelter the domestic economy from deflation, as often happened in similar circumstances in Europe and the United States. Furthermore, as pointed out, prior to the 1857 crisis the Bank would seldom exchange

⁷⁶ *Banker's Magazine*, Vol. 24, November 1864, p. 1008.

⁷⁷ Subsequent deterioration of the rate of exchange can be imputed to the continuing monetary expansion that accompanied the escalation of the Paraguayan War.

⁷⁸ The provinces were largely spared after the Bank of Brazil suspended convertibility of its notes. See *SAJ*, 7 November 1864, p. 13.

⁷⁹ See Peláez, "The Theory"; and, less emphatically, Schulz, *A Crise*, Chapter 2.

⁸⁰ See session of 18 May 1858, in *ASI*, Tome I, p. 107.

its notes for gold, so that convertibility was more of a notional than practical nature.⁸¹ In 1864, by contrast, Bank and government worked closely to fight the crisis. Suspension of convertibility and extension of the Bank's issuing limits were clearly seen as essential components of a set of measures designed to provide *casas bancárias* with the funds they needed to honour deposits.⁸² In a sense, by assisting the market policymakers were indeed pursuing a counter-cyclical policy. Had they failed to enact extraordinary bankruptcy legislation, and maintained convertibility of Bank of Brazil notes, assistance to the market would have been greatly impaired, and losses would have been even greater.

Overall, then, reaction to the 1857 and 1864 crises were undoubtedly different. As a matter of fact, the nature of the two episodes was distinct. The first crisis, as noted, had been "imported". It consisted of a momentary balance of payments crisis, caused by falling export revenues and the drying-up of international commercial credit. The ensuing panic led to massive purchases of sterling, which triggered a speculative attack on the *milréis*. With hindsight, the government's reaction, by trying to defend the rate of exchange, appears to have been correct. Unlike, say, a crisis resulting from a permanent shock in the country's terms of trade, the events of 1857 were transitory. Mauá perceived this at the time, hence his success in restoring the value of the exchange rate after conditions in the international economy resumed their natural state. The decision by the Bank of Brazil to abandon its part in the defence of the currency is also understandable. Apart from legal aspects surrounding its duties as a guarantor of currency stability, which had not yet been cleared up, the Bank's position was greatly limited by the rule that bound its note issues to the reserve fund. The Mauá, MacGregor Bank did not suffer from a similar constraint. In the end, therefore, despite the failure of Bank and government to operate in tandem, both domestic and external balances were restored. Had there been more coordination, and were the Bank free from constraints on its note issues, perhaps the international crisis would not have lasted so long in Brazil.

⁸¹ As seen in Chapter 4, with the 1860 Law of Impediments, this discretionary power was removed, and the Bank would have to redeem its notes for gold whenever demanded by noteholders.

⁸² Banco do Brasil, "Actas", sessions of 12, 13, and 14 of September 1864, AD 007/11-A.

In 1864, on the other hand, the crisis was largely of a domestic nature.⁸³ It amounted to a commercial crisis basically resulting from unsound operations carried out by *casas bancárias*. This time, the Bank's role as lender of last resort was readily acknowledged. Convertibility was suspended, and Bagehot's rule followed.⁸⁴ The government clearly recognised the role played by the Bank in preventing an even greater crisis in Rio in 1864.⁸⁵ Nevertheless, its support soon gave way to criticism when, after almost two years since suspension of gold payments at the Bank, note issues showed no sign of decreasing, nor of returning to convertibility.⁸⁶ The fact that part of the increase in issues of the Bank was made in discounting Treasury bills did not prevent the government from pushing through, in September 1866, the innovation of its agreement with the Bank, whereby issuing rights were transferred to the Treasury. Clearly, financing of the Paraguayan War took precedence over any other consideration at the time and, as a result, hard money gave way to (partial) inflationary financing of the deficit. Or, in Jones's typology, the "orthodox" view of the role of banks took the back-seat, as the "statist" function was taken over by the State itself.

* * *

To sum-up, it was stressed that the role of banks in the economy can be viewed according to different aspects of their activities. The first perspective analysed in this chapter concerned banks' importance in assisting economic development, especially among latecomer countries. This "developmental" role concerns, foremost, the

⁸³ As noted in Chapter 4, an increase in Bank of England Rate in early 1864, as well as fears about the military situation in the River Plate, compounded the liquidity crisis in Rio. See Schulz, *A Crise*, Chapter 2.

⁸⁴ In this sense, the 1857 crisis, but not the episode of September 1864 in Brazil, meets the "Schwartz test" for distinguishing "real" from "pseudo-financial" crises. In her own words, 'a real financial crisis occurs only when institutions do not exist, when authorities are unschooled in the practices that preclude such a development, and when the private sector has reason to doubt the dependability of preventive arrangements'. Cases outside these conditions are consequently labelled "pseudo-financial crises". See A. J. Schwartz, "Real and Pseudo-Financial Crises", in F. Capie and G. Wood (eds.) *Financial Crises and the World Banking System* (London, Macmillan, 1986). For a much broader taxonomy of financial crises, see Kindleberger, *Manias*.

⁸⁵ See *RMF* 1865, p. 13.

⁸⁶ See *RMF* 1866, pp. 6-7.

capacity of banks to link up savers and borrowers. It was seen that this view was entertained by most landowners in nineteenth-century Brazil, and encompassed groups broadly identified as *papelistas*, who favoured expansionist monetary policies and a depreciated rate of exchange. *Fazendeiros* were particularly keen on remedying what they felt was the high cost of credit being charged by factors. For them, plurality of note issue would ensure lower interest rates. However, it was shown that stringent credit conditions derived, to a large extent, from the existence of many middlemen in the financing of crops. This was a direct result of mortgage legislation - which protected rural land from foreclosure - and difficulties in determining authenticity of land titles. The high cost of credit, then, ultimately reflected ill-defined property rights and the costs of assessing planter creditworthiness.

Historically, banks have been seen to perform other functions, at times more important than the pro-industrialisation role stressed by Gerschenkron and his followers, or its pro-agriculture variant. In line with Jones's typology, banks can also be analysed from a "statist" or an "orthodox" viewpoint. In the Brazilian case, it was shown that from 1850 to the mid-1860s banks played a negligible role in financing the State. Budget deficits in the period were marginal and banks did not take up the bulk of government debt issued to finance them. This pattern changed in the early days of the Paraguayan War, when the Bank of Brazil discounted part of the *bilhetes* issued by the Treasury to cover the fiscal deficit. As the conflict escalated the government took over issuing powers from the Bank, and proceeded to finance expenditures partly through seignorage. From then on banks would again play a minor role in financing the State.

Finally, the "orthodox" perspective concerns the role of a proto-central bank in the provision of a particular public good - monetary stability. It was seen that, from the moment it was created, the Bank of Brazil failed to agree with the government on the precise terms under which it should be the agency responsible for providing stability to the market. In particular, it was shown that throughout the period under examination there was a failure to pass precise legislation defining the Bank's remit in this regard. The Bank's role in the effort to defend the *milrês* in 1857 served to show the extent of the disagreement between the agency and the authorities in this respect. Yet, during the Souto crisis they managed to work together

to bring the necessary calm to the market. Notably, the Bank acted as a true lender of last resort, thus conforming to its function under the “orthodox” perspective.

Conclusions

Part III analysed some of the most salient elements of Brazilian monetary history between 1850 and 1870. First, Chapter 5 attempted to verify to what extent the preferences about monetary policy and exchange-rate regime, discussed in Chapter 1, were effectively defended by planters and the government. To that end, the records of the debates in the Chamber of Deputies, and in the Finance Standing Committee of the Council of State, were examined.

In the absence of vocal planter associations at the time, the Chamber of Deputies constituted a natural place where *fazendeiros* would try to influence government policy on issues that interested them. Money and banking was certainly one of those issues, and the research revealed that soft money views were widespread in the Chamber, particularly amongst Liberal deputies. However, given that their party tended to be in a minority in most legislatures, “developmental” considerations did not translate into effective policy. The records of the debates in the Chamber support the view that Conservative politicians, as a whole, endorsed opinions consistent with hard money. Their main concerns, as revealed by the reading of the *Annaes*, were with preventing overissue of non-convertible banknotes, and ensuring exchange-rate stability. This was done to prevent income and wealth shifts from taking place, as well as providing the “good housekeeping seal of approval” sought by foreign investors. Yet, the research has established that not always did Liberal politicians advance soft money positions, nor were Conservatives always wedded to hard money. This serves to prove that the particular political context in which debates took place was also crucial. This was certainly true in 1858 and 1859, when the changing political climate greatly influenced allegiances during the monetary debates.

Reading of the records of the meetings of the Seção de Fazenda provided a look into the thoughts of the cream of the imperial elite, on matters relating to money and banking. Some of the general traits of the resolutions included a sense of fairness, the promotion of prudent banking practices, and a feeling that the “public good” should be upheld. The research established that a definite hard money view of the world transpired from the resolutions issued by the Seção de Fazenda. To the extent that resolutions informed Executive decisions, this had a great influence on the

direction of government policy. This conservative view, it was argued, stemmed mainly from the role of Itaboraí as *rapporteur* during most of the meetings of the Finance Standing Committee, between 1853 and 1867. In a way, then, it is difficult to disentangle the Committee's view from that of the *rapporteur*. And the latter, as noted, was heavily biased by the presence of Itaboraí.

Chapter 6 looked in detail at the question of issuing rights and convertibility, including its legal dimension. Issuing rights - meaning the right to issue notes, or *vales* - were the object of dispute in nineteenth-century Brazil. It was argued that, to some extent, monetary debates in Brazil mirrored, and was influenced by, similar discussions in Britain. Section 6.2.1 showed that legislation enacted throughout the period was geared towards ensuring prudential behaviour on the part of joint-stock banks of issue. As a rule, issues should not exceed three times the reserve fund, and discounts should be confined to the best paper. These general provisions would be enforced both in the periods when plurality of issue prevailed, and during the short spell during which the Bank of Brazil held a monopoly of note issue in the Empire. Moreover, as of 1860, with the Law of Impediments, it was established that the Legislative would be responsible for chartering banks, putting an end to the controversy of the previous years.

Convertibility was a less contentious topic than issuing rights. At the time, almost everyone proclaimed the virtues of pegging the domestic currency to gold, as adherence to the gold standard was equated with sound economic policy. This not only ensured stability of the exchange rate, but also prevented banks from engaging in overissue, while signalling to foreign investors that monetary prudence was being observed. Despite the enthusiasm for the benefits that accompanied a fully gold-backed circulating medium, contemporaries had to deal with the inevitability of a shortage of gold in the economy. Consequently, the Bank of Brazil was allowed to redeem its notes in either gold or Treasury notes, at its own discretion. This arrangement was extended to the other issuing banks, created by government decree in 1857 and 1858. It constituted the major feature of Brazil's peculiar form of gold standard regime. The thesis showed that, in all, Brazil remained on gold for less than five years, between 1850 and 1870. Even then, only part of the notes in circulation were convertible: Treasury notes remained inconvertible. Yet, in the periods when

the Bank ensured redemption, the rate of exchange did remain at close to its par value of 27d/1\$000.

In Chapter 7, it was emphasised that arguments over issuing rights and convertibility concealed broader beliefs as to the proper role of banks in the economy. The “developmental” perspective was said to be entertained by many contemporaries, as well as historians writing in the post-Second World War period. As advocates of soft money, they saw banks as crucial in providing the economy with the necessary liquidity. In their view, the best way to achieve low rates of interest was through monetary expansion. Many believed that this could only result from chartering more banks of issue. It was emphasised how most contemporaries, as well as a few historians, did not perceive the means by which deposit and discount banks could also perform a similar function. It was also stressed that behind the cries for cheaper credit conditions for the rural sector was discontent with existing sources of finance. At the time, factors’ greed was singled out as the main reason for the high discount rates confronting planters. The reluctance of bankers to lend directly to agriculture was also blamed. Yet, it was shown that problems related to mortgage legislation ultimately backfired against planters. Lack of precision in land titles, coupled with excessive protection afforded rural property increased transaction costs, which ended up making banks cautious. Creditors would only agree to lend *fazendeiros* money at necessarily higher rates, in order to compensate for the additional risk. Also, it was argued that rural credit was naturally incompatible with banks of issue. The mismatch between lending long to agriculture, while issuing very short-term liabilities, posed enormous risks on the term structure of their portfolios.

The “statist” perspective on the role of banks, examined in Section 7.2, concerns the extent to which banks finance the State. Examination of the behaviour of the imperial government revealed that it seldom engaged in inflationary financing of the deficit. The value of economic “virtue” - that is, the ability to honour commitments at home and abroad - was acknowledged by policymakers. This was reflected in the fairly manageable budget deficits incurred between 1850 and the mid-1860s, and ultimately financed through the issue of Treasury bills (*bilhetes*). Even if allowance is made for Treasury notes withdrawn from circulation by the Bank of Brazil - which constituted an interest-free loan to the government - and purchase of

government debt, it emerged that banks did not finance the Brazilian government in a substantial way, as was often the case elsewhere at the time. Sound macroeconomic policies - including modest monetary expansion and attempts to keep government expenditure in line with revenue - were clearly pursued before 1864/5. This pattern would only change with the Paraguayan War, when reasons of State dominated concerns with sound monetary policies, and Treasury liabilities, in all shapes, increased dramatically.

In Section 7.3 it was shown that an “orthodox” view of banking operated for most of the period, reflected in a concern with macroeconomic stability. Achievement of exchange-rate stability, as noted, depended on adherence to the gold standard. This, in turn, had to be accompanied by what contemporaries called an “improvement of the circulating medium”, that is, the replacement of inconvertible Treasury notes by gold-backed paper. Originally, this task was entrusted to the government, according to the 1846 “gold standard” law. With the creation of the third Bank of Brazil, and its duty to withdraw from circulation 2,000 *contos* of Treasury notes every year, many thought the duty to “improve” the quality of the currency had been shifted to the Bank. It was shown that failure to clear this point up was partly to blame for the confused reaction to the 1857 crisis. At the time, government and Bank could not agree on a proper lender of last resort role for the Bank. By contrast, during the Souto crisis, in 1864, the Bank behaved as a “proto-central bank”. It provided much needed discounting facilities to solvent, but illiquid, firms, and at penal rates, as mandated by “Bagehot’s rule”.

Going back to the sources examined in Chapter 5, it emerged that the records of the debates in the Chamber of Deputies revealed, more than any other contemporary source, the existence of support for soft money. The “developmental” perspective certainly underscored parliamentary debates to a larger extent than in the reports of the Minister of Finance, *Relatorios* of the president of the Bank of Brazil, and, crucially, the records of the meetings of the *Seção de Fazenda*. The latter, on the contrary, were mostly characterised by advocacy of hard money. Concerns with macroeconomic stability, typical of the “orthodox” perspective, were the norm in the *Seção*. Caught between “developmental” demands from certain representatives of *fazendeiros* in the Chamber, and the normally orthodox advice from the *Seção*, the

government generally opted for the latter. It had ample reasons to do so, as discussed in Chapter 1. Foreign exchange commitments, considerable reliance on import duties, and the desire to remain an attractive market for foreign investors certainly played a part. Yet, there was more to it. The records of the meetings of the *Seção de Fazenda* also serve to highlight the extent of the influence exerted by Itaboraí on the direction of government policy on money and banking. Clearly, ideology was also important. In the end, the picture that emerges from contrasting both sets of documents, against the backdrop of the policies discussed in Part II, is one of an Executive that acted mostly on advice of an orthodox-leaning *Seção de Fazenda*, against the soft money demands of the planter class. This suggests that, in the particular case of monetary and banking policy, the imperial State did enjoy a measure of autonomy vis-à-vis the economic elite represented in the Chamber of Deputies.

CONCLUSIONS

The analysis of Brazil's monetary and banking regime between 1850 and 1870 has challenged several assertions that are still found in the literature, while allowing a few points of historical fact to be settled. More importantly, it has advanced current understanding of a crucial period in the country's history. In particular, it has shed additional light on the nature of State-society relations during the Second Reign.

It has been shown that contemporary policymakers strove to guarantee Brazil's adherence to the discipline of the gold standard. This, it was argued, stemmed not only from "mimicry" of Europe, as claimed by Furtado,¹ but was a direct result of practical concerns. First, the desire to minimise the domestic cost of sterling-denominated expenditures of the imperial government. Second, the need to provide foreign investors with the necessary signal of financial rectitude - the "good housekeeping seal of approval", emphasised by Bordo and Rockoff.² Finally, the perception that the fixed exchange-rate regime that accompanied the gold standard was the best insurance against income and wealth shifts that accompanied sudden changes in the foreign value of the *milréis*. Thus, suggestions in the modern literature that adherence to the gold standard tended to advance British interests,³ however plausible, tend to miss these crucial points. Furthermore, they appear to overlook the undisputed fact that exchange-rate stability is a public good and, as such, it can be enjoyed by both domestic and foreign agents.

A different type of assertion sometimes found in the literature refers to the nature of Brazil's incipient capital market at the time. In particular, this scholarship attacks what are deemed "exploitative" relations between factors (*comissários*) and planters, with the latter having to face outrageous rates of discount on their drafts.⁴ Accordingly, high rates of discount reflected greed on the part of *comissários*, and ultimately hampered the development of agriculture. The thesis rejects this view, on the basis of research done by Sweigart on the commercialisation of the coffee crop in

¹ See Furtado, *Formação*, Chapter 27.

² Bordo and Rockoff, "The Gold Standard".

³ See, for example, Granziera, *A Guerra*; and Levy and Andrade, "Fundamentos".

⁴ See Soares, "A Manufatura".

the imperial period.⁵ It was then remarked that the existence of several intermediaries in the financing chain of the coffee sector - a feature that certainly contributed to the high rates of discount faced by planters - was the direct result of imperfections in mortgage legislation. In particular, the failure to demarcate properly land titles, and the excessive protection afforded planters during adjudication procedures resulted in higher transaction costs, keeping banks away from financing agriculture directly. It is rather surprising that such crucial elements are mentioned in the literature almost as an afterthought, and little effort is made to relate them to the financial question.

In addition, the thesis has provided a more informative taxonomy of the two major schools of monetary thought in nineteenth-century Brazil - *papelistas* and *metalistas*. To begin with, it has unearthed one of the few contemporary references to these schools.⁶ More significantly, the thesis has argued that previous treatments of debates between *metalistas* and *papelistas* have suffered from two major shortcomings: a tendency to exaggerate the degree of anti-bank sentiment among *metalistas*, and the failure to take into account contemporary views on convertibility. There is no disputing that *metalistas* generally opposed the creation of new banks of issue, as revealed by analysis of the records of the meetings of the Seção de Fazenda. Yet, the research has also shown that opposition to deposit and discount banks was much weaker, as a result of contemporary ignorance about the process through which all banks “create” money. This point was clearly demonstrated by Torres Homem’s attempt to charter 17 new deposit and discount banks, in 1859. Moreover, it was shown how previous treatments of monetary debates in nineteenth-century Brazil have often failed to make one crucial distinction between *metalistas* and *papelistas*, namely, their stance on the question of convertibility.⁷ To be fair, earlier works retain the aforementioned contemporary definition of *papelistas*, which was given by the chief *metalista*, Itaboraí. However, in so doing, they overlooked the difference between “ordinary” and “true” *papelistas*. Although both favoured plurality of note issue and an expanding money supply - and, as such, stood opposed to the *metalista* dogma of monopoly of issue and monetary restraint - the thesis has shown that “ordinary” *papelistas* (such as Souza Franco) were in favour of convertibility. In this

⁵ See Sweigart, *Coffee Factorage*.

⁶ See Section 6.3.

⁷ See Saes, *Crédito*; and Andrade, “1864”.

particular point, therefore, they were no different from their *metalista* opponents. On the other hand, “true” *papelistas*, like Mauá, preferred fiduciary, non-convertible, issues to gold-backed ones. In practice, they opposed the gold standard itself, which they felt unsuitable for a small, capital-importing, economy, like Brazil.

Research into the evolving nature of monetary arrangements in the Empire has also allowed two important points of historical fact to be redressed. First, the extent to which Brazil was bound by the rules of the gold standard after 1846. Second, whether conscious, counter-cyclical, policies were pursued at the time. For some authors, when Law 401 established the new official 27d/1\$000 parity, it formally bound Brazil to the rules of the gold standard.⁸ Yet, the thesis has shown that it was only during certain intervals that the first rule of the gold standard - the possibility of redeeming notes in gold at par - was actually observed. Even then, redemption was left at the discretion of the issuing banks, so that more often than not note bearers would be given Treasury notes, not gold, in exchange for convertible banknotes. In all, “potential” convertibility was in force for approximately five years, between 1854 and 1864, and it only covered notes issued by private banks. Treasury notes - which amounted to three-fourths of the total circulation in 1854, falling to one-third in 1864 - remained inconvertible throughout. Still in relation to the monetary standard followed at the time, Schulz has taken the opposite view, claiming that Brazil had never been under gold.⁹ This assertion is equally wrong. Clear proof is provided by the stability of the exchange rate in the periods in which “potential” convertibility existed, when the *milréis* remained at close to its 27d par value. Instead, the research suggests that Brazil adopted a peculiar type of gold standard, in which “potential” redemption of banknotes into gold built credibility into the system, and ensured exchange rate stability.

The thesis has re-established a second point of historical fact, which had led to erroneous interpretations about the extent of the recourse to counter-cyclical monetary policies during the Second Reign. More specifically, it was shown that the decision to abandon convertibility in the wake of a financial crisis, in November 1857, was taken by the Bank of Brazil, not the government. In this regard, Peláez is wrong in

⁸ See for example, Levy and Andrade, “Fundamentos”; and, less emphatically, Peláez and Suzigan, *História Monetária*.

⁹ See Schulz, *A Crise*.

seeing in that move a sign of a conscious governmental effort at counter-cyclical monetary policy.¹⁰ In reality, the Bank was safeguarding its metallic fund, which had been suffering substantial losses since news of the international crisis first reached Rio de Janeiro. Yet, the research does corroborate Peláez's point about the adoption of similar counter-cyclical policies in the wake of the 1864 crisis.

The analysis of monetary and banking policies in the period has also extended current knowledge about two major events - the 1860 banking and corporate law, and the Souto crisis, of 1864. As noted, the 1860 law went down in history as the Law of Impediments, owing to the real, and perhaps imagined, effects it had on economic activity, including the banking sector. According to the traditional view, shared by some contemporaries and later historians, the Law greatly hampered the process of incorporation. Also, by imposing severe limits on the issues of banknotes, it allegedly brought about a veritable "bankicide".¹¹ The thesis does not dispute the assertion that the 1860 legislation somehow restricted the process of incorporation, nor that it curtailed the activities of note issuing banks. Yet, it maintains that part of the claims found in the literature must be put in the correct historical perspective. First, it was shown that the Law did little more than reaffirm the provisions of the 1850 Commercial Code in respect to joint-stock companies. Indeed, its major innovation in relation to the Code concerned the imposition of fines on firms found operating without official approval. Also, other authors have rightly pointed out that the Law of Impediments was no different from contemporary legislation elsewhere in respect to incorporation, which was considered a privilege, not a right.¹² Finally, it could be argued in favour of government supervision of the process of incorporation that it was salutary, since it protected the property rights of eventual investors against mismanagement, or outright fraud.

The other major part of the 1860 legislation, including Decree 2685, of 10 November, dealt with banks of issue. The received view has been that the ceiling

¹⁰ See Peláez, "The Theory". The thesis has also established that suspension of convertibility occurred on 27 November, not 11 November, as earlier imagined.

¹¹ For contemporary criticism of the Law of Impediments, see Soares, *Esboço*; and Milet, *O Meio Circulante*. Several historians have identified the Law with subsequent economic difficulties. See, for example, Cavalcanti, *O Meio*, Vol. 2; Granziera, *A Guerra*; Levy and Andrade, "El Sector"; and Guimarães, "Bancos".

¹² See Barman, "Business".

imposed by the government on unbacked issues led to a major reduction in outstanding note circulation. Yet, the analysis has revealed that, while the limits introduced by the legislation were, in some cases, restrictive, for other banks they provided for a modest expansion of issuing activities. In the end, provincial banks benefited as a whole for their limits increased. By contrast, the Bank of Brazil - and, particularly, its provincial branches - was caught at a point when its issues had been decreasing and, as a result, was forced to scale down its operations. Still, it was shown that the overall (net) result of the new limits for unbacked issues was modest - equivalent to a reduction of 1,000 *contos*, or 2% of average outstanding issues in the first semester of 1859. Clearly, “bankicide” does not accurately reflect the immediate effects of the 1860 banking and corporate law.

Although reductions in banks’ issuing limits was relatively modest, in practice the volume of total outstanding issues (which included Treasury notes) declined dramatically after the Law. As the thesis repeatedly emphasised, issues of the Bank of Brazil were made in proportion to its holdings of either gold or Treasury notes. Given that the Bank was still under obligation to withdraw from circulation 2,000 *contos* in Treasury notes every year, an additional 4,000 *contos* in its own paper - corresponding to the 2:1 issuing ratio - would have to be retired as well, unless its metallic fund could be reinforced. In the medium term, then, monetary contraction indeed followed the Law. But the reason for this had nothing to do with the Law itself but, rather, with the Bank’s obligation to withdraw Treasury notes from circulation, under the contract signed with the government in 1853.

The thesis also remarked that the drop in the money supply in the first years after the Law was not accompanied by a comparable loss of output. One possibility for this paradox, as noted, was that prices dropped to such an extent as to compensate for the monetary contraction. Unfortunately, there are no reliable inflation indices for the pre-1870 period, so that this remains a theoretical conjecture. A more likely explanation refers to the way money supply itself is traditionally measured. In fact, the estimates constructed by Peláez and Suzigan, and used in this research, comprise solely the supply of bank money (including deposits) and Treasury notes. However, at the time there were other types of liabilities that performed functions akin to money. Among these substitutes were promissory notes (*vales*) issued by private

banks (*casas bancárias*), and deposits held by these establishments. The thesis called attention to the fact that issues from private banks were left untouched by the Law of Impediments, which imposed limits, instead, on joint-stock banks. It might have been the case that *casas bancárias* stepped into the space left by the reduced supply of banknotes and Treasury paper, thus providing the economy with additional liquidity not captured by available estimates of the money supply.

The research has also provided new insights into the 1864 financial crisis. Previous analyses of the events - triggered by the failure of Casa Souto - have often interpreted it as a direct result of the monetary contraction following the Law of Impediments. Yet, the thesis has demonstrated that the money supply (M1) in the first semester of 1864 was at a (nominal) level similar to that at the time of the Law, some 96,000 *contos*. It is, therefore, unlikely that a monetary crunch sparked the problems at Souto. Instead, the research suggested that the crisis might have originated in the *casas bancárias* themselves. On the basis of anecdotal contemporary evidence, it was remarked how, free from official supervision, these establishments sometimes overlook essential prudential rules, lending long against short-term liabilities. Although hard evidence - particularly of a statistical type - is clearly lacking, this possibility must also be taken into account in future attempts to explain the origins of the Souto crisis.

In the Introduction, it was noted that the thesis would consist of a monetary and banking history with a political perspective. Although a political economy approach to the monetary question has never been fully attempted, earlier works on this period have sometimes claimed that the evolution of the banking framework roughly followed political events. More specifically, the conferring of a monopoly of note issue on the Bank of Brazil in 1853 constituted the economic facet of the political centralisation obtained around 1850.¹³ In other words, the primacy of the Rio-based *saquarema* Establishment would be reflected in the supposed dominance exercised by the Bank over “commercial circuits” across the Empire. This approach

¹³ See, for example, Levy and Andrade, “Fundamentos”; Melo, *O Norte*; and Guimarães, “Bancos”. Contemporaries at times expressed this view, as well. When discussing the 1859 Torres Homem project of banking reform, deputy Bandeira Duarte argued that ‘no one will fail to see in the project a powerful aid to the centralising system that has been taking over Brazil, and that appears to want to invade everything, aiming as it does, without a doubt, to achieve the principle of banking unity’. See session of 13 July 1859, in *ACD*, Tome III, p. 117.

also suggests that Liberals were usually in favour of plurality of issue and soft money, whereas Conservatives tended to side with monopoly and hard money.¹⁴

However plausible this interpretation of the political economy of banking in the Second Reign may be, it has major shortcomings. First, how was it possible that the interests of the city and province of Rio de Janeiro were so dominant while, at the same time, *fazendeiros* from that very region were constantly complaining about the cost of credit? Clearly, had Rio-based interests been as powerful as these authors suggest, they would have found the means to obtain cheaper credit for themselves and/or friends in the agricultural sector. Repeated complaints and formal petitions issued by groups of *fazendeiros* in the province of Rio are testament to the difficulties they were experiencing in obtaining cheaper credit. Moreover, the Bank was not willing to risk supplying credit directly to agriculture, nor was it allowed by its statutes to lend against mortgages, be they guaranteed by properties in Rio province or elsewhere. Like most private banks, it was interested in maximising profits for its shareholders, not performing a “developmental” role, as expected by some contemporaries, and many historians. In this regard, it is also worth noting that José Antonio Saraiva (Conservative, Bahia), when opposing the Torres Homem project of banking reform in 1859, claimed to have taken the side of what the Minister considered ‘the false ideas propounded by the illustrious commercial class of the Court’.¹⁵ In other words, Rio-based merchants, too, were against a project that ultimately restored a monopoly of note issues in Rio to the Bank of Brazil. In light of this, the existence of a natural “symbiosis” between the Rio merchant community and the Bank of Brazil - which would be teamed up against the rest of the country - must be doubted.

The political model implicit in the works of Levy and Guimarães also suggests that the Bank of Brazil prevailed over the government. Nothing could be more removed from the truth. Indeed, Souza Franco’s authorisation for the establishment of six new banks of issue in 1857-8 hardly squares with the view of an all-powerful Rio-based establishment. This measure represented an end to the Bank’s monopoly

¹⁴ See, for example, Guimarães, “Bancos”, pp. 58-9.

¹⁵ Session of 7 July 1859, in *ACD*, Tome III, p. 52. Saraiva and Torres Homem were referring to the petition sent on 30 June to the Chamber of Deputies, by the Commercial Association of Rio de Janeiro. In it, businessmen criticised the government’s proposed measures relating to the banks of issue.

of note issue, held since 1854. Likewise, in changing the Bank's charter in 1866, the government cancelled its issuing powers, thereby removing a source of profits to the institution. Finally, refusal to increase the Bank's leverage on many occasions provides further evidence that the government was not hostage to the Bank.

The opposite was also true, that is, the Bank was not easily manipulated by the government, as abandonment of efforts to defend the exchange rate in early 1858 clearly showed.¹⁶ As seen in Chapter 3, on the occasion the Bank unilaterally suspended convertibility and, against official advice, lowered its rate of discount, in order to assist firms seeking help. As a matter of fact, the thesis emphasised how the Bank would often clash with the government over its proper role in assisting economic activity, while also ensuring the stability of the *milréis*. The reactions to the Law of Impediments also attest to the conflicting relationship between Bank and government. In fact, the commission set up by the Bank to look into the Law openly contested the convenience, and legality, of the new legislation.¹⁷ In short, the rapport between Bank and government is more complex than it has sometimes been suggested.

The question of the stance on monetary and banking matters maintained by the major political parties is no easier to establish. It was not until the mid-1860s, when monetary debates had receded, that both Liberals and Conservatives first published an actual party programme. Furthermore, empirical evidence about their views is mixed. Liberals, as shown by Jequitinhonha's opposition in the Senate, did not unanimously endorse Souza Franco's decision to charter new issuing banks in 1857-8. Subsequently, approval of the 1860 Law of Impediments counted on a solid Conservative majority in the Chamber of Deputies. Yet, this same majority had earlier rejected the Torres Homem project of corporate and banking reform, which essentially bore the same restrictive spirit. Lastly, a Progressive (that is, dissident

¹⁶ The Bank's independence from the government was keenly defended by its president, Dias de Carvalho, in 1858. Speaking in the Senate about the operation to defend the exchange rate in the previous year, Carvalho was emphatic: 'never had the Minister of Finance sent orders to the bank to draw, or not to draw (bills of exchange). The Minister agreed with the bank on this point (...), each part proceeded according to its sphere of action, and I can guarantee the Senate that if the bank's board of directors were convinced that it was not convenient to undertake the operation with drafts, it would not submit to orders from the Minister'. Session of 14 May 1858, in *ASI*, Tome I, p. 146.

¹⁷ 'The law of 22 August of last year (...) could not have been applied to our establishment without gravely offending our rights, without violating a bilateral contract that cannot be altered without the necessary mutual consent'. Cf. Banco do Brasil, *Parecer Apresentado à Assembléa*, p. 5.

Conservative) cabinet and parliamentary majority saw through exceptional legislation dealing with the Souto crisis of 1864, which helped quell the panic. Two years later, the same forces were responsible for stripping the Bank of Brazil of its issuing rights, and restoring monopoly of issue to the hands of the Treasury. Still, Chapter 5 showed that, on the basis of the debates held in the Chamber of Deputies, it is generally true that Liberals backed economic and political liberty. In the case of banks, this translated into defence of plurality of issue, against the Conservative-supported monopoly. Nevertheless, these “philosophical” positions were mediated by partisan disputes, which served to muddle the picture further still.

Finally, in regard to the central objective of the thesis - namely, to test the hypothesis about the relative autonomy of the imperial State vis-à-vis the planter class, in the context of monetary and banking policy - the following schema was established:

“SOFT MONEY”: depreciated rate of exchange/monetary expansion → plurality of issue → *papelistas* → “developmental” view → *fazendeiros*

“HARD MONEY”: appreciated rate of exchange/monetary restraint → monopoly of issue → *metalistas* → “orthodox” view → imperial government

In Chapter 1, it was argued that, a priori, the planter class tended to favour soft money policies - consisting of monetary laxity and a slipping *milréis*. Contemporaries hoped that this would be achieved via the granting of issuing powers to the largest possible number of banks. Ideologically, this was consistent with what the thesis termed the “developmental” view of the role of banks, which was primarily concerned with their role in financing economic activity. By the same token, the research established that, in principle, the imperial government entertained an opposite set of preferences as regards monetary and banking policies - defined as hard money. Moreover, it was remarked that these policies were pursued with the aim of creating the conditions for the formal pegging of the *milréis* to gold. Essentially, the thesis sought to establish what type of monetary regime was adopted between 1850 and 1870 - one consistent with soft money, or hard money. Depending on the findings, a particular rapport between the imperial State and the planter class could be inferred.

Careful analysis of the changing nature of the monetary regime in imperial Brazil revealed the importance of ideology in the conduct of policy. Ideology in this case was defined in a very loose way, as meaning particular views that people may entertain in regard to what banks should do. The thesis borrowed a framework consisting of three major perspectives on the role of banks - “developmental”, “statist”, and “orthodox”. It was then argued that the “developmental” perspective motivated the demands of planters for cheaper credit for agriculture. It was also shown that most of the scholarly research in the post-Second World War period implicitly embraced this perspective, reflecting contemporary debates about the economic development of Brazil. In looking at past events through “developmental” lenses, most recent writers have succumbed to ahistoricism, that is, they have projected into the past present-day concerns and concepts. In the process, they overlooked a second major approach to the role of banks, embodied in the “orthodox” perspective. Apparently as a reaction to early-twentieth-century monetary historians - who emphatically advocated orthodoxy - many modern writers have failed to recognise the macroeconomic dimension of banking policy. As a result, the concerns of mid-nineteenth-century policymakers with exchange-rate instability, and its effects, are largely ignored in the modern literature.

Contemporaries knew better. They were aware of how excessive monetary expansion might lead to exchange-rate instability and depreciation. As the thesis has shown, they also recognised the income and wealth shifts that large oscillations in the value of the *milréis* could bring about. Finally, policymakers knew perfectly well what would be the implications of a depreciating rate of exchange for the finances of the State. True, like everybody else, they had their personal predilections as far as monetary and banking theory, and policy, were concerned. And, without question, the orthodoxy of the time praised the virtues of the gold standard. In practical terms, this meant pegging the domestic currency to gold, and relinquishing monetary policy autonomy. Yet, if convertibility could not always be maintained, at least it was thought that there should be controls over the process of monetary creation by the private sector. In the eyes of most nineteenth-century policymakers, this implied checking the expansion of banks of issue. As the research revealed, many contemporaries wrongly assumed that only banks entrusted with issuing powers were

capable of altering the money supply, a mistake implicitly followed by historians writing with the “developmental” perspective in mind.

The thesis further argued that the “orthodox” perspective involved concerns with what would currently be seen as typical central bank functions. Even though central banking theory was still some decades away, policymakers who sought to invest the Bank of Brazil with the task of looking over the money supply and, indirectly, the rate of exchange, were ultimately concerned with defending the value of the national currency. This is what central banks are expected to do nowadays. But at the time, modern instruments were lacking. There was no requirement for commercial banks to deposit part of their reserves with the Bank of Brazil. Nor could the Bank influence overall liquidity via open market operations. In addition, the Bank had to face competition in the note issuing business. Its actions, then, could always be countered by the other banks of issue. Furthermore, as a private, profit-maximising, institution, the Bank had difficulty in performing typical central bank duties, such as acting as a lender of last resort, lest it overburden its own portfolio. Finally, by making the Bank’s note issues contingent on the volume of specie and Treasury notes in its reserve fund - both of which tended to decline over time - the Bank was condemned to scale down its operations. In the end, therefore, the Bank could neither meet the demands of planters, nor fulfil its “proto-central bank” functions, as expected by contemporaries espousing the “orthodox” view of banks.

The research has demonstrated that regardless of the specific difficulties faced by the Bank of Brazil, advocates of hard money triumphed through most of the period. Their voices were present in the Chamber of Deputies, where they shared space with those arguing a “developmentalist” view. Yet, in view of the Conservative majority in the lower House, support for monetary expansion was constrained by the more orthodox preferences that the party entertained. And these preferences were greatly influenced by the views of Itaboraí. The thesis showed how Itaboraí - in his capacity as Minister of Finance, president of the Bank of Brazil and, crucially, long-serving member of the Council of State - set the agenda for monetary management for the period. His condition as *rapporteur* in most of the resolutions taken by the *Seção de Fazenda* ensured that hard money considerations prevailed over more “developmental” demands. To the extent that official policy stemmed from Council

of State resolutions - and given that the Emperor himself appeared to sympathise with financial orthodoxy - it is hardly surprising that hard money was generally followed. Also, as the thesis argued, this approach held sway because it met the interests of a State that was politically capable of enforcing these policies.

To conclude, it should be said that the research would have certainly benefited from access to documents pertaining to preliminary stages of the discussions in Parliament and the *Seção de Fazenda*, even though there is no clear indication if these sources exist. Methodologically, therefore, the approach had to resort to looking solely at the end result of policies in the monetary and banking sphere, that is, those policies that were effectively implemented. In so doing, it emerged that monetary management between 1850 and 1870 was often - but not always - done in accordance with the hard money scenario summarised above. Starting with the 1846 Law, which established the 27d/1\$000 parity, hard money policies were observed in 1853 (when the third Bank of Brazil was founded), and culminated with the 1860 banking and corporate law. However, it was also remarked that departures from hard money were more frequent than usually claimed. Not only was the chartering of six new banks of issue, in 1857-8 an exception to orthodoxy, counter-cyclical reaction to the 1864 crisis, and the monetary expansion throughout the Paraguayan War were clearly unorthodox. In the end, then, the thesis argues that the imperial government displayed what could be termed “pragmatic conservatism” in its approach to monetary and banking questions. It was, therefore, willing to compromise on its hard money beliefs in cases of *force majeure*, such as the Souto crisis and the war against Paraguay.

Be that as it may, the fact remains that under normal circumstances, monopoly of note issue, monetary restraint, convertibility, and a high rate of exchange were pursued as an objective of policy. As argued throughout, this was diametrically contrary to the demands from the planter class for plurality of issue, monetary expansion, paper money and a depreciated *milréis*. It is, therefore, safe to conclude that, at least in regard to money and banking, the imperial government enjoyed a degree of autonomy from the economic elite. This lends further support to Holanda’s

claim that ‘the empire of *fazendeiros* (...) in Brazil would only begin with the fall of the Empire’.¹⁸

¹⁸ Holanda, “Do Império”, p. 283.

Appendix 1 - Major Banking and Currency Legislation, 1846-68

Legislation	Date	Content
Law 401	11 September 1846	established new 27d/1\$000 “gold” parity; government must retire paper money from circulation in order to maintain exchange rate at that level
Decree 575	10 January 1849	first attempts to regulate joint-stock banks (Art. 9 and 10)
Decree 596	24 March 1849	approved statutes of the Banco Comercial do Maranhão
Law 552	31 May 1850	authorised the government to replace currency in circulation by provincial notes; total circulation in the Empire could not be increased for any reason (law was never put into practice)
Decree 801	2 July 1851	approved statutes of the “second” Bank of Brazil (Mauá)
Decree 888	22 December 1851	approved statutes of the Banco Comercial de Pernambuco
Law 683	5 July 1853	authorised the government to approve the incorporation of a bank of deposits, discounts and issue, based in Rio
Law 688	15 July 1853	authorised government to lend 4,000 <i>contos</i> in Treasury bills to “second” Bank of Brazil and Banco Comercial do Rio de Janeiro
Decree 1223	31 August 1853	approved statutes of the “third” Bank of Brazil, following merger of the “second” Bank and the Banco Comercial do Rio de Janeiro
Decree 1490	20 December 1854	approved statutes of the Ouro Preto branch of the Bank of Brazil
Decree 1580	21 March 1855	approved statutes of the branches of the Bank of Brazil in Salvador, Recife, São Luís, Belém, Porto Alegre and São Paulo
Decree 1581	2 April 1855	authorised Bank of Brazil to increase issues to up to three times its reserve fund
Decree 1721	5 February 1856	extended 3:1 issuing limit to <i>caixas filiais</i>
Decree 1971	31 August 1857	approved statutes of the Banco Comercial & Agrícola
Decree 2005	24 October 1857	approved statutes of the Banco da Província do Rio Grande do Sul
Decree 2021	11 November 1857	approved statutes of the new Banco de Pernambuco
Decree 2035	25 November 1857	approved statutes of the Banco do Maranhão
Decree 2111	27 February 1858	altered several points in the statutes of the Banco Rural & Hipotecário, giving it the right to issue notes to bearer

		redeemable on demand
Decree 2140	3 April 1858	approved statutes of the Banco da Bahia
Decrees 2383 and 2400	2 April 1859	authorised creation of 17 new deposit and discount banks
Law 1083	22 August 1860	("Law of Impediments") determined resumption of convertibility of banknotes under penalty of progressive reduction of outstanding notes
Decree 2679	3 November 1860	required banks and other corporations to send copies of their statements and other documents to the relevant government department
Decree 2685	10 November 1860	outlined details of new rules applying to note-issuing banks, as determined by Law 1083
Decree 2691	14 November 1860	regulated bankruptcy procedures for banks and other joint-stock companies
Decree 2694	17 November 1860	determined that issues of notes, <i>vales</i> , or other paper payable to bearer would henceforth depend on Legislative approval
Decree 2711	19 December 1860	regulated the creation of banks, joint-stock companies, <i>caixas econômicas</i> and <i>monte-pios</i> , in accordance with Law 1083
Decree 2970	9 September 1862	increased capital of the Bank of Brazil to 33,000 <i>contos</i> ; Comercial & Agrícola liquidated; issuing rights of the Rural & Hipotecário transferred to Bank of Brazil
Decree 3054	28 February 1863	authorised Bank of Brazil to increase issues to three times reserve fund
Decree 3062	16 March 1863	revoked Decree 3054
Decree 3306	13 September 1864	increased Bank of Brazil's issuing rights to 3:1, in order to tackle Souto crisis
Decree 3307	14 September 1864	suspended convertibility of Bank of Brazil notes; notes given legal tender status in the provinces where they had been issued
Decree 3308	17 September 1864	mandated a 60-day moratorium on all payments in the capital and province of Rio de Janeiro
Decree 3309	20 September 1864	regulated bankruptcies of both joint-stock and private banks
Decree 3339	14 November 1864	determined that deposits held by the Bank of Brazil in current account would henceforth be considered as part of its outstanding circulation
Law 1349	12 September 1866	innovated contract between Bank of Brazil and government; Bank loses issuing rights; mortgage department created

Decree 3720	18 October 1866	laid down details for the proper execution of Law 1349
Decree 3739	23 November 1866	approved new statutes of the Bank of Brazil, in accordance with Law 1349
Decree 3814	16 March 1867	mandated gradual withdrawal of Bank of Brazil notes from circulation
Law 1508	28 September 1867	authorised government to issue 50,000 <i>contos</i> in Treasury notes for expenses associated with the Paraguayan War
Decree 4232	5 August 1868	authorised an additional issue of 40,000 <i>contos</i> in Treasury notes, for the same purpose
Decree 4244	15 September 1868	authorised Ministry of Finance to contract domestic “gold” loan of up to 30,000 <i>contos</i> , in order to extend maturity of government debt

Sources: Brasil, *Colleção de Leis e Decretos*, various volumes; A. Cavalcanti, *O Meio Circulante Nacional* (Rio de Janeiro, Imprensa Nacional, 1893, 2 vols.); J. Meili, *O Meio Circulante no Brazil* (Zurich, Jean Frey, 1903); and C. Pacheco, *História do Banco do Brasil* (Banco do Brasil, 1973, 4 vols.).

Appendix 2 - Ministers of Finance, 1848-70

Period in Office	Minister
6 Oct 1848 to 6 Dec 1850	Joaquim José Rodrigues Torres (Visc. de Itaboraí)
6 Dec 1850 to 13 Jan 1851	Paulino José Soares de Sousa (Visc. de Uruguai)
13 Jan 1851 to 12 Feb 1853	Joaquim José Rodrigues Torres (Visc. de Itaboraí)
12 Feb 1853 to 6 Mar 1853	Manuel Felizardo de Sousa e Melo
6 Mar 1853 to 6 Sep 1853	Joaquim José Rodrigues Torres (Visc. de Itaboraí)
6 Sep 1853 to 12 Jan 1855	Honório Hermeto Carneiro Leão (Marquês de Paraná)
12 Jan 1855 to 27 Jan 1855	Antônio Paulino Limpo de Abreu (Visc. de Abaeté)
27 Jan 1855 to 23 Aug 1856	Honório Hermeto Carneiro Leão (Marquês de Paraná)
23 Aug 1856 to 4 May 1857	João Maurício Wanderley (Barão de Cotegipe)
4 May 1857 to 12 Dec 1858	Bernardo de Sousa Franco
12 Dec 1858 to 10 Aug 1859	Francisco de Sales Torres Homem (Visc. de Inhomirim)
10 Aug 1859 to 2 Mar 1861	Ângelo Muniz da Silva Ferraz
2 Mar 1861 to 24 May 1862	José Maria da Silva Paranhos (Visc. de Rio Branco)
24 May 1862 to 30 May 1862	José Pedro Dias de Carvalho
30 May 1862 to 8 April 1863	Antonio Francisco de Paula Holanda Cavalcanti de Albuquerque
8 Apr 1863 to 15 Jan 1864	Miguel Calmon du Pin e Almeida (Marquês de Abrantes)
15 Jan 1864 to 31 Aug 1864	José Pedro Dias de Carvalho
31 Aug 1864 to 12 May 1865	Carlos Carneiro de Campos
12 May 1865 to 4 Mar 1866	José Pedro Dias de Carvalho
4 Mar 1866 to 7 Mar 1866	Francisco de Paula da Silveira Lobo
7 Mar 1866 to 3 Aug 1866	João da Silva Carrão
3 Aug 1866 to 16 Jul 1868	Zacarias de Góis e Vasconcelos
16 Jul 1868 to 29 Sep 1870	Joaquim José Rodrigues Torres (Visc. de Itaboraí)

Source: J. A. Pinto de Carmo, *Ministros da Fazenda, 1822-1930* (Rio de Janeiro, Ministério da Fazenda, 1944).

Statistical Appendix

	Total Deposits	M1	M2	reserves as % of demand deposits	reserves as % of total deposits	currency held by public as % of M1	currency held by public as % of M2	Multipliers	
	(12)=(8)+(11)	(13)=(5)+(8)	(14)=(11)+(13)	(4)/(8)*100	(4)/(12)*100	(5)/(13)*100	(5)/(14)*100	M1 as multiple of H (13)/(1)	M2 as multiple of H (14)/(1)
1852.I	13,6	45,8	57,6	238,9	31,6	96,1	76,4	0,95	1,19
1852.II	16,4	46,1	60,6	242,1	28,0	95,9	72,9	0,94	1,24
1852.III	16,6	46,9	61,5	190,0	22,9	95,7	73,0	0,96	1,26
1852.IV	19,7	49,2	66,7	150,0	16,8	95,5	70,5	0,98	1,33
1853.I	19,8	49,7	67,4	161,9	17,2	95,8	70,6	0,97	1,32
1853.II	18,3	49,4	65,3	183,3	24,0	95,1	72,0	0,96	1,27
1853.III	18,9	49,8	65,9	167,9	24,9	94,4	71,3	0,96	1,27
1853.IV	19,1	49,1	65,6	211,5	28,8	94,7	70,9	0,94	1,26
1854.I	8,9	48,3	56,3	344,4	34,8	98,1	84,2	0,96	1,11
1854.II	14,4	58,2	69,3	75,8	17,4	94,3	79,2	1,01	1,21
1854.III	16,8	61,0	72,6	61,5	19,0	91,5	76,9	1,03	1,23
1854.IV	16,2	64,6	76,4	77,3	21,0	93,2	78,8	1,02	1,20
1855.I	15,5	65,6	76,8	83,7	23,2	93,4	79,8	1,01	1,18
1855.II	15,0	65,9	76,1	102,1	32,7	92,7	80,3	1,00	1,15
1855.III	14,3	66,1	76,4	122,5	34,3	93,9	81,3	0,99	1,14
1855.IV	15,8	70,6	80,1	76,2	30,4	91,1	80,3	1,02	1,16
1856.I	16,5	71,8	80,8	68,0	30,9	89,6	79,6	1,03	1,16
1856.II	28,6	85,6	94,7	45,1	30,8	77,2	69,8	1,14	1,26
1856.III	13,5	72,5	81,2	247,9	88,1	93,4	83,4	0,91	1,02
1856.IV	13,2	78,8	87,5	257,8	87,9	94,3	84,9	0,92	1,02
1857.I	12,0	85,2	93,2	255,0	85,0	95,3	87,1	0,93	1,02
1857.II	13,3	90,8	99,1	168,0	63,2	94,5	86,6	0,96	1,05
1857.III	17,8	98,0	106,4	83,0	43,8	90,4	83,3	1,02	1,10
1857.IV	23,8	100,3	111,2	59,7	32,4	87,1	78,6	1,05	1,17
1858.I	24,3	88,7	100,3	74,8	39,1	85,7	75,8	1,04	1,17
1858.II	29,1	98,7	113,0	65,5	33,3	85,0	74,2	1,05	1,21
1858.III	32,0	95,2	107,2	60,0	37,5	79,0	70,1	1,09	1,23
1858.IV	28,8	96,5	108,1	77,3	46,2	82,2	73,4	1,04	1,17

	Total Deposits	M1	M2	reserves as % of demand deposits	reserves as % of total deposits	currency held by public as % of M1	currency held by public as % of M2	Multipliers	
	(12)=(8)+(11)	(13)=(5)+(8)	(14)=(11)+(13)	(4)/(8)*100	(4)/(12)*100	(5)/(13)*100	(5)/(14)*100	M1 as multiple of H	M2 as multiple of H
								(13)/(1)	(14)/(1)
1859.I	27,3	95,8	109,0	100,7	52,0	85,3	75,0	1,00	1,14
1859.II	29,1	97,5	111,0	85,9	46,0	84,0	73,8	1,02	1,16
1859.III	27,4	93,4	108,0	105,5	49,3	86,3	74,6	0,99	1,15
1859.IV	26,2	96,2	110,3	100,0	46,2	87,4	76,2	1,00	1,15
1860.I	34,0	99,2	113,8	46,4	26,5	80,4	70,1	1,12	1,28
1860.II	34,4	98,2	113,0	49,0	27,9	80,0	69,6	1,11	1,28
1860.III	34,0	92,9	109,0	55,3	29,1	80,7	68,8	1,09	1,28
1860.IV	35,6	96,2	111,8	50,0	28,1	79,2	68,2	1,12	1,30
1861.I	37,8	85,9	100,9	84,2	50,8	73,5	62,5	1,04	1,23
1861.II	36,2	80,3	93,6	101,7	64,4	71,5	61,3	1,00	1,16
1861.III	39,1	77,5	92,3	101,6	63,2	68,6	57,6	0,99	1,18
1861.IV	38,2	85,0	98,9	82,3	52,4	71,4	61,4	1,05	1,23
1862.I	38,3	82,9	97,4	76,5	47,5	71,3	60,7	1,07	1,26
1862.II	38,9	84,5	98,3	68,1	44,0	70,3	60,4	1,10	1,28
1862.III	46,8	83,5	101,6	73,9	45,3	65,6	53,9	1,10	1,34
1862.IV	38,5	86,7	99,3	62,5	42,1	70,1	61,2	1,13	1,29
1863.I	36,6	93,2	103,3	44,2	32,0	71,6	64,6	1,19	1,32
1863.II	44,7	93,3	107,9	48,5	32,7	67,7	58,6	1,20	1,39
1863.III	40,9	84,8	96,2	68,1	49,1	65,2	57,5	1,12	1,28
1863.IV	40,2	95,1	104,1	53,5	41,5	67,2	61,4	1,18	1,29
1864.I	35,5	96,2	105,8	48,3	35,2	73,1	66,4	1,16	1,28
1864.II	44,8	98,0	112,9	49,2	32,8	69,5	60,3	1,18	1,36
1864.III	48,8	108,8	124,4	59,6	40,6	69,5	60,8	1,14	1,30
1864.IV	44,7	112,7	128,9	50,9	32,4	74,7	65,3	1,14	1,31
1865.I	39,1	117,6	129,0	39,0	27,6	76,4	69,7	1,17	1,28
1865.II	37,9	116,9	130,3	47,3	30,6	79,0	70,9	1,12	1,25
1865.III	42,7	121,7	134,8	42,2	29,3	75,7	68,3	1,16	1,29
1865.IV	37,4	127,2	137,2	33,2	24,3	78,5	72,7	1,17	1,26
1866.I	44,0	136,7	150,4	21,1	14,5	77,8	70,7	1,21	1,33
1866.II	33,3	138,1	148,2	33,6	23,4	83,2	77,5	1,13	1,21
1866.III	40,4	142,8	153,9	38,9	28,2	79,5	73,7	1,14	1,23
1866.IV	35,9	138,1	150,8	37,1	24,0	83,2	76,2	1,12	1,22

	Total Deposits	M1	M2	reserves as % of demand deposits	reserves as % of total deposits	currency held by public as % of M1	currency held by public as % of M2	Multipliers	
	(12)=(8)+(11)	(13)=(5)+(8)	(14)=(11)+(13)	(4)/(8)*100	(4)/(12)*100	(5)/(13)*100	(5)/(14)*100	M1 as multiple of H	M2 as multiple of H
								(13)/(1)	(14)/(1)
1867.I	33,1	127,6	137,7	54,8	38,1	82,0	76,0	1,09	1,17
1867.II	37,8	133,7	147,8	59,5	37,3	82,3	74,4	1,08	1,19
1867.III	38,3	146,6	159,0	37,8	25,6	82,3	75,9	1,12	1,22
1867.IV	36,3	149,4	160,5	40,1	27,8	83,1	77,4	1,11	1,19
1868.I	37,0	158,6	169,9	24,5	17,0	83,8	78,2	1,14	1,22
1868.II	36,8	159,9	170,7	45,4	32,1	83,7	78,4	1,10	1,17
1868.III	42,9	175,2	188,1	23,3	16,3	82,9	77,2	1,15	1,24
1868.IV	41,2	181,7	194,1	20,5	14,3	84,1	78,8	1,14	1,22
1869.I	41,9	195,7	205,9	19,6	14,8	83,8	79,7	1,15	1,21
1869.II	42,1	199,2	209,9	23,2	17,3	84,2	79,9	1,14	1,20
1869.III	47,6	222,9	233,8	22,1	17,0	83,5	79,6	1,15	1,20
1869.IV	37,8	221,9	232,2	20,0	14,6	87,6	83,7	1,11	1,16
1870.I	40,6	229,4	241,4	16,1	11,3	87,5	83,2	1,12	1,18
1870.II	45,4	216,9	229,9	25,9	18,5	85,1	80,3	1,12	1,19
1870.III	44,9	215,0	227,3	33,7	24,5	84,8	80,2	1,11	1,18
1870.IV	51,3	217,2	236,1	27,8	17,5	85,1	78,3	1,12	1,22

Table A2 - TOTAL NOTES OUTSTANDING, BY ISSUER: 1854-66
(in contos '000)

year	Treasury		Bank of Brazil				Other Banks		Total
		%	Head Office	%	Branches	%		%	
1854	46.692,8	75,0	15.530,7	25,0	-	-	-	-	62.223,5
1855	46.692,8	68,9	21.062,9	31,1	-	-	-	-	67.755,7
1856	45.692,8	53,3	27.488,2	32,0	12.609,1	14,7	-	-	85.790,1
1857	43.676,7	44,7	33.175,0	34,0	20.860,9	21,3	-	-	97.712,6
1858	41.664,6	45,0	22.125,5	23,9	19.811,3	21,4	8.967,7	9,7	92.569,1
1859	40.700,6	42,4	21.889,8	22,8	18.972,1	19,7	14.510,7	15,1	96.073,2
1860	37.599,9	42,0	22.626,3	25,3	16.189,9	18,1	13.038,7	14,6	89.454,8
1861	35.108,4	42,8	18.131,9	22,1	15.258,2	18,6	13.513,1	16,5	82.011,6
1862	33.323,6	43,3	20.152,4	26,2	18.556,0	24,1	4.843,0	6,3	76.875,0
1863	30.594,4	37,5	27.297,3	33,4	19.654,6	24,1	4.115,6	5,0	81.661,9
1864	29.094,4	29,2	43.168,0	43,4	23.270,5	23,4	4.030,8	4,0	99.563,7

Note: Figures are for end of year. Data not comparable with estimates of the monetary base presented in Table A1.

Sources: Treasury notes in *Legislação Sobre Papel Moeda* (Rio de Janeiro, Imprensa Nacional, 1923);

Bank of Brazil, from Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas*, various issues; other banks, *Relatorio da Commissão de Inquerito Nomeada por Aviso do Ministerio da Fazenda, de 10 de Outubro de 1859* (Rio de Janeiro, undated), and *Relatorio da Commissão Encarregada pelo Governo Imperial por Aviso do 1o. de Outubro e 28 de Dezembro de 1864, de proceder a um inquerito sobre as causas principaes e accidentaes da crise do mez de setembro de 1864* (Rio de Janeiro, Typ. Nacional, 1865).

Table A3 - BRAZILIAN BANKS OF ISSUE AND THEIR MAIN ACCOUNTS, 1850-59
(in *contos*)

Year/Banks	capital	issues	deposits	loans
1850				
Banco Comercial Rio	2.500	5	7.526	9.839
Banco Comercial Bahia	2.000	1.000	1.458	4.236
Banco Comercial Maranhão	370	142	464	4
1851				
Banco Comercial Rio	5.000	2	7.395	10.243
Banco Comercial Bahia	2.000	1.000	1.582	4.205
Banco Comercial Maranhão	390	190	516	26
Bank of Brazil (Mauá)	2.000	98	5.138	4.665
1852				
Banco Comercial Rio	5.000	257	12.508	3.277
Banco Comercial Bahia	1.000	1.934	4.822	552
Banco Comercial Maranhão	500	241	726	43
Bank of Brazil (Mauá)	4.999	1.594	6.801	11.149
Banco de Pernambuco	838	500	141	1.371
1853				
Banco Comercial Rio	5.000	1.574	10.758	14.734
Banco Comercial Bahia	2.000	1.000	2.565	4.771
Banco Comercial Maranhão	524	298	801	10
Bank of Brazil (Mauá)	8.000	1.938	5.763	14.028
Banco de Pernambuco	1.000	500	67	1.500
1854				
Banco Comercial Bahia	2.000	1.000	2.294	4.848
Banco Comercial Maranhão	680	339	1.010	61
Bank of Brazil (Mauá)	8.000	1.880	6.464	14.150
Banco de Pernambuco	1.400	700	n.a.	n.a.
'third' Bank of Brazil	11.000	16.125	3.255	20.493
1855				
Banco Comercial Bahia	2.000	100	1.457	4.056
Banco Comercial Maranhão	680	325	924	65
Banco de Pernambuco	1.700	850	276	2.046
Bank of Brazil (head office)	15.900	21.300	3.605	25.598
1856				
Banco Comercial Bahia	2.000	1.000	817	2.463
Banco Comercial Maranhão	81	44	n.a.	n.a.
Bank of Brazil (head office)	19.752	27.829	1.489	32.574
Bank of Brazil (branches)	4.540	16.179	n.a.	7.791
1857				
Bank of Brazil (head office)	22.560	34.007	9.545	46.294
Bank of Brazil (branches)	6.140	22.966	1.760	14.295
1858				
Bank of Brazil (head office)	22.560	35.209	15.263	32.470
Bank of Brazil (branches)	5.932	29.460	462	18.493
Banco Com. e Agrícola	5.822	5.490	44	6.509
Banco do Maranhão	1	430	6	737
Banco da Bahia	2.401	1.255	940	5.606
Novo Banco de Pernambuco	1.431	1.462	271	2.406
1859				
Banco Rural & Hipotecário	8.000	1.926	12.832	20.528
Bank of Brazil (head office)	22.560	36.334	9.639	23.349
Bank of Brazil (branches)	5.940	29.124	583	23.052
Banco Com. & Agrícola	7.313	7.238	358	9.234
Bco. Prov. Rio Grande	590	1	300	824
Banco do Maranhão	42	680	183	938
Banco da Bahia	4.000	3.200	20.017	n.a.
Novo Banco de Pernambuco	2.000	1.466	304	2.702

Notes: Figures are for end of year.

Banking establishments for which data could not be found were omitted.

n.a. = not available

Source: Adapted from M. B. Levy and A. M.R. de Andrade, "Fundamentos do Sistema Bancário no Brasil: 1834-1860", Estudos Econômicos, Vol. 15, No. Especial, 1985, pp. 47-8.

Table A4 - BANK OF BRAZIL: SELECTED INDICATORS, 1854-60
(in contos)

Date	Head Office			Branches (**)		
	<i>Fundo Disponivel</i>	Notes in Circulation	Value of Portfolio (*)	<i>Fundo Disponivel</i>	Notes in Circulation	Value of Portfolio
1854						
Apr	4.851,6	2.874,3	6.201,7			
May	5.113,0	6.508,4	12.680,3			
Jun	5.620,9	8.642,7	16.400,0			
Jul	6.119,1	9.113,9	17.375,1			
Aug	6.443,8	10.032,8	17.971,7			
Sep	7.022,4	10.290,5	19.441,2			
Oct	7.540,5	12.964,2	20.174,2			
Nov	8.156,2	14.524,8	19.903,7			
Dec	8.179,2	15.530,7	21.079,4			
1855						
Jan	8.131,0	15.215,0	20.521,4			
Feb	7.698,7	14.804,8	20.623,0			
Mar	7.735,5	16.050,4	22.239,5			
Apr	7.686,2	16.624,2	23.625,8			
May	7.949,6	16.119,5	22.837,7			
Jun	8.815,3	17.159,7	24.120,1			
Jul	9.023,5	17.953,6	24.297,3			
Aug	9.319,3	18.006,8	23.805,7			
Sep	9.915,9	18.999,5	24.213,2			
Oct	10.329,7	18.353,4	23.171,2			
Nov	9.863,4	18.897,0	24.557,1			
Dec	9.878,9	21.062,9	26.542,8			
1856						
Jan	8.954,6	20.220,9	25.628,5	431,5	403,2	33,1
Feb	8.251,1	20.401,3	26.430,7	455,8	536,6	48,0
Mar	8.353,6	20.790,1	27.048,7	1.288,7	1.090,2	651,9
Apr	8.957,9	21.665,1	27.532,1	1.240,6	1.352,2	721,0
May	8.775,8	21.873,3	27.637,4	1.116,7	1.578,2	767,4
Jun	9.367,4	23.451,3	29.435,4	5.131,1	4.011,8	2.919,5
Jul	9.978,2	23.252,3	29.096,4	5.996,2	5.943,3	4.463,6
Aug	11.324,8	22.875,5	28.444,0	6.318,7	7.064,4	5.029,4
Sep	11.296,9	25.191,5	30.422,3	6.851,0	8.348,9	5.879,4
Oct	10.576,0	26.027,3	32.174,6	6.904,9	9.907,8	4.519,2
Nov	9.887,0	26.315,3	33.126,3	7.426,2	10.939,4	6.927,5
Dec	10.762,5	27.488,2	33.139,8	7.779,3	12.609,1	8.745,5
1857						
Jan	11.996,5	27.011,2	34.467,0	7.689,7	14.242,1	8.663,6
Feb	11.517,4	26.782,6	34.535,8	7.742,2	15.209,5	9.171,4
Mar	12.254,2	29.047,7	37.893,4	7.707,8	17.060,1	10.393,5
Apr	9.595,3	29.852,4	38.468,4	n.a.	n.a.	n.a.
May	12.023,1	31.303,2	38.796,3	n.a.	n.a.	n.a.
Jun	13.125,7	32.804,9	40.193,7	n.a.	18.157,7	12.031,9
Jul	13.049,8	32.366,8	38.895,4	n.a.	19.459,9	12.479,4
Aug	13.467,1	32.983,5	38.404,6	n.a.	19.356,2	12.074,5
Sep	12.872,1	29.312,9	39.009,9	n.a.	19.327,0	11.569,3
Oct	12.848,2	30.208,4	41.426,4	n.a.	19.388,0	12.208,5
Nov	11.322,7	30.522,3	46.424,5	n.a.	20.218,8	13.301,8
Dec	10.859,3	33.175,0	51.836,6	n.a.	20.860,9	14.291,4

Date	Head Office			Branches (**)		
	<i>Fundo Disponível</i>	Notes in Circulation	Value of Portfolio (*)	<i>Fundo Disponível</i>	Notes in Circulation	Value of Portfolio
1858						
Jan	11.105,8	31.084,8	49.538,5	n.a.	21.201,6	14.921,8
Feb	10.994,1	28.858,1	47.668,3	n.a.	21.346,7	15.538,9
Mar	9.978,8	27.131,6	46.210,5	n.a.	21.621,8	16.406,2
Apr	8.877,3	24.545,9	43.843,4	n.a.	21.354,2	16.313,3
May	8.929,6	23.418,4	42.965,2	n.a.	20.975,3	16.119,3
Jun	8.753,0	25.607,0	45.780,0	n.a.	20.322,0	15.992,3
Jul	8.974,5	23.620,0	44.868,7	n.a.	20.436,3	16.089,7
Aug	9.482,1	20.874,0	39.541,4	n.a.	20.281,6	16.441,8
Sep	10.994,2	18.848,7	38.912,2	n.a.	19.373,2	16.108,5
Oct	11.216,3	19.349,2	36.994,9	n.a.	18.971,9	16.637,9
Nov	11.430,4	19.661,9	35.609,0	n.a.	19.146,7	17.037,9
Dec	11.379,8	22.125,2	33.784,2	n.a.	19.811,3	18.492,5
1859						
Jan	9.305,6	21.242,5	32.785,0	n.a.	20.986,7	19.786,9
Feb	9.319,4	19.093,3	29.620,1	n.a.	21.416,0	21.206,1
Mar	9.225,0	20.330,8	29.476,7	n.a.	21.700,1	22.229,6
Apr	7.471,1	19.196,2	29.201,3	n.a.	22.473,2	22.016,5
May	7.636,6	18.008,5	28.357,8	n.a.	21.703,5	21.409,1
Jun	7.696,2	18.974,4	27.996,1	n.a.	21.523,2	20.914,3
Jul	8.098,0	18.530,6	26.297,1	n.a.	19.516,5	20.642,0
Aug	8.127,8	20.172,7	25.162,9	n.a.	18.913,9	20.507,9
Sep	7.903,7	19.831,5	23.555,2	n.a.	18.434,5	20.192,3
Oct	7.186,6	20.564,9	23.006,4	n.a.	17.802,2	21.560,0
Nov	7.390,7	20.272,4	22.853,0	n.a.	18.234,1	21.953,9
Dec	7.170,5	21.889,8	24.205,1	n.a.	18.972,1	22.616,5
1860						
Jan	6.857,4	19.044,9	22.500,3	n.a.	18.897,4	23.244,6
Feb	6.774,2	18.158,2	22.011,5	n.a.	19.218,7	23.037,4
Mar	7.114,9	17.846,5	21.251,2	n.a.	19.234,2	22.301,6
Apr	6.820,8	17.768,5	23.808,9	n.a.	18.366,6	20.913,5
May	7.345,9	17.376,3	24.040,9	n.a.	18.639,2	20.162,8
Jun	7.718,5	19.176,9	26.601,0	n.a.	18.342,8	19.167,7
Jul	7.651,3	18.743,1	24.920,9	n.a.	17.493,7	18.094,9
Aug	9.051,7	19.331,2	26.240,0	n.a.	17.125,8	17.553,3
Sep	9.484,9	20.545,6	26.089,0	n.a.	15.891,0	16.802,9
Oct	9.369,8	21.018,3	26.516,4	n.a.	15.538,6	16.626,7
Nov	9.087,6	21.331,4	26.929,1	n.a.	16.472,7	16.663,5
Dec	9.484,8	22.626,3	27.943,0	n.a.	16.189,9	16.540,7

Note: (*) From April 1854 to June 1855 figures are not for the end-period.

(**) Bank of Brazil branches started issuing notes as follows: Ouro Preto and São Paulo in January 1856; Porto Alegre in March; Salvador, Recife and São Luís in June; and Belém in July.

Source: Banco do Brasil, *Relatório Apresentado à Assembléa Geral dos Accionistas*, various issues.

Table A5 - BANK OF BRAZIL, HEAD OFFICE: PORTFOLIO BALANCES
(in contos)

Date	Discounts (a)	Payments (b)	Portfolio Balances (c)=(a)-(b)
30 June 1854	19.375,0	3.075,1	16.299,9
30 June 1855	99.258,6	75.138,5	24.120,1
30 June 1856	120.442,9	91.007,5	29.435,4
30 June 1857	128.453,0	117.694,7	10.758,3
30 June 1858	208.250,6	162.470,6	45.780,0
30 June 1859	165.236,7	137.270,6	27.966,1
30 June 1860	110.068,0	83.467,0	26.601,0
36 June 1861	121.052,7	94.350,9	26.701,8
30 June 1862	130.328,8	99.900,2	30.428,6
30 June 1863	183.204,3	138.099,9	45.104,4
30 June 1864	178.600,6	141.261,3	37.339,3
30 June 1865	284.739,3	213.364,2	71.375,1
30 June 1866	346.516,3	265.388,9	81.127,4

Source: Banco do Brasil, *Relatorio Apresentado á Assembléa Geral dos Accionistas*, various issues.

Table A6 - AVERAGE RATES OF DISCOUNT AT RIO BANKS, 1850-60
(in %)

period	rate	period	rate
1850		1856	
1 Jan to 16 Jan	7	1 Jan to 27 Nov	8
17 Jan to 31 Jul	8	28 Nov to 31 Dec	8
1 Aug to 31 Dec	7		
		1857	
1851		1 Jan to 11 Jan	9
1 Jan to 16 Apr	7	12 Jan to 6 May	8
17 Apr to 22 Apr	6,5	7 May to 13 Aug	9
23 Apr to 2 Nov	6	14 Aug to 14 Dec	8
3 Nov to 31 Dec	5	15 Dec to 23 Dec	10
		24 Dec to 31 Dec	11
1852			
1 Jan to 9 Jul	5	1858	
10 Jul to 31 Dec	6	1 Jan to 27 Jan	11
		28 Jan to 10 Feb	10
1853		11 Feb to 24 Aug	9
1 Jan to 28 Apr	6	25 Aug to 11 Oct	11
29 Apr to 31 May	7	12 Oct to 3 Nov	10
1 Jun to 30 Jun	8	4 Nov to 20 Dec	9
1 Jul to 31 Aug	9	21 Dec to 31 Dec	8
1 Sep to 26 Sep	8		
27 Sep to 29 Nov	7	1859	
30 Nov to 31 Dec	7	1 Jan to 8 Jun	8
		9 Jun to 31 Dec	8
1854			
1 Jan to 23 Apr	8	1860	
24 Apr to 31 Dec	8	1 Jan to 31 Mar	9
1855			
1 Jan to 3 Apr	7		
4 Apr to 31 Dec	8		

Note: Rates refer to bills with two known signatures and, therefore, can be regarded as a minimum ("prime") rate.

Source: *Relatorio da Comissão de Inquerito Nomeada Por Aviso do Ministerio da Fazenda, de 10 de Outubro de 1859* (undated), Annex.

Table A7 - EXCHANGE-RATE ON LONDON, 1850-70
(in pence per *milréis*)

Year	Low	High	Average
1850	26 3/4	28	n.a.
1851	27 1/2	30 1/2	29 1/8
1852	28 3/4	30 1/4	27 7/16
1853	27 1/2	29 1/4	28 1/2
1854	26 1/2	28 5/8	27 5/8
1855	27	28	27 9/16
1856	27	28 1/4	27 9/16
1857	23 1/2	28	26 5/8
1858	23 3/4	27	25 9/16
1859	23 1/4	27	25 1/16
1860	24 1/2	27 1/4	25 13/16
1861	24 1/2	26 3/4	25 9/16
1862	24 3/4	27 3/4	26 5/16
1863	26 3/4	27 1/8	27 1/4
1864	25 1/2	27 3/4	26 3/4
1865	22 3/8	27 1/4	25
1866	22	26	24 1/4
1867	19 3/8	24	22 7/16
1868	14	20	17
1869	18	20	18 13/16
1870	19 5/8	24 3/4	22 1/16

Sources: Highs and Lows in *Legislação Sobre Papel-Moeda* (Rio de Janeiro, Imprensa Nacional, 1923); average from J. C. da Fontoura, *Documentação para o Histórico das Tarifas Aduaneiras no Brasil, 1808-1889* (Rio de Janeiro, J. Leite, undated), p. 104.

Table A8 - RATE OF EXCHANGE IN THE RIO MARKET, OCT 1857-SEP 1858
(in pence per *milréis*)

1857				1858			
10/out	27 1/4	27 3/8		08/mai	25 1/2		
12/out	27 1/4	27 3/8		10/mai	25 1/2		
14/out	27 1/4	27 3/8	27 1/2	11/mai	25 1/2		
				12/mai	25 1/2		
05/nov	27 1/4			14/mai	25 1/2		
06/nov	27 1/4						
07/nov	27 1/4	27 3/8		04/jun	25 1/2		
10/nov	27	27 1/4		05/jun	25 1/2		
11/nov	27	27 1/4		07/jun	25 1/2		
12/nov	27 1/8			18/jun	27		
13/nov	27	27 1/8		22/jun	26		
				23/jun	25 1/2		
14/dez	26 1/4			26/jun	25 1/2		
15/dez	26						
30/dez	24			03/jul	25 1/2		
31/dez	23 1/2	24		05/jul	25 1/2		
				06/jul	25 1/2	26 1/8	
1858				07/jul	26	26 1/4	
09/jan	24			08/jul	26		
11/jan	24			09/jul	26		
12/jan	25			15/jul	25 3/4		
13/jan	25	25 1/4		26/jul	27		
06/fev	25			03/ago	26		
08/fev	24 1/2	24 3/4		04/ago	25 7/8	26	
09/fev	24 1/2			05/ago	25 3/4	26	
10/fev	24	24 1/4	24 1/2	06/ago	25 3/4	26	
11/fev	24	24 1/4		24/ago	26		
12/fev	24			28/ago	26 5/8		
13/fev	24			30/ago	26 5/8		
				31/ago	26 5/8		
04/mar	22 3/4						
10/mar	23			01/set	26 3/8	26 3/4	
13/mar	25 1/2			02/set	26 5/8		
15/mar	25 1/2			04/set	26 5/8		
16/mar	25 1/2			06/set	26 5/8		
				18/set	26 3/4		
07/abr	25 1/2			20/set	26 3/4		
08/abr	25 1/4	25 1/2		21/set	26 3/4		
09/abr	25 1/4	25 1/2		22/set	26 3/4		
10/abr	25 1/4	25 1/2		23/set	26 3/4	26 7/8	
12/abr	25 1/2			24/set	26 3/4		
13/abr	25 1/2			25/set	26 3/4		
				28/set	26 3/4		
				30/set	26 5/8		

Note: Rates refer to the only days in which there were actual transactions in the Bolsa.

Source: Arquivo Nacional, Junta de Corretores de Títulos e Valores da Cidade do Rio de Janeiro, "Livro de Registro Oficial de Títulos e Valores", 1858 and 1859.

Table A9 - REVENUE AND EXPENDITURE OF THE IMPERIAL GOVERNMENT, 1849/50 to 1870/1
(in contos)

Fiscal Year	BUDGETED			EFFECTIVE		
	Revenue	Expenditure	Surplus (+) or Deficit (-)	Revenue	Expenditure	Surplus (+) or Deficit (-)
1849/50	25.717,2	26.802,2	-1.085,0	28.200,1	28.949,6	-749,5
1850/1	27.200,0	26.275,7	924,3	32.696,9	33.224,6	-527,7
1851/2	27.200,0	26.275,7	924,3	35.786,8	42.754,8	-6.968,0
1852/3	30.500,0	27.482,8	3.017,2	36.391,0	31.653,5	4.737,5
1853/4	32.353,0	29.633,7	2.719,3	34.516,5	36.234,5	-1.718,0
1854/5	34.000,0	31.153,3	2.846,7	36.985,5	38.740,3	-1.754,8
1855/6	34.000,0	32.441,2	1.558,8	38.634,4	40.242,6	-1.608,2
1856/7	34.000,0	33.785,4	214,6	49.156,4	40.374,0	8.782,4
1857/8	35.500,5	35.500,5	0,0	49.747,0	51.755,7	-2.008,7
1858/9	39.428,1	40.097,1	-669,0	46.920,0	52.718,6	-5.798,6
1859/60	45.000,0	48.302,9	-3.302,9	43.807,4	52.606,2	-8.798,8
1860/1	45.000,0	48.302,9	-3.302,9	50.051,7	52.358,4	-2.306,7
1861/2	49.659,7	51.313,9	-1.654,2	52.488,9	53.049,7	-560,8
1862/3	49.659,7	51.313,9	-1.654,2	48.342,0	57.000,1	-8.658,1
1863/4	51.500,0	53.878,7	-2.378,7	54.801,4	56.494,4	-1.693,0
1864/5	51.500,0	53.878,7	-2.378,7	56.995,9	83.346,2	-26.350,3
1865/6	55.000,0	58.871,7	-3.871,7	58.523,4	121.856,0	-63.332,6
1866/7	55.000,0	58.871,7	-3.871,7	64.776,8	120.889,8	-56.113,0
1867/8	71.250,0	68.530,2	2.719,8	71.200,9	165.984,8	-94.783,9
1868/9	71.250,0	68.530,2	2.719,8	87.542,5	150.894,8	-63.352,3
1869/70	71.250,0	68.530,2	2.719,8	94.847,3	141.594,1	-46.746,8
1870/1	94.100,0	83.326,7	10.773,3	95.885,0	100.074,3	-4.189,3

Sources: IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987); and L. C. Carreira, *História Financeira e Orçamentária do Império no Brasil* (Brasília, Senado Federal, 1980, 2nd edn.).

TABLE A10 - REVENUE AND EXPENDITURE OF THE IMPERIAL GOVERNMENT, 1849-50 to 1870-1
(in sterling '000)

Fiscal Year	Revenues	Expenditures	Balance
1849/50	3.039,8	3.120,6	-80,8
1850/1	3.917,2	3.980,5	-63,3
1851/2	4.574,6	5.186,2	-611,6
1852/3	4.355,1	3.618,0	737,1
1853/4	4.096,9	4.300,8	-203,9
1854/5	4.141,9	4.459,0	-317,1
1855/6	4.435,1	4.619,8	-184,7
1856/7	5.643,0	4.634,8	1.008,2
1857/8	5.511,5	5.734,1	-222,6
1858/9	4.986,2	5.602,4	-616,3
1859/60	4.573,2	5.491,8	-918,6
1860/1	5.380,8	5.628,7	-247,9
1861/2	5.589,9	5.649,6	-59,7
1862/3	5.297,8	6.246,6	-948,8
1863/4	6.221,7	6.413,9	-192,2
1864/5	6.356,9	9.295,8	-2.938,9
1865/6	6.099,3	12.699,9	-6.600,6
1866/7	6.504,4	12.138,8	-5.634,4
1867/8	6.658,0	15.521,3	-8.863,3
1868/9	6.085,3	10.489,0	-4.403,7
1869/70	7.438,4	11.104,5	-3.666,1
1870/1	8.852,8	9.239,6	-386,8

Note: Original values in *milréis* converted into sterling using the implicit rate of exchange derived from trade data, as listed in Table 11.1 of *Estatísticas Históricas*.

Source: IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987), Table 12.1.

Table A11 - IMPERIAL GOVERNMENT REVENUE STRUCTURE, 1849/50 to 1870/1
(in contos)

Fiscal Year	Total Revenue	SOURCE OF REVENUE							
		Imports	(%)	Exports	(%)	Interior	(%)	Other	(%)
1849/50	26.977,8	17.429,4	64,6	3.815,9	14,1	3.884,4	14,4	1.848,1	6,9
1850/1	31.532,8	20.506,6	65,0	4.718,9	15,0	4.462,3	14,2	1.845,0	5,9
1851/2	35.786,8	24.840,3	69,4	4.538,3	12,7	4.466,7	12,5	1.941,5	5,4
1852/3	36.391,0	24.758,2	68,0	4.982,3	13,7	4.702,7	12,9	1.947,8	5,4
1853/4	34.516,5	23.527,1	68,2	3.833,4	11,1	5.045,9	14,6	2.110,1	6,1
1854/5	35.985,0	23.687,6	65,8	4.476,5	12,4	5.906,6	16,4	1.914,3	5,3
1855/6	38.634,4	25.485,0	66,0	4.662,4	12,1	6.229,7	16,1	2.257,3	5,8
1856/7	49.156,4	32.856,3	66,8	6.911,0	14,1	7.065,7	14,4	2.323,4	4,7
1857/8	49.747,0	32.213,4	64,8	6.661,9	13,4	7.945,1	16,0	2.926,6	5,9
1858/9	46.920,0	29.021,8	61,9	7.380,1	15,7	7.922,0	16,9	2.596,1	5,5
1859/60	43.807,3	27.247,1	62,2	5.569,6	12,7	8.329,5	19,0	2.661,1	6,1
1860/1	50.051,7	30.027,6	60,0	7.266,3	14,5	9.107,8	18,2	3.650,0	7,3
1861/2	52.488,9	31.365,4	59,8	8.226,8	15,7	9.427,7	18,0	3.469,0	6,6
1862/3	48.342,2	27.438,0	56,8	8.345,0	17,3	8.880,9	18,4	3.678,3	7,6
1863/4	54.801,4	30.795,4	56,2	9.081,8	16,6	9.510,6	17,4	5.413,6	9,9
1864/5	56.995,9	34.477,7	60,5	9.663,4	17,0	9.343,9	16,4	3.510,9	6,2
1865/6	58.523,4	33.411,5	57,1	10.967,1	18,7	9.319,9	15,9	4.824,9	8,2
1866/7	64.776,8	37.640,1	58,1	10.768,6	16,6	11.658,7	18,0	4.709,4	7,3
1867/8	71.200,9	35.873,9	50,4	15.368,1	21,6	17.137,3	24,1	2.821,6	4,0
1868/9	87.542,5	45.347,0	51,8	18.698,2	21,4	19.374,9	22,1	4.122,4	4,7
1869/70	94.847,3	52.369,6	55,2	17.843,4	18,8	22.255,8	23,5	2.378,5	2,5
1870/1	95.885,3	52.994,5	55,3	14.915,9	15,6	23.379,3	24,4	4.595,6	4,8

Source: Ministério da Fazenda, *Proposta e Relatório Apresentados á Assembléa Geral Legislativa pelo Ministro e Secretario d' Estado dos Negócios da Fazenda*, various issues.

**Table A12 - TOTAL EXPENDITURE AND INTEREST PAYMENTS OF THE IMPERIAL GOVERNMENT
1840/50 to 1870/1 (in contos)**

Fiscal Year	TOTAL EXPENDITURE (a)	Total Interest		Of Which			
		Payments (b)	(b)/(a) (%)	Interest on Domestic Debt	(%)	Interest on Foreign Debt	(%)
1849/50	28.949,6	6.053,6	20,9	3.296,0	11,4	2.757,6	9,5
1850/1	33.224,6	5.964,6	18,0	3.289,1	9,9	2.675,5	8,1
1851/2	42.754,8	6.072,4	14,2	3.400,1	8,0	2.672,3	6,3
1852/3	31.653,5	6.123,7	19,3	3.440,1	10,9	2.683,6	8,5
1853/4	36.234,5	7.582,9	20,9	3.446,3	9,5	4.136,6	11,4
1854/5	38.740,3	6.881,9	17,8	3.447,0	8,9	3.434,9	8,9
1855/6	40.242,6	6.891,7	17,1	3.443,0	8,6	3.448,7	8,6
1856/7	40.374,0	7.207,3	17,9	3.446,3	8,5	3.761,0	9,3
1857/8	51.755,7	7.184,1	13,9	3.439,9	6,6	3.744,2	7,2
1858/9	52.718,6	7.917,6	15,0	3.455,7	6,6	4.461,9	8,5
1859/60	52.606,2	7.504,0	14,3	3.444,5	6,5	4.059,5	7,7
1860/1	52.358,4	7.852,1	15,0	3.893,8	7,4	3.958,3	7,6
1861/2	53.049,7	8.129,6	15,3	4.121,3	7,8	4.008,3	7,6
1862/3	57.000,1	8.218,7	14,4	4.169,2	7,3	4.049,5	7,1
1863/4	56.494,4	8.025,9	14,2	4.562,5	8,1	3.463,4	6,1
1864/5	83.346,2	9.051,5	10,9	4.805,0	5,8	4.246,5	5,1
1865/6	121.856,0	11.477,6	9,4	5.414,3	4,4	6.063,3	5,0
1866/7	120.889,8	16.205,2	13,4	6.402,8	5,3	9.802,4	8,1
1867/8	165.984,8	16.101,4	9,7	7.773,7	4,7	8.327,7	5,0
1868/9	150.894,8	19.748,1	13,1	11.583,4	7,7	8.164,7	5,4
1869/70	141.594,1	22.618,9	16,0	14.525,3	10,3	8.093,6	5,7
1870/1	100.074,3	25.287,9	25,3	17.249,0	17,2	8.038,9	8,0

Note: From the way in which the original figures for interest payments on the foreign debt were published before the 1858-9 financial year it is not possible to ascertain whether the sterling values were converted into *milréis* at the going rate of exchange or at its par value of 27d. This problem disappears after 1858-9, when interest payments are clearly calculated at the average yearly rate of exchange.

Sources: Total expenditures from Ministério da Fazenda, *Proposta e Relatório Apresentados à Assembléa Geral Legislativa pelo Ministro e Secretario d'Estado dos Negócios da Fazenda*, various issues; interest payments from *Balanços da Receita e Despesa do Império*, various issues.

Table A13 - Brazil: Issues of Treasury Notes, 1835-70
(in *contos*)

Purpose	Amount
Replacement of notes issued by the "first" Bank of Brazil and of those given in exchange for copper coins	33,888.1
Deficit financing, in accordance with Legislative Resolution 91, 23 October 1839	6,075.0
Ditto, Legislative Resolution 231, 13 November 1841	4,704.5
Ditto, Legislative Resolution 283, 7 July 1843	1,150.0
Advances to the Treasury in 1845 and 1846	1,185.9
Ditto, between 1865 and 1867	10,220.4
Notes issued in accordance with Law 1349, 12 September 1866, towards:	
payment to Bank of Brazil for Treasury notes in its reserves	3,837.7
purchase of the Bank's metallic fund	25,766.7
payment of the debt incurred by the Treasury with the Bank of Brazil for the paper money retired from circulation	11,000.0
Credit opened by Law 1508, 28 September 1867, for expenses with the Paraguayan War	50,000.0
Issues made in accordance with credit of 40,000 <i>contos</i> opened by Decree 4232, 5 August 1868, for the same purpose	23,389.5
TOTAL	171,217.9

Notes: The excess of the total amount issued over the volume of outstanding Treasury notes in circulation in 1870 is accounted for by the paper money retired from circulation by the Bank of Brazil, as well as losses owing to wear and tear.

Source: *Proposta e Relatorio Apresentados á Assembléa Geral Legislativa Pelo Ministro e Secretario d'Estado dos Negócios da Fazenda*, 1877.

Table A14 - SHORT-TERM LIABILITIES OF THE IMPERIAL TREASURY, 1850-70

(in *contos*)

Year	Notes (<i>notas</i>)	%	Bills (<i>bilhetes</i>)	%	Total
1850	46.884,1	90,8	4.741,0	9,2	51.625,1
1851	46.684,3	90,8	4.741,0	9,2	51.425,3
1852	46.684,3	92,2	3.972,0	7,8	50.656,3
1853	46.692,8	99,7	154,5	0,3	46.847,3
1854	46.692,8	97,1	1.396,0	2,9	48.088,8
1855	46.692,8	92,9	3.586,0	7,1	50.278,8
1856	45.692,8	98,4	756,6	1,6	46.449,4
1857	43.676,7	99,2	366,6 (*)	0,8	44.043,3
1858	41.664,6	99,9	27,0	0,1	41.691,6
1859	40.700,6	99,7	135,0	0,3	40.835,6
1860	37.599,9	85,4	6.410,0	14,6	44.009,9
1861	35.108,4	87,7	4.937,5	12,3	40.045,9
1862	33.323,6	85,1	5.815,0	14,9	39.138,6
1863	30.594,4	78,2	8.541,0	21,8	39.135,4
1864	29.094,4	77,9	8.248,5	22,1	37.342,9
1865	28.090,9	49,1	29.174,0	50,9	57.264,9
1866	28.090,9	41,9	38.986,8	58,1	67.077,7
1867	42.560,4	41,7	59.572,7	58,3	102.133,1
1868	81.749,3	52,9	72.705,6	47,1	154.454,9
1869	127.229,7	66,3	64.575,3	33,7	191.805,0
1870	149.397,6	77,8	42.586,1	22,2	191.983,7

Notes: Notes refer to legal tender Treasury notes, while bills were short-term (less than one year) interest-bearing liabilities.

(*) figure refers to March 1857.

Sources: *Legislação Sobre Papel Moeda* (Rio de Janeiro, Imprensa Nacional, 1923); and Ministério da Fazenda, *Proposta e Relatório Apresentados à Assembléa Geral Legislativa Pelo Ministro e Secretário d'Estado dos Negócios da Fazenda*, various issues.

Table A15 - ISSUES OF 6% BONDS OF THE CONSOLIDATED IMPERIAL DEBT, 1851-72(in *contos*)

Year	Purpose of Issue	Value
1851 to 1853	Deficit financing	5,213.8
1858	Payment of Portuguese claims	5.5
1860 to 1862	Share swaps of the Pernambuco Railway Co.	2,466.4
1860 to 1863	Share swaps of the Bahia Railway Co.	186.6
1860 to 1872	Share swaps of the D. Pedro II Railway Co.	11,328.6
1861 to 1862	Payment to Bank of Brazil for Treasury notes retired from circulation	2,150.0
1863	Compensation for goods captured from the Spanish, as well as in the war of Independence and in the River Plate; payment to Bank of Brazil for Treasury notes retired from circulation	5,890.4
1864	Nationalisation of the União e Indústria Co.	3,161.0
1865	Retirement of Treasury notes; wedding expenses of Princesses Izabel and Leopoldina	1,228.0
1865 to 1872	Expenses incurred in the Paraguayan War	143,894.7
1869	Purchase of property at the Lagoa	50.0
1870	Purchase of the Enxadas Island	1,705.8
1870	Retirement of Treasury notes	25,000.0

Note: Figures do not include the issue of 30,000 *contos* in "national" (gold) bonds made through Decree 4244, 15 September 1868.

Source: *Proposta e Relatório Apresentados à Assembléa-Geral Legislativa Pelo Ministro e Secretario d'Estado dos Negócios da Fazenda - 1877*, Table 22.

Table A16 - OUTSTANDING ISSUES OF LONG-TERM IMPERIAL DEBT, 1849-71
(in contos)

Month/Year	Circulating Debt	Month/Year	Circulating Debt
Sep 1849	51.237,4	Mar 1861	67.450,7
Mar 1851	53.186,8	Dec 1861	68.579,4
Apr 1852	57.474,8	Dec 1863	76.054,4
Mar 1853	57.488,8	Mar 1864	76.777,4
Jan 1854	57.706,0	Mar 1865	80.376,4
Dec 1854	57.774,0	Mar 1866	90.442,2
Dec 1855	57.739,2	Mar 1867	106.350,6
Dec 1856	57.743,8	Mar 1868	125.206,7
Dec 1857	57.747,2	Mar 1869	191.076,5
Dec 1858	57.752,0	Mar 1870	234.312,0
Dec 1859	57.757,0	Mar 1871	280.456,9

Source: Ministério da Fazenda, *Proposta e Relatório Apresentados á Assembléa Geral Legislativa pelo Ministro e Secretario d'Estado dos Negócios da Fazenda*, 1877.

Table A17 - BRAZIL: FOREIGN LOANS, 1850-70

Nominal Value in Sterling	Discount	Final Value	Rate of Interest	Value in <i>milréis</i> at 27d (in <i>contos</i>)	Purpose
1.040.000	5,0%	954.250	4,5%	8.226,9	Payment of remaining part of loan contracted by Portugal in 1823, and taken-up by Brazil
1.526.500	4,5%	1.425.000	4,5%	12.330,4	Nationalisation and extension of the D. Pedro II Railway
508.000	----	508.000	5,0%		Rescheduling of 1829 loan
1.373.000	10,0%	1.210.000	4,5%	10.525,9	Loan for Cia. União e Indústria, Cia. Mucury and Pernambuco Railway Co.
3.855.300	12,0%	3.300.000	4,5%	28.612,1	Liquidation of outstanding part of the 1824 and 1843 loans; and consolidation of part of the floating Treasury debt
6.963.600	26,0%	5.000.000	5,0%	44.444,0	Financing of extraordinary expenses of the Treasury with the Paraguayan War

TABLE A18 - BRAZIL: FOREIGN TRADE STATISTICS, 1849/50 to 1870/1

Fiscal Year	Exports	Imports	Balance	Implicit Rate of Exchange
1849/50	5.932,0	6.378,0	-446,0	9,28
1850/1	8.121,0	9.215,0	-1.094,0	8,35
1851/2	8.083,0	11.264,0	-3.181,0	8,24
1852/3	8.418,0	9.982,0	-1.564,0	8,75
1853/4	9.121,0	10.189,0	-1.068,0	8,43
1854/5	10.439,0	9.803,0	636,0	8,69
1855/6	10.841,0	10.651,0	190,0	8,71
1856/7	13.150,0	14.376,0	-1.226,0	8,71
1857/8	10.669,0	14.446,0	-3.777,0	9,03
1858/9	11.372,0	13.554,0	-2.182,0	9,41
1859/60	11.793,0	11.800,0	-7,0	9,58
1860/1	13.241,0	13.300,0	-59,0	9,30
1861/2	12.857,0	11.771,0	1.086,0	9,39
1862/3	13.424,0	10.868,0	2.556,0	9,13
1863/4	14.892,0	14.267,0	625,0	8,81
1864/5	15.733,0	14.695,0	1.038,0	8,97
1865/6	16.370,0	14.359,0	2.011,0	9,60
1866/7	15.786,0	14.463,0	1.323,0	9,96
1867/8	17.326,0	13.146,0	4.180,0	10,69
1868/9	14.351,0	11.802,0	2.549,0	14,39
1869/70	15.453,0	13.195,0	2.258,0	12,75
1870/1	15.439,0	14.925,0	514,0	10,83

Notes: Trade data are in sterling '000; exchange rate in *milréis* per pound sterling.

The implicit rate of exchange is obtained as the ratio of total foreign merchandise trade (exports + imports) in local currency divided by the corresponding value in sterling.

Source: IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987), Table 11.1.

**Table A19 - TOTAL EXPORTS AND COFFEE EXPORTS,
1849/50 to 1870/1**
(in sterling '000)

Fiscal Year	Total Exports (a)	Coffee Exports (b)	(b)/(a) (in %)
1849/50	5.932	2.462	41,5
1850/1	8.121	3.906	48,1
1851/2	8.083	3.997	49,4
1852/3	8.418	3.874	46,0
1853/4	9.121	4.207	46,1
1854/5	10.439	5.581	53,5
1855/6	10.841	5.512	50,8
1856/7	13.150	6.211	47,2
1857/8	10.669	4.824	45,2
1858/9	11.372	5.340	47,0
1859/60	11.793	6.289	53,3
1860/1	13.241	8.564	64,7
1861/2	12.857	6.257	48,7
1862/3	13.424	6.201	46,2
1863/4	14.892	6.144	41,3
1864/5	15.733	7.151	45,5
1865/6	16.370	6.377	39,0
1866/7	15.786	7.044	44,6
1867/8	17.326	7.818	45,1
1868/9	14.351	6.409	44,7
1869/70	15.453	6.039	39,1
1870/1	15.439	7.766	50,3

Source: IBGE, *Estatísticas Históricas do Brasil* (Rio de Janeiro, IBGE, 1987), Tables 11.1 and 6.43.

Table A20 - COFFEE EXPORTS AND PRICES, 1850-70

Year	Exports (sterling '000)	Exports (^{'000} 60-kg bags)	Average Price in the USA (cents/lb)
1850	2.684	1.969	8,05
1851	3.452	2.411	7,95
1852	3.936	2.384	7,55
1853	4.041	2.280	8,30
1854	4.894	2.660	8,80
1854	5.547	3.022	8,90
1856	5.862	3.021	9,10
1857	5.518	2.785	9,35
1858	5.082	2.558	9,50
1859	5.815	2.630	10,10
1860	7.427	3.048	10,95
1861	7.411	2.996	11,20
1862	6.229	2.278	11,90
1863	6.173	2.070	12,25
1864	6.648	2.325	11,75
1865	6.764	2.541	11,35
1866	6.711	2.797	11,05
1867	7.431	3.359	10,50
1868	7.114	3.682	9,90
1869	6.224	4.486	10,00
1870	6.903	3.471	10,05

Source: M. Martins and E. Johnson, *150 Anos de Café* (Rio de Janeiro, Salamandra, 1992), Statistical Appendix, Tables 1.6 (exports) and 1.8 (prices).

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