COMPETITION IN THE UNDERWRITING MARKETS OF SOVEREIGN DEBT: THE BARING CRISIS REVISITED

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I

INTRODUCTION

An important topic in the literature on capital markets is the role of underwriters as gatekeepers. Underwriters are mainly used by investors to reduce information costs about new issues, thereby improving market efficiency.[1] They are called "reputational intermediaries" because they put their reputation at stake if a new issue turns out to be a failure. Underwriters also act as distributors of new securities, participate in most of the activities related to the pricing and selling of new securities, and give advice to both issuers and investors. Still, for practical purposes, they bear limited responsibility for failures and defaults in the case of sovereign debt. More recent sovereign defaults have involved issues that were equally distributed among all underwriters, with the result that the value of reputation has strongly diminished.[2] In addition, the regulatory framework in place and the emergence of rating agencies in the 1930s have dissolved the gatekeeping functions of these different actors.[3]

The nineteenth century is regarded as a period of high international financial integration, for capital could flow freely across international borders. Underwriting of bonds for foreign governments was an important business, and its expansion was interrupted only by World War I. Financial intermediaries fulfilled a role as sole gatekeepers because this was the only way international capital markets could operate; information asymmetries were high and thus merchant, or investment, banks were the only agents informally responsible for the success of investment in foreign securities. Of course, this system involved

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1. *See* Ronald J. Gilson & Reinier H. Krankman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 621 (1984).

2. *See* Marc Flandreau et al., *The End of Gatekeeping: Underwriters and the Quality of Sovereign Debt Markets, 1815–2007*, at 16 (Nat'l Bureau of Econ. Research, Working Paper No. 15,128, 2009).

3. *See* Royce de R. Barondes et al., *Underwriter's Counsel as Gatekeeper or Turnstile: An Empirical Analysis of Law Firm Prestige and Performance in IPOs*, 2 CAP. MARKETS L.J. 164, 164 (2007) (providing empirical evidence that law-firm prestige affects the performance of IPOs).

other risks such as potential conflicts of interest and occasional overlending during euphoric periods. The first episode of overlending began during the 1820s as the lending boom to the newly independent Latin American countries ended with a series of defaults and the sudden stop of capital exports from London, then the main financial center of the world.[4] A second lending boom occurred during the 1860s and ended similarly, this time with the international crisis of 1873, a second wave of defaults, and attempts by the British authorities to regulate their capital market. By then, a few financial intermediaries had differentiated themselves from the rest by their reputation, for they issued bonds that mostly avoided default. Among these merchant houses were the Barings and the Rothschilds. They also held by far the highest market shares, providing credibility to their gatekeeping function; a bad choice would have negatively affected their reputation and thus, their market power.

This article looks at the third lending boom episode, which took place during the 1880s and ended in 1890 with the so-called Baring crisis. Underwriters in Europe issued loans on behalf of Argentina's municipalities, states, and federal government. Competition pushed them to assume increasing risk exposure, which eventually led to Baring's bankruptcy in 1890 and the need for a rapid bailout orchestrated by the Bank of England. This prevented a banking panic in London but could not avert a sudden stop in capital exports from England to the rest of the world.

This article revisits the episode and focuses on the bargaining power of Argentina's federal government relative to that of the underwriting banks. In particular, it examines how the financial intermediaries' gatekeeping function eroded when faced with increased competition. The fiscal position of Argentina's government deteriorated during those years, mainly due to increased fiscal imbalances and the depreciation of the paper peso. Under normal circumstances, underwriters should have impeded Argentinean access to capital markets or at least hardened the terms under which Argentina could borrow. Instead, underwriters offered better terms and accelerated lending. To demonstrate this phenomenon, this article looks at two particular clauses in debt contracts. First, it examines the clause related to the agreed-upon distribution system. Before the 1880s, Argentina's debt contracts were issued under what is now known as the "best efforts" system. Beginning in 1881, however, new loans were mainly issued under the "firm commitment" system. Second, this article reviews the clause related to the *cost* of each distribution system. Net proceeds for a government under firm commitment generally decrease because banks impose a commission for the risk they incur if they fail to place the bonds. Looking at the purchase prices received by Argentina for its loans, however, this article finds that Argentina's borrowing costs actually decreased during the 1880s. Thus, underwriters assumed the risk from the loan

4. *See* Marc Flandreau & Juan Flores, *Bonds and Brands: Intermediaries and Reputation in Sovereign Debt Markets*: *1820–1830*, 69 J. ECON. HIST. 646, 659 (2009).

issues, but with lower expected gains, giving Argentina greater incentives to overborrow and culminating in the Baring crisis.

II

THE BARING CRISIS: ON ECONOMICS AND BEYOND

A brief overview of more than a hundred years of economic analysis on the Baring crisis may sound too ambitious. However, this financial episode has traditionally been looked at only from a macroeconomic point of view. Conventional explanations have exposed problems mostly on the demand side (mainly Argentina's economic policies). The only existing supply-side theory that explains lender problems has focused on speculative manias.[5]

Scholars initially reasoned that the Baring crisis was due to increasing commercial deficits in Argentina during the 1880s. Because foreign capital flows were necessary to minimize exchange-rate depreciation (foreign debt was denominated in foreign currency), the freezing of these flows translated into exchange-rate depreciation and thus, an external crisis.

Using the same data, other scholars have similarly analyzed the cyclical aspects of external factors (capital flows and exports) and their repercussions on the Argentinean economy.[6] The Baring crisis was preceded by an expansive phase in the world economy and was fed by a rise in demand for external loans by the government. This situation resulted in credit expansion, consumption increase, excessive confidence, and a general feeling of prosperity that translated into financial and property speculation. When the Bank of England raised its interest rates in the late 1880s, capital flows stopped and brought Argentina into the lowest point of its financial crisis.

Adopting a similar view, some scholars have suggested that imbalances in the external sector were responsible for the convertibility failure in the 1880s as a result of the different phases in capital flows: indebtedness was followed by an increase in imports and currency depreciation.[7] When these flows stopped, the debt still had to be serviced—in gold. This phase did not last long because investment returns did not sufficiently compensate for the increase in imports and debt payments. In 1890, Argentina was particularly affected by this imbalance, which was reinforced by the macroeconomic policies of the 1880s that encouraged credit expansion, even though investment returns in the export sector were not yet adequate to cover external payments.

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5. *See* CHARLES H. KINDLEBERGER, MANIAS, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES 25, 101–02 (4th ed. 1978) (describing how speculative manias, or high volume trading in assets at inflated prices, may arise from investment bubbles).

6. *See, e.g.*, Raúl Prebisch, *Anotaciones Sobre Nuestro Medio Circulante. A Propósito del Último Libro del Dr. Norberto Piñero* IX–X, REVISTA DE CIENCIAS ECONÓMICAS (Buenos Aires) 10, serie 2 (10–11): 287–307 (Mayo – Junio 1922) (alternatively, the same article has been published in: Raúl Prebisch: Obras; 1919–1948. Buenos Aires, Fundación Raúl Prebisch, 1991, vol. I, 142–75).

7. *See* ALEC G. FORD, THE GOLD STANDARD, 1880–1914: BRITAIN AND ARGENTINA 102–47 (1962).

Alternatively, the Baring crisis may have had its roots in Argentina's monetary policies.[8] As a response to increases in credit and money supply, the public purchased gold anticipating currency devaluation. This caused reserve outflows and money depreciation, which translated into difficulties for Argentina in meeting the country's debt service.

Others have expanded this view to encompass the fiscal side.[9] The Baring crisis, they have argued, was caused by inconsistent monetary and fiscal policies in Argentina during the 1880s that sought a return to currency convertibility while running persistent fiscal deficits. There was some improvement by 1886, but fiscal matters became fragile in 1888, which affected the public's perception of inflation. This caused people to abandon paper currency for specie, resulting in currency depreciation. These problems were compounded by further money creation to finance deficits and by the impossibility of obtaining access to capital markets.

On the supply side, some writers have questioned investors' rationality and have suggested that the Baring crisis was a typical investment bubble.[10] Low rates of return on British investments and suddenly favorable investment prospects in Argentina caused the displacement necessary for a boom in Argentinean financial assets. The writers argue that the Baring crisis followed a typical euphoria-to-distress path during the 1880s. However, they identify the downturn of the euphoria for Argentinean bonds as occurring in 1888—two years before the outbreak of the crisis—when German investors sold their bonds to their British counterparts even as other investors continued to buy. This has attracted scholars' attention as one of the few historical cases where "enthusiasm of one class of investor for a security failed to communicate itself for long to another."[11] The crisis precipitated when the true state of Argentina became publicly known through the calamitous adverse events of 1890, such as the March technical default and the July political riots in Buenos Aires.

In this author's view, fiscal and monetary policies were full of flaws and investors' sustained purchases were not well advised. By taking into account key features of the nineteenth-century international financial architecture, this article will introduce new elements that led to the crisis. Traditional explanations leave a number of important questions unanswered, including the forecast of the crisis. The deteriorating financial situation of the country in general—and of the fiscal position of the government in particular—did not deter investors from channeling new and increasing funds to Argentina. We can

8. *See* ROBERTO CORTES CONDE, DINERO, DEUDA Y CRISIS: EVOLUCIÓN MONETARIA Y FINANCIERA EN ARGENTINA 155–57 (1989).

9. *See* Gerardo della Paolera, *Monetary and Banking Experiments in Argentina: 1861–1930*, at 540 (Universidad Torcuato Di Tella, Working Paper No. 11, 1995); GERARDO DELLA PAOLERA & ALAN TAYLOR, STRAINING WITH THE ANCHOR: IN SEARCH OF MONETARY STABILITY, ARGENTINA AND THE GOLD STANDARD, 1880–1935, at 133–52 (2001).

10. *See* KINDLEBERGER, *supra* note 5, at 23–47.

11. CHARLES P. KINDLEBERGER, KEYNESIANISM VS. MONETARISM, AND OTHER ESSAYS IN FINANCIAL HISTORY 230 (1985).

only wonder how Argentina managed to maintain its capital-market access in the months before the outbreak of the crisis.[12] Contemporary economists as well as economic historians in their later works adhere to this view, and one pointed out that "[i]n 1886, European investors already began to suspect that the Argentine credit was being overworked."[13] They argue that fear for the stability of Argentine finances existed as early as 1886.[14] Some also suggest that investors could have expected the crisis in early 1888 and remark that the first "technical default" of Argentina was in 1889, more than a year before the crisis.[15]

In fact, reports and publications of the time lead us to support this generalized consensus. Crédit Lyonnais, a French deposit bank that became a leading voice in European financial markets after 1890, advised against investing in Argentina as early as 1887.[16] Michael Mulhall, a recognized statistician on economic matters in South America, suggested prudence about the immediate economic future of the country.[17] The financial press in Europe was increasingly hostile to Argentina, openly referring to the country's financial situation as a "crisis" since 1887.[18] Finally, the publication *Fenn on the Funds* classified Argentina as a problem country in 1889 by calculating an "early warning" debt crisis indicator that took into account the country's debt service and its level of exports.[19]

Surprisingly, the markets' behavior did not reflect these views. Spreads of Argentinean public bonds on U.K. consols remained stable during the late 1880s. Moreover, bonds on behalf of Argentina's federal, provincial, and municipal governments continued to be issued in European financial markets. Although speculation may have been persistent during the last years before the crisis, it likely does not explain the whole story. Besides, a purely macroeconomic view cannot explain what led to the crisis, given that some macroeconomic variables deteriorated considerably in the preceding years. The answer may instead come from a microeconomic perspective, as historians have

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12. From a public finance point of view, some scholars argue that Argentina's troubles began in 1885 with the suspension of the gold exchange standard. *See* JOSE TERRY, LA CRISIS, 1885–1892, at 78–87 (1893). In addition, others have pointed out that the financial policy of Argentina's government in the late 1880s could only lead to bankruptcy. *See* Tim Duncan, *La Política Fiscal Durante el Gobierno de Juarez Célman, 1886–1890*, 23 DESARROLLO ECONÓMICO 479, 479–514 (1984).

13. Max Wirth, *The Crisis of 1890*, 1 J. POL. ECON. 214, 218 (1893).

14. *See* Barry Eichengreen, *The Baring Crisis in a Mexican Mirror*, 20 INT'L POL. SCI. REV. 249, 263 (1999).

15. *See* DAVID JOSLIN, A CENTURY OF BANKING IN LATIN AMERICA 121 (1963); DELLA PAOLERA & TAYLOR, *supra* note 9, at 19.

16. Crédit Lyonnais Archives, DEEF 73405.

17. *See* Michael Mulhall, *Argentine Wealth and Debt,* BUENOS AIRES STANDARD, Feb. 26, 1890 (containing some of Michael Mulhall's estimates on wealth and debt in Argentina).

18. *See, e.g.*, THE BULLIONISH, Aug. 27, 1887 (referring to Argentina's finances as having a "disastrous condition"); THE STATIST, Nov. 3, 1888 (favoring a change in economic policy to prevent a "crash").

19. For a detailed explanation of this index, see MARC FLANDREAU & FREDERIC ZUMER, THE MAKING OF GLOBAL FINANCE, 1880–1913, at 48–49 (2004).

long recognized.[20]

III

NINETEENTH-CENTURY CAPITAL MARKETS FOR SOVEREIGN PUBLIC OFFERINGS

This article tries to fill the gaps in the literature on the Baring crisis by taking into account the industrial organization of international capital markets. One specific channel that is vital in explaining the crisis is the sovereign debt issue mechanism.[21] The sources consulted for this section are both primary and secondary, including classic works mainly concerned with London and Paris bond issues, some German works, debt contracts from bank archives in London and Paris, and associated correspondence.

Classic scholarly works detail how, in the nineteenth century, European financial markets were integrated in many aspects, particularly in sovereign debt bond issues.[22] Analyzing only one market would not create a complete picture of this integration due to the interaction of competition and solidarity between these markets. This article thus focuses on the main differences between financial places and on the role of debt contracts in the whole mechanism.

Bond issuance in the financial markets of the late nineteenth century can be regarded as a four-stage process, although particulars varied according to the countries, intermediaries, and markets involved. The four stages are (1) the search for an intermediary, (2) the choice of an issue system, (3) the planning of the issue, and (4) market placement. The decision on how the bonds were to be issued was made in the first two stages and the terms were formalized in a document—the debt contract—signed by the financial intermediary and the government.

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20. *See* Carlos Marichal, *Los Banqueros Europeos y los Empréstitos Argentinos: Rivalidad y Colaboración, 1880–1890*, 2 REVISTA DE HISTORIA ECONOMICA 47, 75 (1984).

21. Today, this channel is also known as sovereign initial public offerings (IPOs).

22. *See generally* LELAND H. JENKS, THE MIGRATION OF BRITISH CAPITAL TO 1875 (1927); ALEC K. CAIRNCROSS, HOME AND FOREIGN INVESTMENT, 1870–1913: STUDIES IN CAPITAL ACCUMULATION (1953); DAVID FINNIE, CAPITAL UNDERWRITING: AN ACCOUNT OF THE PRINCIPLES AND PRACTICE OF UNDERWRITING CAPITAL ISSUES, TOGETHER WITH A CRITICAL ANALYSIS OF ALL THE MAIN UNDERWRITING AND SUBUNDERWRITING AGREEMENTS (1934); TOSHIO SUZUKI, JAPANESE GOVERNMENT LOAN ISSUES ON THE LONDON CAPITAL MARKET, 1870–1913 (1934). It has been a general practice that these authors use almost the same primary sources. A first and basic reference is an article in *The Banker's Magazine* of July 1876, which describes the evolution of bonds' issues mechanism during the period of 1860 through 1870 (although other press articles are sometimes cited, particularly in Suzuki's work). A second reference is the writings of Henry Osborne O'Hagan, an active stockbroker in foreign loans and an important supporter of banks' syndicalization in order to diminish the risks from bonds' issues. A third and recurrent reference is the work of 2 HENRY D. WOLFF, RAMBLING RECOLLECTIONS (1908). Finally, Leland Jenks primarily uses the "Special Reports from the Select Committee on Loans to Foreign States." United Kingdom House of Commons Select Committee on Loans to Foreign States (Apr. 19, 1875).

A. Searching for an Intermediary

External borrowing through international financial markets required governments to look for an intermediary.[23] In some cases, parliaments enacted laws allowing the government to look for funds for particular projects. Governments could name an agent to negotiate a loan in Europe with financial intermediaries, mainly merchant banks. Banks could also take the initiative and propose their services to potential borrowers, a process facilitated by the close relationships that financial institutions and their agents had already developed with government officials in the course of foreign business operations.[24]

This stage varied across European financial markets. In London, for example, a few merchant banks established several decades before the 1880s dominated the market for bond issues. From 1866, the most prominent banking houses in London were of foreign origin, like Frühling & Goschen or J.S. Morgan.[25] Some had branches in London, like the American house, Morton & Rose, and others operated in main cities on the continent, as was the case for houses like Rothschild and Stern, and also for houses of lesser reputation like Bischoffsheim and Erlangers.[26]

B. Choosing an Issue System

Each bank could differentiate its offered services with respect to specific bonds' issue systems so that choosing a bank and setting a mechanism were jointly decided. First, the issuer and bank had to choose the most appropriate issue system, for which several possibilities existed. The simplest way was to use the system that the French called *vente a commission* or "sale on commission." Banks acted merely as distributors, receiving subscriptions from investors for the purchase of bonds and, more generally, doing every necessary administrative step for the floating of the loan.[27] For each service, banks received a commission as a percentage of each bond handled.[28] If a bond issue failed, the banks held no responsibility. On the other hand, governments might well prefer cash, and receiving it with full certainty often involved the formation of bank syndicates.[29] These syndicates bought part or all of the bonds and then

23. Nowadays, financial intermediaries are called "lead managers."

24. This latter dynamic has been surprisingly overlooked in secondary literature, although it was a general rule for some Latin American countries, particularly Argentina in the 1880s, when bank competition for issues was peaking.

25. *See* JENKS, *supra* note 22, at 267.

26. *See id.* at 268.

27. This system would thus be analogous to today's "best efforts" system.

28. These commissions could take several forms, including placement, *guichet* (counter), and brokerage.

29. One writer defined a financial syndicate as a "means to concentrate capitals, particularly floating capitals, to canalize them to an economic, industrial or financial object." IOUDA TCHERNOFF, LES SYNDICATS FINANCIERS: SYNDICATS D'EMISSION ET DE PLACEMENT, SYNDICATS DE BLOCAGE, SYNDICATS DE RESISTANCE, SYNDICATS DE BOURSE, INVESTMENT TRUST ET HOLDING: SUIVI DE FORMULES D'APPLICATION 5 (1930).

placed them later.[30] This was the most popular system in France and Germany and it also became common practice in other European countries.

In Paris, syndicates were classified into two groups. A "firm offer" syndicate could subscribe a certain amount of bonds or buy directly from the government, taking for itself a part or all of the risk of a bond issue's failure. A "guarantee" syndicate was represented by a manager who, in return for a commission, "committed to find underwriters, otherwise he would take firm the remaining of the issue."[31] This guarantee system was analogous to the *underwriting system* in London.[32] To ensure the success of the bond issue and to diminish the risk of the business, issuers arranged for persons or institutions to take a certain amount of the bonds in the event the public did not subscribe to the entire issue.

By the 1880s, the practice of forming syndicates in London had been developed over several decades.[33] Syndicates had an essential function: to provide a service of risk insurance against market uncertainty and "ensure a firm placement of the loan on the market."[34] Risk sharing between the members of syndicates made the business more attractive, since it decreased the risk of issue due to the borrower as well as the risk associated with high amounts. In addition, syndicates were another means to guarantee the placement of some or all of a government's issue.[35]

C. Planning the Issue

This stage depended completely on the issue system chosen. In the case of syndicates, several terms had to be specified from the very beginning, including the quantity of bonds to be guaranteed, the nominal rate and issue price, and every loan feature; only then could banks decide whether or not they should adhere to the syndicate. Banks also had to agree on other aspects, such as the syndicate's starting date, duration, expenses, and expected benefits. Benefits depended on different commissions and, in the case of the guarantee syndicates, the manager's remuneration. This kind of syndicate also demanded a commission for each bond guaranteed, a placement commission for the unsold bonds (to be distributed between the members of the syndicate), and a counter commission. Managers of these syndicates also reserved a part of net benefits for the payment of their commission. On the other hand, underwriting syndicates received the difference between the issue price and the purchase

30. *See* WALTHER LOTZ, DIE TECHNIK DES DEUTSCHEN EMISSIONSGESCHAFTS: ANLEIHEN, KONVERSIONEN UND GRUNDUNGEN 5 (1890). The difference between the price paid by the banks and the price of issue offered to investors is the resulting *underwriting fee*.

31. TCHERNOFF, *supra* note 29, at 34.

32. The term "underwriting" will therefore be used as synonymous with "firm commitment," which is different from today's general practice of bond issuing with no connection to the distribution system utilized.

33. *See* FINNIE, *supra* note 22, at 2–4.

34. SUZUKI, *supra* note 22, at 26.

35. Syndicate participants and underwriters did not need to be the same, although syndicates could be formed to underwrite a loan.

price (that is, the price at which the government sold the bonds). Depending on the terms agreed to in the contract, issue expenses could be absorbed either by the government or by the syndicate. Syndicate participants could be responsible both for the total results of the syndicate operations and for the part assigned to them.[36]

In the underwriting system, issuers contacted institutions or investors who would commit to subscribing the issue in case the public did not take it all. Underwriters were usually business partners of the issuers, brokers (that is, those charged with placing the bonds), or parties that had relationships with the issuers' brokers, such as merchants, manufacturers, or other financial institutions. Merchant bankers active in bond-issue matters usually devoted some of their assets to underwriting operations in their own-issued bonds and in other bonds considered attractive to them.

D. Market Placement

In Paris, for example, there were three ways to place a bond issue. First, a bond could be placed via a public offering, which consisted of an announcement that public subscriptions to an issue were to take place in certain banks or financial institutions designated in the prospectus or other public disclosures.[37] Second, it could be placed through introduction in the stock market, which meant that issuers had to determine the introduction price. However, the limits of price variation were quite narrow.[38] For instance, if similar bonds had already been quoted in the market, the new issue could not then exceed their price. Furthermore, bond issues depended strongly on temporary movements. Some authors maintain that issuers used "ficticious" operations to inflate bond prices.[39] This practice was supposedly widespread in London, where introduction in the stock market was the most common manner to place bonds. Members of syndicates, underwriters, and brokers purchased bonds before even the publication of the prospectus. As some writers have noted, "[a]bility to make the market rather than financial prestige was the crucial qualification for a successful dealer in Government loans."[40] Curiously, one of the most remarkable exceptions of financial intermediaries *not* following this practice

36. Some argue that this depended on the syndicate system chosen. In theory, two different systems existed. The first was called *Lyonnais* (from Lyon, where this system was common). For the non-placed remainder of a bond issue, each participant was to receive a proportional part according to its number of placed bonds (in other words, each bank was only responsible for the difference between its syndical part and the number of bonds that it was able to place). The second system was called *de la repartition a la parisienne*. If any of the bond issue was not placed, then the unplaced bonds were to be distributed proportionally between the participants. In practice, a considerable number of hybrid systems existed. A syndicate manager could, for instance, modify to his preference not only placement commissions, but also cession to other intermediaries and bond placement prices. *See* TCHERNOFF, *supra* note 29, at 75.

37. This practice was also used in London and other European financial markets.

38. *See* TCHERNOFF, *supra* note 29, at 75.

39. *See, e.g.*, CAIRNCROSS, *supra* note 22, at 93–94; JENKS, *supra* note 22, at 277–78.

40. JENKS, *supra* note 22, at 278.

was Baring.[41]

The third method of placing a bond issue in Paris was through the banks. Issuers could use bank branches subject to a commission (called a "placement" or "counter" commission). If these banks were themselves issuers, it was in their own interest to directly recommend the bonds to clients in their establishments. A main characteristic of this system was that no publicity was attracted other than that from the direct recommendations.[42]

The entire four-stage process can be summarized as follows: in the simplest model, the financial intermediary is the only agent between the government and final investor and merely provides a distribution service (or sale on commission). Other kinds of more complicated structures, however, could emerge. Intermediaries could constitute syndicates at any stage depending on the issue, market situation, and place of issue. In general terms, banks could also "take firm" an issue, whereby they would act as risk takers if the issue failed, through direct purchasing of the bonds or through formation of "guarantee" syndicates. They could also enlist other underwriters to act as distributors in different financial centers or become parties to any kind of agreement with the end of ensuring the best results for their issues.

As already mentioned, debt contracts were important because they provided information on every term agreed upon in the issuing process. They were signed by the interested parties (that is, the governments and issue banks) from the very beginning, and they established all the conditions of the bond issues.

IV

ARGENTINEAN, BRAZILIAN, AND CHILEAN CONTRACTS BEFORE THE BARING CRISIS

The debt contract sources for this article are almost every Argentinean, Brazilian, and Chilean debt contract for the period of 1880 through 1890. For Argentina, a significant number of contracts for the period of 1880 through 1913 are available in the Baring and Paribas archives. Additional sources consulted contain information on the contracts and public finances of Argentina.[43] With

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41. *See* CAIRNCROSS, *supra* note 22, at 93. However, a turning point conducive to Baring's failure was the underwriting of the Drainage and Waterworks of Buenos Aires public offering, which markets rejected. *See generally* Henry S. Ferns, *The Baring Crisis Revisited*, 24 J. LATIN AM. STUD. 241 (1992).

42. This would explain why researchers today are not able to find prospectuses on certain loans of the period. For instance, the absence of these documents seems to be an impediment to the widening of one researcher's contracts database. *See* Layna Mosley, *Golden Straightjacket or Golden Opportunity? Sovereign Borrowing in the 19th and Early 20th Centuries* 22, (Univ. of Notre Dame Dep't of Political Sci., Working Paper, 2002) (revised version), *available at* http://www.unc.edu/~lmosley/mosleygold standardapril2003.pdf.

43. *See generally* PEDRO AGOTE, RAPPORT DU PRÉSIDENT DU CRÉDIT PUBLIC NATIONAL, PIERRE AGOTE, SUR LA DETTE PUBLIQUE, LES BANQUES, LES BUDGETS, LES LOIS D'IMPÔT ET LA FRAPPE DES MONNAIES DE LA NATION ET DES PROVINCES (TRADUIT DE L'ESPAGNOL PAR HENRI MENJOU. LIVRE IV (ET LIVRE V)) (1887 and 1889); *see also* JOSÉ PEÑA, DEUDA ARGENTINA: COPILACIÓN DE LEYES, DECRETOS, RESOLUCIONES, NOTAS, Y CONTRATOS SOBRE LA DEUDA PÚBLICA NACIONAL 1 (1907).

regard to Brazil, the Rothschild archives contain all the contracts of the period, although a good amount of information in those contracts can be found in other sources like the Brazilian Yearbook[44] and in the Ministry of Finance reports.[45] For Chile, the Rothschild archives contain some contracts, and additional information can be found in the Crédit Lyonnais archives.

Contrary to contemporary practices, debt contracts in the 1880s varied from one underwriter to another, depending on whether a bank and a country held a long-term relationship.[46] More generally, these documents began with a statement explaining how a country's parliament had authorized an external loan for which the contract established the agreed terms between the government and the underwriting bank or banks. The number of clauses varied describing the specifics of each loan, such as whether it involved short-term advances, the bond's characteristics, the date and places of issue, and the way and times of funds sending. A contract could include an agreed price of issue (as was the case in Rothschild's contracts with Brazil), agreed minimum prices,[47] agreed dates of issue (thus excluding a price of issue), or none of them, with the result that banks could decide both date and price at issue and thus underwriting fees and benefits. A firm-commitment contract would typically include in one of the first clauses, "The Government of the Republic of Argentina sells and the above specified syndicate buys the totality of the loan . . . at 88% . . . ."[48]

The history of Argentina's external debt, like that of most Latin American sovereign debt, was an eventful one throughout the nineteenth century. For the purposes of this study, the decade prior to the crisis is divided into three sub-periods.[49] In the first sub-period, 1880 through 1884, Argentina signed four contracts with European bankers. One important characteristic of these years was the dominance of French banks in the Argentinean national business, replacing British banks' dominating position and limiting them to bond-placing activities. French banks successfully upstaged British competition by creating underwriting syndicates (later imitated by German banks), whereas British banks acted alone and engaged only in financial intermediation activities without the risk of commitment.[50]

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44. THE BRAZILIAN YEARBOOK, Vol. 1–2 (J.P. Wileman ed., 1908–1909).

45. *Ministry of Finance Reports from 1883, 1886, and 1888*, http://www.crl.edu/fr/brazil/ministerial/fazenda (last visited Nov. 25, 2010).

46. Boilerplate contracts were commonly used and, consequently, modifications were introduced at a slow pace. For a review and discussion on the current evolution of boilerplate contracts, see Mitu Gulati & Stephen J. Choi, *The Evolution of Boilerplate Contracts: Evidence from the Sovereign Debt Markets* (N.Y.U. Law & Econ. Research Paper Grp., Paper No. 05-17; Georgetown Law & Econ. Research Paper Grp., Paper No. 800,264, 2005).

47. For examples of agreed minimum prices in Argentinean contracts, see *infra* Table 1.

48. Paribas Archives, reference *102 955 637 A 57*. Author's translation from Spanish. For instance, see the 1887 contract shown below between Argentina and a syndicate of European bankers.

49. *See* HAROLD E. PETERS, THE FOREIGN DEBT OF THE ARGENTINE REPUBLIC 33–49 (1934).

50. For a detailed description of French banks entering Argentinean business, see Andres Regalsky, *Exportaciones de Capital Hacia los Países Nuevos: los Bancos Franceses y las Finanzas*

The second sub-period is the year 1885, a brief period of crisis in Argentina after it left a temporary gold-standard regime. During this year, Argentina's government and European banks involved in Argentinean bond issuance signed a contract: it cancelled two previous loans that had completely failed and converted the debt into a large long-term loan while conceding a new short-term advance to alleviate a critical fiscal situation. It also, however, imposed hard conditions on Argentina's government, even though, as later shown, they would not be met.

The third sub-period of 1886 through 1889 began with the issue of the long-term loan in two parts, one in January of 1886 and the other in 1887. This sub-period encompasses an important boom in Argentinean bonds—national (five loans, including three conversions), provincial, and municipal—and the entry of a new competitor: German banks.

A. First Sub-period (1880–1884): The Breakdown of the British Monopoly

Table 1: Argentina's Debt Contracts[51]

Loans	Nominal Amount (millions £)	Net Purchase Price (a)	Proportion of the Loan Taken Firm (b)	Issue Price	Resulting Fee	Short-term Advance (b); [Commission, and Interest Rate]	Commission on Sold Bonds	Minimum Price
Railways 1881 6%	2.45	82	1	91	9	0	0	No
Treasury 6%	0.81	90.5	1	92.5	2	0	0	No
National Bank 1884 5%	1.7	79.35	0.56 (c)	84.5	5.1	0.56 [0.25 (d), 6%]	0	No
Salubridad and Riachuelo 5%	5.9	78.6	0.33	Not issued	NA	0	2.5	Yes
Public Works 5%	2.4	78.3	0.33	84	5.7	0	0	Yes
1885 Agreement 5%	8.4	0	0	NA	NA	0.48 [0.5 (e), 6%]	2.5	Yes, 75
National Bank 1886 5%	2	85	0.75 (c)	90	5	0.75 [0.5 (d), 6%]	0	No
Railways 1886 5%	3.9	80	0	84.5	4.5	0	2.5*	No
Conversion Hard Dollars 3.5%	2.75	0	0	NA	NA	0	1.25	No
Refinance 1887 4.5%	5.26	82.5	1	87	4.5	0	0	Yes, 85
Refinance 1889 4.5%	5.29	85.5	1	90	4.5	0	0	Yes, 88

This table shows the loans issued from 1880 through 1889 and their key characteristics.[52] The first two loans were contracted with the Paribas syndicate,

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Publicas Argentinas 1881–1887, 5 REVISTA DE HISTORIA ECONÓMICA 73, 73–97 (1987).

51. (a) Purchase price as part of the nominal amount issued; (b) part from total amount; (c) firm part taken by the banks, or short-term advance; (d) each trimester; (e) each semester. *See* Juan Flores, Lorsque le leader suit la foule: la crise Baring dans une perspective microéconomique 209–10 (2004) (unpublished dissertation) (on file with Sciences Po Paris).

52. Financial market conditions in Europe could also have affected contract terms and, particularly, purchase prices in firm-taking contracts. Controlling for this fact by dividing the purchase price with the normalized price of the U.K. consol at contract date (not reported in the tables) does not

which dominated the market for issues of Argentina's national government bonds during the first half of the 1880s.[53] Fierce competition between intermediaries marked the negotiation of the first loan (the "Railway Loan"). For the first time since the independence of the country, Argentina's national government received several offers from British and French banks even before the Argentinean parliament had promulgated the law allowing the external loan.[54] An interesting feature of the loan is that the government showed a strong preference for "firm offers," thereby leaving a sizable amount on the table. Thus, although the issue price was 91[55] and was not determined by the contract, the purchase price received by the government was only 82.[56]

The second loan contracted by Paribas was the "Treasury Loan" of a much smaller amount. It was also negotiated on a firm basis, yet the public offering resulted in an unexpected reduced underwriting fee for the banks. Unfavorable conditions in European markets[57] and the high frequency of new bond issues[58] seem to be the principal factors underlying this unforeseen reduction.

Matters then became more complicated. For the third loan, known as the "National Bank Loan", the same syndicate refused to take the whole loan on a firm basis at the first stage. It opted instead to make a short-term advance to the government while preserving the possibility of buying firm, in a one-year period, the totality of the loan or the nominal capital equivalent of the sum to be paid by the Argentinean government.

For each of the public offerings, Baring acted as the sole issuer in London. More specifically, the French syndicate negotiated the loans with Argentina's government, then agreed with Baring through another contract on the conditions under which Baring would place the bonds in the London market.[59]

This sub-period ended with two loans negotiated at almost the same time with two different syndicates, but both of which failed to be placed in the market. The "Public Works Loan" was signed with a new Anglo–French

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change the basic results. For complete contract features, see *supra* Table 1.

53. Members of that syndicate were Paribas, Cahen d'Anvers, and Comptoir d'Escompte.

54. According to Regalsky, *supra* note 50, at 79, four candidates were ready to negotiate the loan issue: two English banks and two French syndicates (represented by Paribas and Société Générale, respectively). However, Jones writes that two other banks were also interested in the affair: the Spanish bank of Vega, Ibañez & Co., and Erlanger & Co. from London. *See* Charles A. Jones, *European Bankers and Argentine*, *1880–1890* 3 (Univ. of Cambridge, Ctr. of Latin Am. Studies, Bus. Imperialism Series, Working Paper No. 3, 1972).

55. All prices are expressed as a percentage of the bonds' nominal value (this would be 91% of a bond worth 100 sterling pounds).

56. The resulting underwriting fee, which was extraordinarily high, was unknown at the moment of the contract; Argentina's government expected a negative shock (war against Chile) that would damage the country's credit. *See* Jones, *supra* note 54, at 5.

57. Regalsky, *supra* note 50, at 81.

58. Jones, *supra* note 54, at 6.

59. The contracting parties stipulated a 1% placement commission on the nominal amount of the loan for Baring, and the syndicate was in charge of all expenses for the issue. At the same time, commissions paid by the Argentinean government were to be shared between Baring and the syndicate: 1% on coupon payments and 0.5% on redemption.

syndicate. The main cause behind the switch of bankers was the refusal of the Paribas syndicate to issue any new loans before the market had absorbed the whole amount of bonds from former issues that still remained in their hands. The new loan was also negotiated on a firm basis, although for only one-third of the issue. However, on the eve of the issuance in September 1884, widespread rumors about convertibility suspension in Argentina caused the syndicate to be left with most of the bonds in their hands.[60] Finally, the Paribas syndicate agreed to negotiate a new loan called "Salubridad y Riachuelo Loan" on terms similar to those of the previous Public Works Loan, although market conditions had changed to make placement of the bonds impossible.

B. Second Sub-period (1885): The Pellegrini Agreement

At this stage, the Argentinean government found itself needing fresh funds to meet its short-term obligations. After the 1884 failures, a government agent, Dr. Carlos Pellegrini, was sent to Europe to unblock the situation.

An agreement between the government and a "unified syndicate" of all banks participating in the 1884 loans was signed on the 6th and 7th of July, 1885.[61] The Salubridad y Riachuelo Loan of £2.4 million, taken by the Paribas syndicate, was completely cancelled, whereas the Public Works Loan of £4 million nominal value bonds out of £6 million, taken by the syndicate represented by Société Générale was only partially cancelled. On the other hand, the government agreed to repurchase part of the loans taken firm by the banks. The arrangement "consolidated" both loans into one big issue amounting to £8.4 million, which became the most important loan ever accorded to a Latin American country.

Not surprisingly, no firm offer was made and the bonds were left to be placed in the market by the sale-on-commission system.[62] The contract presented two special features. First, it contained the famous guarantee that Argentina's government was obliged to cede to the bankers the customs revenues.[63] The National Bank of Argentina, responsible for the collection of the government's revenues, was charged with opening a special account for deposits of the necessary funds to meet debt service. Second, Argentina's government committed to not "authorize or sanction, as long as this Government is in charge, the issue of any loan, without a formal previous

60. *See* PETERS, *supra* note 49, at 39.

61. The banks participating in the agreement were Paribas, Comptoir d'Escompte, Cahen d'Anvers, Société Générale, Crédit Industriel, Baring, and the North American house of Morgan.

62. The government paid 2.5% on the nominal amount of the bonds sold. Charges for the issue, brokerage, stamp, publicity, and legal fees were all paid by the government as well.

63. In 1884, customs duties were about sixty-two percent of total revenues. Banks seem to have been aware of this fact. See HENRY S. FERNS, BRITAIN AND ARGENTINA IN THE NINETEENTH CENTURY 403 (1960) for a detailed discussion on the effects of the agreement. *See also* Juan Flores, The Pellegrini Agreement: A Historical Case of Moral Hazard 13 (2002) (unpublished manuscript) (on file with Sciences Po Paris).

agreement from the other contracting party."[64] The contract referred specifically to a loan already approved by the parliament to raise capital for the Bank of the Province of Buenos Ayres, the most important bank in the country.

However, matters did not happen as foreseen. The Argentinean parliament, upon whose approval the agreement was conditioned, rejected it on August 11, 1885. Its main reason was the agreement's inclusion of the guarantee clause, which was considered "depressive to the dignity of the country."[65] One can only speculate about the real reasons of this refusal, though gaining more time is a plausible one. Within the next few months, a new law was passed to take out an external loan of £4 million. The "Bank of the Province of Buenos Ayres Loan" was approved by the provincial government, and on October 21, 1885, the parliament finally voted on a new agreement with the banks. Except for a few insignificant modifications, the new contract, called the "1885 Agreement" was practically the same as the previous one.

C. Third Sub-period (1886–1889): The Loan Boom

Despite the prohibitive clause not allowing the Argentinean government to take new loans, Argentina continued to seek external funds in 1886. In October, it signed a contract with Murrieta for extension of the "North Station Railway." This bank had not participated in the 1885 Agreement; in fact, no bank participating in that syndicate was allowed to contract new loans. However, the favorable results of the 1886 issue, the first part of the £8.4 million loan, eased the market for new bonds. For instance, Baring could finally place a bond issue for the Bank of the Province of Buenos Ayres as contracted several years before. However, the real turning point occurred with the entrance of the new competitors stalking the Argentinean market—the German banks.

On January 25, 1887, a French–German syndicate[66] signed a contract to advance the Argentinean National Bank the equivalent of £1.5 million. As a guarantee, the syndicate would receive bonds equivalent to £2 million in internal debt, which were to be converted to external debt by a law to be passed by the Argentinean parliament. Later, on July 14, 1887, an additional syndicate represented by Deutsche Bank also signed a contract on a firm basis with Argentina's government and aimed to convert the five percent loans contracted for at the beginning of the decade.[67] Once again lacking an English partner in the syndicate, Baring acted as the issuer in London and obtained a favorable outcome.

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64. Author's translation from French. Contract of July 1885, Paribas Archives.

65. *Congreso Nacional Camara de Diputados, Su Discussion en Session Secreta: la Ley Sancionada, La Prensa* (Oct. 21, 1886).

66. The syndicate was formed by Disconto Gesellshcaft, Norddeutsche Bank, Oppenheim, and Banque d'Anvers.

67. The other participants were Mendehlsohn, Bank für Hander, Bethmann, Deutsche Vereinsbank, Disconto Gesellshcaft, Norddeutsche Bank, Bleichschröder Bank, Oppenheim, Cahen d'Anvers, Heine, Société Génerale pour Favoriser le Développement du Commerce et de l'Industrie en France, and Société Générale du Crédit Industriel et Commerciale.

At the end of the decade, Argentina's national government contracted for two additional loans. The first contract was signed with a syndicate formed by German, French, and English banks. The second loan was contracted for with the banking house of Stern. According to the first contract, the objective of the loan was the conversion of six percent bonds issued in the 1870s and early 1880s. The syndicate, composed of eight banks, took firm the total amount of the loan. The second loan was taken by the sale-on-commission system. The conversion was of the problematic "Hard Dollar Loan" to a 3.5% coupon and 1% redemption.[68]

From a total of eleven contracts, eight were taken totally or partially firm; of those eight, six were taken at the moment of the signing of the contract and two as an option.[69] For the latter two contracts taken as an option (both National Bank loans), a short-term advance was included in the contract. The lowest net purchase price was the 1884 Public Works Loan while the highest was the Treasury Loan of 1882. Short-term advances implied interest rates of 7% (interest rate plus commission) except for the 1886 National Bank Loan, whose rate was 8%. Sale commissions for the loans not taken firm amounted to 2.5% on nominal capital, not taking into account the Hard Dollar Loan conversion, whose commission amounted to only 1.25%.

In conclusion, the conditions surrounding Argentina's external loans from 1880 through 1889 were quite volatile. It seems that conditions were favorable at the beginning of the decade, deteriorated considerably between 1884 and 1886, and improved in the final three years.

V

CONTRACT TERMS, ARGENTINA'S ECONOMY, AND UNDERWRITERS' COMPETITION

After the 1885 Agreement, there was a considerable improvement in the terms of later contracts from Argentina's perspective. Banks underwrote half of the 1886 National Bank Loan, with a better purchase price than the "minimum price" of the 1885 Agreement, resulting in lower underwriting fees. By the end of the period, underwriting was complete (that is, entirely firm taken) for all the loans with higher purchase prices. Thus, Argentina had succeeded in obtaining the maximum proceeds from its loans while simultaneously avoiding the risk of placement failures, which it delegated to underwriting banks.

68. This was originally an internal loan issued in 1876 with a nominal amount of six million gold pesos, bearing 9% annual interest and 4% redemption. Although at the time of the issue, the price remained low (75% of the bond's nominal value), by 1881, the quotation was 122. The government refused to redeem the bonds through purchase in the market and "insisted upon its right to call at par, which was disputed by British holders." *See* PETERS, *supra* note 49, at 40 (discussing Argentina's conflicts with foreign bondholders).

69. There was an additional contract signed with Murrieta for a nominal amount of £0.6 million, with a 5% coupon issued in June 1887. Insufficient information was available to include this loan in the analysis.

What lies behind these results? There may be two answers. A first possible explanation lies in the behavior of economic fundamentals. Capital markets, and more precisely, underwriters selling the bonds, were supposed to closely monitor the Argentinean economic position. Therefore, one would have expected that a government exhibiting solid fundamentals would have had access to loans on better terms, reflecting the decreased risk of default. In other words, the stronger the fundamentals, the better these terms. As mentioned previously, bankers expected diminished risks and higher profits for bond issues of "well behaved" countries, so they had incentives to sweeten their offers concerning government loans.

A second possibility is market failure. Regardless of fundamentals, banks may have become more eager to get the loans as competition intensified. Competing banks may have been willing to lower fees (offering higher purchase prices), underwrite higher portions of the loans, or both. This meant that banks were obliged not only to make better offers concerning prices, but also to take greater risks. In order to identify the effects of both fundamentals and competition, the behavior of the Argentinean economy and the banks in that decade must be examined more closely.

Beginning with Argentinean economic fundamentals, many variables influenced risk perception of a given country.[70] Most studies of late-nineteenth-century Argentina offer the generalized vision of a vigorous young country that attracted both labor and capital. The 1880s in particular was an expansionary period: estimated real GDP per capita amounted to an impressive eight percent average growth.[71] But the other side of the coin is the general fragility of the economy, which was abruptly disrupted after the Baring crisis. Increasing obscure deficits, interrupted only during the two years of the 1885 crisis, marked Argentina's external position. The gold standard was abandoned after 1885 and an increasing depreciation of the peso then followed. Reserves then in banks of issue were also decreasing in those years, but monetary issues were still booming. The following table illustrates some of the variables that influenced risk perception of Argentina.

70. Literature on nineteenth-century finance has suggested some of the variables. For more information, see Marc Flandreau, *Crises and Punishment: Moral Hazard and the Pre-1914 International Financial Architecture* 32 (Ctr. for Econ. Policy Research, Discussion Paper No. 3742, 2003).

71. *See* Ana María Cerro, La Conducta Ciclica de la Actividad Economica Argentina en el Periodo 1820–1970 (2000) (unpublished thesis) (on file with the Universidad Nacional de Tucuman); ROBERTO CORTES CONDE, EL PROGRESO ARGENTINO 1880–1914, at 291 (1979); Gerardo della Paolera, How the Argentine Economy Performed During the International Gold Standard: A Re-examination (1988) (unpublished Ph.D. thesis) (on file with the University of Chicago).

Table 2: Argentina's Macroeconomic Situation[72]

Years	Real GDP Growth (%)	Depreciation of Paper Peso / British pound (%)	Inflation	Deficit / Public Revenue	Debt Service / Public Revenue	Percentage of Debt Service Paid in Gold
1885	6.03	37	22.8	0.48	0.3	0.77
1886	-0.03	1.45	3.1	0.34	0.51	0.68
1887	11.9	-2.87	-4	0.18	0.43	0.6
1888	9.9	9.6	0	0.34	0.47	0.89
1889	17.2	21.62	19.8	0.34	0.62	0.93
1890	-4.3	43.33	40.9	0.25	1.07	NA

Public finances of the national government as well as provincial and municipal governments were deteriorating. In fact, a careful analysis of the fiscal position of the national government gives a good idea of the troubles faced by Argentina in meeting its debt service.[73] One such analysis by Jose Terry, later to become finance minister during the 1890s, shows that public finances had already begun to deteriorate by 1885.[74]

A close examination of the Finance Ministry Reports would reveal some worrisome signs, as noticed by the press and by different economic reports on Argentina. First, as already mentioned, public deficits were booming, financed by external debt and by monetary issues that began in 1887. Second, debt service as a portion of public revenues was also increasing, due in part to the further depreciation of the paper peso. Third, debt denominated in foreign currency (gold) was also higher, including loans in 1887 and 1889 that converted some paper-denominated loans into gold loans. Finally, beginning in 1887, debt service was aided by extraordinary revenues, including the sale of public assets and the gold that came within the government's purview via the Free Banking Law.[75]

Competition was a key factor behind the Baring crisis. First, previous works on Argentina's loans in the 1880s have emphasized the competitive behavior of European bankers in attempting to get the business. Second, comparing Argentina's situation with Latin American countries in which competition was

72. GDP growth and inflation from della Paolera, *supra* note 71; paper peso values are monthly averages from the figures provided in *Bank Returns and Money Market*, tbl. Foreign Rates of Exchange on London, THE ECONOMIST (The Economist Historical Archive, 1843–2006), at 20, *available at* Gale Cengage Learning database; Public finance variables from ARGENTINA MINISTRY OF FINANCE, MEMORIAS DE HACIENDA, 1885–1890, ch. I (Rentas Generales (General Revenues)) and II (Inversion y Pagos (Ordinary and Extraordinary Expenditures)).

73. *See, e.g.*, DELLA PAOLERA & TAYLOR, *supra* note 9, at 89; Tim Duncan and Sibila Seibert, *La Política Fiscal Durante el Gobierno de Juárez Celman, 1886–1890: Una Audaz Estrategia Financiera Internacional*, 23 DESARROLLO ECONÓMICO 11–34 (1983); ANDRES REGALSKY, MERCADOS, INVERSIONES Y ELITES: LAS INVERSIONES FRANCESAS EN LA ARGENTINA, 1880–1914, at 182–83 (2001).

74. *See* TERRY, *supra* note 12, at 78.

75. Under this law, provinces were supposed to deposit gold in exchange for national government bonds, thus constituting the reserves of the newly created provincial banks. For the Free Banking Law, see DELLA PAOLERA & TAYLOR, *supra* note 9, at 240.

limited (Chile) or nonexistent (Brazil) has illustrated the importance of competition when debt contracts are negotiated. Third, the terms of a contract signed between Baring and the Argentinean government, while ultimately not issued, were the worst of the decade from Argentina's perspective and were negotiated at a time when Baring no longer had any competition. Finally, and as a consequence of the 1890 crisis, Argentina's re-entrance to international capital markets was marked by the monopoly of Baring as the only bank issuing the bonds.

Market shares of Argentina's two main banks, Murrieta and Baring, decreased from one hundred percent at the beginning of the 1880s to less than forty percent by 1889.[76] Argentina's historiography supports the conclusion that competition between bankers played in favor of Argentina in the form of decreasing borrowing costs.[77] The law approved by the Argentinean congress on a £2.4 million loan initiated a race among European banks to get the loan.[78] As illustrated in Table 3, after a few months of receiving several offers, the Argentinean government agreed with the French syndicate, represented by Paribas, to accept a firm offer with a net price of 82.

Table 3: Successive Offers for the French Loan of 1881[79]

Date	Offer Made By	Purchase Price	Issue System	Observations
December 1880	Stern	75.5	Sale on Commission	Successive offers came afterwards from other banks improving price terms.
March 1881	Stern	78	Firm Offer	Stern improved the offer some days later to 80.5 but retired thereafter.
March 1881	Baring	85	Firm Offer	The offer was not finally made because it was not authorized in London.
March 1881	Paribas Syndicate	82	Firm Offer	The final contract was signed on the 24th.

The second argument involves a comparison of Argentina's situation with that of other countries. In order to obtain this comparative benchmark, the Argentinean situation is analyzed in a broader context by studying two additional Latin American countries. Brazil, to begin with, signed four contracts with the Rothschild monopoly. The relationship between Brazil's government and Rothschild differed from Argentina's own relationship with any other bank. For instance, Rothschild was literally Brazil's only bank in the sense that the government had its own account on Rothschild's balance sheet, thereby facilitating any monitoring. It was called "Brazil agency":

> This account shows the amount standing to the credit of the Brazilian government,

76. The market share measure is based on the cumulative value of the bonds on the market in each year.

77. Jones offers a detailed analysis on competition for the first Argentinean loan in the 1880s (the French Loan). *See* Jones, *supra* note 54, at 3.

78. Those banks included Barings, Stern, Vega Ibañez & Co., a French syndicate (BNPB, Comptoir de'Escompte, and Cahen d'Anvers), Heine, Heimendahl, Murrieta, a second French syndicate, and Erlanger.

79. *See* Flores, *supra* note 51, at 211–12.

> and the amounts debited for dividends and for sinking funds charges. The account is balanced at the end of each month and a copy is sent to the government. It contains also a record of the installments received on account of each loan . . . .[80]

General conditions for the rest of the Brazilian contracts are shown in Table 4. Unlike Argentina, Brazil was obliged to face all the risk of the issue because it used a sale-on-commission system. On the other hand, Brazil benefited from better contract terms than Argentina's: the minimum price (guaranteed) was generally higher while commissions were lower. However, these differences between the countries tended to diminish over time and by the end of the period were minimal.

Table 4: Brazil's Contract Terms and Macroeconomic Situation[81]

Loans	Nominal Amount (millions £)	Issue Price	Net Price	Banker's Commission and Stamps	Brokerage Commission	Commission for Redemption by Drawing/Purchase in the Market		Service / Revenue	Exchange Rate Depreciation
1883 4.5%	4.6	89	86.75	2	0.25	0.5	0.125	0.4	0.3
1886 5%	6.4	95	92.75	2	0.25	0.5	0.125	0.5	-10.7
1888 4.5%	6.3	97	95.25	1.5	0.25	0.5	0.125	0.3	-11.35
1889 4%	19.8	90	88.25	1.5	0.25	0.5	0.125	0.3	-7.2

A second interesting case is Chile, a country with which Argentina had a strong rivalry. Chile was indeed given the best terms among the countries compared in this paper. Differences between Chile and Argentina were more than marginal. Chile signed four contracts with European and American banking houses in 1885, 1886, 1887, and 1889. The first contract was signed with City Bank, but insufficient information exists in order to describe it adequately. The 1886 and 1887 contracts were signed with Rothschild, and the 1889 contract featured a syndicate represented by Deutsche Bank that floated the loan.

In terms of economic fundamentals, Chile had a stable but flexible exchange-rate regime; more importantly, it was less indebted than either Argentina or Brazil. Table 5 shows its contracts' terms and economic fundamentals. A striking feature is that for its 1886 and 1887 contracts, Rothschild took firm the whole amount of the loans, and for a relatively high price. In fact, Brazil and Chile are directly comparable because they negotiated with the same bank. For instance, Rothschild underwrote the issue of the 1887 Chilean loan at a purchase price of 96, good contract terms compared to any other Latin American country.

80. Rothschild Archives, *Transactions of a Committee to Enquire into the Organization of the Accounts,* reference number: RAL 000/179 (Nov. 18, 1908).

81. *See* Flores, *supra* note 51, at 214, 254–59.

Table 5: Chile's Contract Terms and Macroeconomic Situation[82]

Loans	Nominal Amount (millions £)	Issue Price	Net Price	Banker's Commission and Stamps	Brokerage Commission	Commission for Redemption by Drawing/Purchase in the Market		Service / Revenue	Exchange Rate Depreciation
1886 4.5%	6	98	96	G	0	0.5	0.125	0.2	6.25
1887 4.5%	1,2	97.1	96	G	0	0.5	0.125	0.2	-2.29
1889 4.5%	1,5	102	97	0.5	0	0.5	0.125	0.2	-1.09

The most advantageous contract for Chile was signed in 1889 with a German syndicate. Its terms were similar to the Rothschild contracts but had another feature favorable to Chile, one that arose from competition between banks: the syndicate paid the first coupon of the loan (thus lowering the final fee paid by Chile). As far as is known, no other Latin American country could get such a clause in its contracts, and this reflected the higher status of Chilean credit in international financial markets. However, as with Brazil, differences between Argentina and Chile tended to diminish as the decade approached its end, and the terms of Argentina's latest loans were only slightly worse than Chile's. As discussed before, one possible explanation is that Argentina's economic fundamentals improved while Chile's remained stable or worsened. However, in reality, Argentina's fundamentals did not improve and Chile's did not change.[83]

In conclusion, Argentina began the decade with arguably worse terms but rapidly made up these differences by the end of the period. Clearly, economic fundamentals cannot explain this "convergence."

The 1890 Baring contract is further proof that macroeconomics and the fiscal position of the government were viewed as secondary concerns. Although the trajectory of Argentina's contract terms showed improvement in the second half of the 1880s, the crucial year of 1890 offers a completely different story. Correspondence of Baring with other bankers reveals how Baring tried to form a syndicate for a loan issue of £10 million in order to improve the fiscal situation of Argentina's national government and support the depreciating peso.[84] While Baring succeeded in convincing Morton and Murrieta to become at least minimally involved, it remained alone in terms of risk. Clearly, with a desperate macroeconomic situation and without competition, the terms of this contract considerably worsened, and the strong conditionality imposed at this stage may have played a role in Argentina's eventual decision to default.[85]

Finally, the crisis and its aftermath marked a difficult period for both Argentina and Baring. On the one hand, Baring needed a bailout orchestrated

82. *See id.* at 216, 254–59.

83. *See supra* Tables 3, 5.

84. ING Baring Archives, HC4.1.113.

85. ING Baring Archives, HC4.1.71 1890 (contract including four clauses that Baring extracted from the Government in an intensive negotiation: (1) a pledge of customs revenues; (2) no external borrowing for three years; (3) a reduction of the monetary base in order to appreciate the peso; and (4) the approval of a law requiring that fifty percent of customs revenues be payable in gold).

by the Bank of England and was divided into separate branches.[86] On the other hand, Argentina needed two successive funding loans and did not have access to international capital markets for almost ten years following the crisis. In fact, the loans contracted between 1900 and 1913 were all negotiated and issued by Baring, replicating the quasi-monopolist position it held in the pre-1880 period.

VI

CONCLUSION

Financial intermediation and competition issues may have played a key role in pushing Argentina into the financial situation of 1890 by incentivizing overborrowing at decreasing costs. The 1880s was a particularly interesting decade because Baring's quasi-monopoly over Argentina's debt issues was replaced with a competitive market structure. Although Baring was usually aware of the government's fiscal position, it had little or no incentive to properly monitor that position and release information to the market. Rather than risk its market position, the bank preferred to nourish the mania for Argentinean bonds, thereby abandoning its gatekeeping functions. Although other information sources had raised suspicions about the deteriorating financial situation in Argentina, the market was reassured by Baring's involvement with Argentina's bond issues, reflecting the growing importance of "reputational intermediaries" in nineteenth-century finance. As conditions for raising capital worsened between March and July of 1890—with partial default and political riots in Buenos Aires making the market hostile to any new loans to Argentina despite Baring's plans for new issues to ease the situation—neither the market nor the rent-seeking banks were willing to channel new funds to Argentina. Hence, this article emphasizes the importance of long-term financial relationships as the main source of information for underwriters. After 1890, Baring reemerged as the sole gatekeeper of Argentina's issues and Argentina did not default until the First World War. The year 1890, however, marked a critical turning point in the production and use of information by investors and financial intermediaries.

86. However, the bank was soon back on its own feet and re-entered the business of foreign borrowing.