

**THE BANK OF SPAIN: A NATIONAL FINANCIAL INSTITUTION**


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**ABSTRACT**

This paper explains the process by which the Bank of Spain became a national bank, first by obtaining the monopoly of issue in 1874 and then by extending its sphere of financial action by creating the country's only network of bank branches before 1900. The implementation of a "unified or national banknote" in 1884 and the creation of a system of free transfers for its clients were also decisive steps towards the Bank's transformation from a local Madrid-based institution into a Spanish national institution. The paper also argues that the transformation of the Bank of Spain into a genuine national financial institution contributed to the modernization of the Spanish administrative fabric.

**Keywords:** Bank of Spain, financial history, banknote issue, banking modernization

**RESUMEN**

En este trabajo se explican los mecanismos a través de los cuales el Banco de España se convirtió en una institución financiera de alcance nacional. Primero merced a la obtención del monopolio de emisión de billetes en 1874 y después mediante la creación de una red de sucursales única en el país. La adopción del billete único para todo el territorio en 1884 y un sistema de transferencias gratuito para sus clientes también fueron elementos claves en el proceso de conversión del Banco en una entidad nacional. El trabajo también sostiene que la transformación del Banco de España en un banco nacional genuino contribuyó a la modernización de la estructura administrativa española.

**Palabras clave:** Banco de España, historia financieras, emisión de billetes, modernización bancaria.

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# THE BANK OF SPAIN: A NATIONAL FINANCIAL INSTITUTION<sup>1</sup>

## **Introduction**

The aim of this paper is to study the process by which the Bank of Spain became a national bank, first by obtaining the monopoly of issue in 1874 and then by extending its sphere of financial action by creating the country's only network of bank branches before 1900. The implementation of a "unified banknote" in 1884 and the creation of a system of free transfers for its clients were also decisive steps towards the Bank's transformation from a local Madrid-based institution into a Spanish national institution.

The oldest private credit corporations that would eventually become central banks were formed for fiscal reasons. In order to meet their financial needs, many European states created banks which were granted various privileges in exchange for funds to help the states cover their growing civil and military expenses. Once these new institutions had been created, rather than disappearing, their roles and financial influence expanded. As bankers for the State, which was the reason why they were established, over time they obtained the monopoly of banknote issue in their respective areas of action, and in most cases eliminated their competitors. Other responsibilities soon followed: as depositories of the country's cash reserves or base money, they were obliged to take responsibility for the stability of the banking system, as lenders of the last resort; and at a later stage they played a macroeconomic role, including regulating and monitoring the amount of money in the economy.

This process paralleled the emergence of "national currencies," which emerged at the same time as the construction and consolidation of the structures of modern nations. In the words of Karl Polanyi, "the new national unit and the new national currency were inseparable"<sup>2</sup>. Like the flag, the territorial currency (sterling, the French franc, the Italian lira, the Austrian crown and the Spanish peseta, to name a few) soon became a part of national identity. It also satisfied the desire of the political authorities for a powerful instrument which they could use to intervene in the economy and possibly use as a fiscal instrument<sup>3</sup>. Monetary union, the homogenization of money and issuing banks thereby made a decisive contribution to nation-building in Europe and elsewhere in the world<sup>4</sup>.

We present some brief reflections on the origin and development of central banks below. The second section examines the brief period during which Spain's plurality of issue regime was in force. We then consider the monopoly of issue granted

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<sup>1</sup> We are very grateful to the participants at the Conference "Les banques centrales et les Etats" (Banque de France, Paris, March, 2012) for their useful comments. We would also like to thank Pierre-Cyrille Hautcoeur and Lluís Castañeda for their valuable comments and observations. This paper has received financial support from the Spanish Ministry of Science and Innovation. Project ECO2009-08791: Financial crises. Past, present and future. Spain and the International economy. What have we learned?

<sup>2</sup> Karl Polanyi, *The Great Transformation*. Boston, Beacon, 1944, pp. 202-03

<sup>3</sup> Benjamin J. Cohen, *The Geography of Money*. Ithaca, Cornell University Press, 1998; Eric Helleiner, *The Making of National Money. Territorial Currencies in Historical Perspective*. Ithaca, Cornell University Press, 2003.

<sup>4</sup> Evidence of this for Europe can be found in Helleiner's book, *The Making of National Money*; in particular for France, Alain Plessis, "The Banque of France and the Emergence of a National Financial Market in France during the Nineteenth Century", in Philip L. Cottrell, Even Lange, and Ulf Olsson (eds), *Centres and Peripheries in Banking. The Historical development of Financial Markets* (Ashgate, 2007), pp. 143-169. For other geographical areas, Carlos Marichal, "Nation building and the origins of banking in Latin America", Alice Teichova et al, *Banking, Trade and Industry, Europe, America and Asia from the thirteenth to the twentieth century*. Cambridge, Cambridge University Press, 1997.

to the Bank of Spain. The following section examines the role of the Bank of Spain as a nation builder. The text ends with some brief conclusions.

### **Notes on the establishment and evolution of issuing banks**

The Bank of Spain is one of the oldest institutions in Europe, especially if we date its foundation to 1782, when the Banco Nacional de San Carlos was established. This institution was created by the French financier Francisco de Cabarrus, with the task of supporting the price of government debt in circulation during the reign of Charles III. In 1829, after an eventful history, the San Carlos changed its name to the Banco Español de San Fernando, and it adopted its current name in 1856.

The Bank of Spain has always been one of the backbones of the State, in a country characterized until recently by the relatively limited nature of its public civil institutions. As we have been reminded by the historian Juan Pablo Fusi, Spain's great problem in the nineteenth and twentieth centuries was that of creating the structure for a true national state. The late construction of this structure led to the late development of a modern machinery for government and administration<sup>5</sup>. By becoming the State's Treasury in Spain and abroad and the sole issuer of banknotes throughout the country, and by gradually extending its network of branches throughout the provinces, the Bank of Spain was a key player in the process of market integration and one of the cornerstones of the structure of the State.

This "nation-building" task was not unlike the role played by other national banks similar to the Bank of Spain, which were established to meet the financial needs of their Treasuries. As pointed out by Forrest Capie, Charles Goodhart and Norbert Schnadt in their extremely useful historical review of the development of central banks, both the older ones, like the Bank of England (established 1694) and of France (1800), and those who followed them all over Europe, such as the Bank of Portugal (1846), the Reichsbank (1876) and the Banca d'Italia (1893), helped to shape national identity and to consolidate territorial unity, by nationalizing and unifying the monetary system, establishing national systems of payment, and of course, assisting the financing of the Treasuries of the emerging states<sup>6</sup>.

This was because in effect, the so-called national banks were established on the initiative of the public authorities, which gave them special privileges including some kind of monopoly on banknote issue, in exchange for financial support. However, the early issuers were private commercial institutions and acted as such as soon as they were set, motivated by the natural desire to maximize their profits, while attempting to use their founding privileges in the most advantageous manner to extend the scope of their business and increase their political and economic influence; in some cases they attempted to prevent or limit competition from other lending institutions. The Bank of England unsuccessfully tried to maintain its status as the only corporation in the London area, and the Bank of France made strenuous efforts to prevent competitors from emerging. As can be seen in the case studies by Rondo Cameron and associates, most of the first national banks greatly influenced the development and formation of the respective financial systems<sup>7</sup>.

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<sup>5</sup> Juan Pablo Fusi, *Epaña. La evolución de la identidad nacional*, Madrid, Ediciones Temas de Hoy, 2000, pp. 165-66.

<sup>6</sup> Forrest Capie, Charles Goodhart, Stanley Fischer and Norbert Schnadt, *The Future of Central Banking. The Tercentenary Symposium of the Bank of England*, Cambridge. Cambridge University Press, 1944, pp. 1-92.

<sup>7</sup> See the studies in Rondo Cameron (ed), *Banking in the Early Stages of Industrialization: A Study in Comparative Economic History*, Oxford, Oxford University Press, 1967 and *Banking and Economic Development: Some Lessons of History*, Oxford, Oxford University Press, 1972.

Over time, their dual role as State bankers and privileged issuing banks, on one hand, and private profit-making commercial institutions on the other, created a dilemma that was not easy to resolve. They were forced to choose between their obligations as "national banks," and their corporate purpose as private companies that had to be accountable to their shareholders. The extraordinary profits they could obtain from their privilege of issue led to behaviour that was not consistent with the "common good." A private company that the public authorities had entrusted with providing the economy with high-powered money could use this power for its own benefit, without taking the public interest into consideration. The most irresistible temptation was overissue. Since the profits of the issuing bank would increase in line with its ability to place a greater volume of revenue-generating assets into circulation, it seemed logical to assume that directors and shareholders would abuse their privileged position. A second risk also emerged; this arose from the use that governments made or could make of central banks as providers of financing. The conflict in this case arose between the institutions, which as issuers had to guarantee the value of their notes, and governments, which relentlessly demanded liquid resources to finance their spending, especially when this spending increased during periods of war. As a result, relations between the central banks and the monetary authorities were not easy, and were subject to heavy strain<sup>8</sup>.

Adherence to some sort of metallic standard, negotiated between the heads of the bank and the Treasury, resolved the conflict, albeit only temporarily. Resolving the relationships between issuing banks and the rest of the financial system proved more difficult. The issuing banks competed for the credit market with other banking companies, and attempted to increase the volume of their deposits by attracting as many customers as possible; but this facet as a private institution could come into conflict and indeed did come into conflict with its other functions, and particularly with its responsibility as the guarantor of the convertibility of banknotes and as the owner of the reserves on which the monetary system was based. The issuers competed with the other banks, but at the same time were the ultimate suppliers of liquidity in the system and were responsible for ensuring its stability. Furthermore, while the central banks were commercial institutions, the other credit companies viewed them with suspicion, fearing that they would use any crisis to take advantage of their privileged position and force their rivals to close, by failing to provide them with the help they needed at those critical junctures.

The fact that these situations occurred at different times and for a considerable number of banks is attested by the financial history books, which are full of examples and episodes of rivalry settled by the bankruptcy of the private non-issuing company<sup>9</sup>. As a result, while the national banks remained private commercial institutions concerned with maximizing their profits, their role as lenders of last resort, and as guarantors of the stability of the system, meant that their objectives were inherently contradictory. In fact, they found it impossible to fully carry out this public task without interference until they ceased to operate as commercial banks; for Goodhart, the transition from commercial institutions to non-commercial non-profit-maximizing institutions was what marked the real birth of true central banks. However, this author acknowledges that the issuing banks' assumption of responsibility for the proper functioning of the financial system, or to put it another way, the fact that they became

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<sup>8</sup>Charles Goodhart has accurately referred to this dual conflict in several studies, including *The evolution of Central Banks*, The MIT Press, 1991, chaps. 1, 3 and 8; and *The Central Bank and the Financial System*, Macmillan, 1995, p. 205 *et seq.*

<sup>9</sup> Charles Goodhart, *The Evolution of Central Banks*, pp. 39-43, documents some of the most striking episodes.

guarantors of the system's stability, led to a long and turbulent learning period, from which no institution was exempt. For Capie and Goodhart, the first time that the Bank of England, a pioneer in this process of transformation, acted as a real and conscious lender of last resort was during the Baring crisis of 1890<sup>10</sup>. The transition on the Continent took place much later and in some cases did not occur until well into the twentieth century; furthermore, the process in which the original commercial banks that received the privilege of issue in exchange for financing the Treasury became the guarantors of the financial system and macroeconomic stability had common features in all countries, as well as some particular features due to the political, social and economic circumstances in each one<sup>11</sup>.

### **Spanish banking: 150 years ago**

The modern history of Spanish banking begins in 1856, with the approval of the Issuing Banks Law and the Credit Companies Law. The former established the principle of plurality of issue, while changing the name of the Banco de San Fernando to the Banco de España (Bank of Spain), a name which it retains today. Many banks were founded under the terms of this legislation. The existing three banks (San Fernando, Barcelona and Cadiz) increased to 21 by 1866. The issuing banks law of 1856 ended the "de facto" monopoly enjoyed by the Banco de San Fernando since 1849, by authorizing the creation of an institution with the capacity to issue in each province. A network of credit institutions throughout the country soon emerged, and put an increasing amount of banknotes in circulation, which contributed to the diversification of the then underdeveloped Spanish payment system<sup>12</sup>.

Table 1 shows the number of issuing institutions in existence in 1857 and 1873. In 1873, just before the Bank of Spain was granted the monopoly, the country had 15 issuing institutions. Although there were many issuers, the Madrid bank was far bigger than the others. Its 50 million pesetas of paid-up capital was more than six times greater than that of the Banco de Barcelona, Spain's second largest credit company<sup>13</sup>. Banks such as those of Bilbao and Santander, which are today major financial players, were tiny by comparison. If we consider the volume of issue, the conclusion is the same. The Bank of Spain's banknotes accounted for 64 and 56 percent of the total in circulation in 1857 and 1873 respectively.

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<sup>10</sup>Other authors, such as Anna J. Schwartz ("Real and Pseudo Financial Crises") and Roy A. Batchelor ("The avoidance of Catastrophe: Two Nineteenth-century Banking Crises") prefer to use the crisis of Overend, Gurney and Co. in 1866 when dating the beginning of the Bank of England's activities as a lender of last resort. Both studies can be found in Forrest Capie and Geoffrey E. Wood (eds), *Financial Crises and the World Banking System*, London, Macmillan, 1986.

<sup>11</sup>Goodhart, *The Central Bank*, pp. 209-210.

<sup>12</sup>The law of 1856 established a twofold limit on the banks' issuing capacity. They could issue an amount of notes equivalent to three times their paid-up capital, and were required to maintain a reserve in specie (gold and/or silver) equivalent to one third of the notes in public hands. The second law - the Credit Companies Law - led to the emergence of a number of institutions capable of carrying out a wide range of activities, ranging from discount and trade credit to long-term loans and investment in industrial stocks and bonds. An overview of the development of the Bank of Spain between 1856 and 1874 is available in Pedro Tedde de Lorca, "The Bank of Spain, 1856-1874", *150 Years in the History of the Bank of Spain*. Madrid, Bank of Spain, 2006, pp. 69-108. The best study of the provincial banks of issue is Carles Surdrià, "Los bancos de emisión provinciales en la España del siglo XIX", in Pedro Tedde y Carlos Marichal (eds), *La formación de los bancos centrales en España y América Latina*. Madrid, Banco de España. Estudios de Historia Económica, 1994, vol. I, pp. 81-108.

<sup>13</sup>The Spanish unit of currency was the real, until the adoption of the peseta in 1868. In order to present amounts in pesetas for the entire period, the real has been converted based on its equivalence (one peseta for four reales).

Figure 1 shows that the amount of Bank of Spain notes was greater than that of all the provincial banks combined. Although it had only two branches, in the cities of Valencia and Alicante, by the middle of the century the Bank of Spain was already a national and parastatal financial institution, not only in terms of its name but because of its size. Its bills were beginning to be used as a reserve, and it had close links with the Ministry of Finance, which included providing tax collection services and acting as the government's treasury. These links, which dated back to the institution's origins, had increased over time: in 1857, 59 percent of its total assets were loans, advances and discounts on letters of exchange and promissory notes to the Treasury; and in 1873 the proportion was 70 percent. Although the Bank defended its independence as a private credit institution, contemporary observers acknowledged that the government had a great deal of influence over the decisions taken by the members of the institution's Board, since it not only appointed the governor but also used the Bank's resources to meet the Treasury's financial needs. In return, the Bank's directors demanded special treatment and repeatedly asked for the "de jure" privilege of sole issue<sup>14</sup>.

The plurality of issue and the existence of a considerable number of credit companies all over the country created a degree of competition that did not exist prior to 1856. This is especially true when one considers the existence of many private bankers and merchant bankers who met the demand for local credit, and even loaned money to the Government when it sought funds from the market. Despite its position of dominance and near monopoly in Madrid, the Bank of Spain had to share the market with new competitors<sup>15</sup>.

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<sup>14</sup> Gabriel Tortella Casares, "El Banco de España entre 1829-1929. La formación de un banco central", in *El Banco de España. Una historia económica*, Madrid, Banco de España, 1970, pp. 277-83); Rafael Anes Alvarez, "El Banco de España (1874-1914): Un banco nacional", in *La banca española en la Restauración*. Vol I. Madrid, Banco de España, 1974, pp. 116-124.

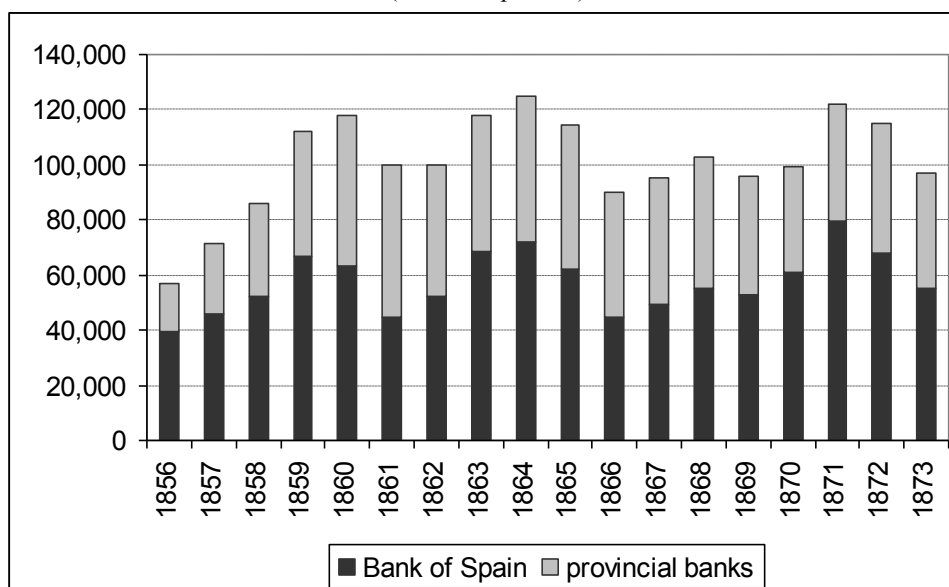
<sup>15</sup> On the experience of "free banking" or near free banking, see K. Dowd (ed), *The experience of free banking*. New York, Macmillan, 1992; Hugh Rockoff, "Lessons from the American Experience with Free Banking", in Forrest Capie and Geoffrey Wood (eds), *Unregulated Banking: Chaos or Order?*. London, Macmillan, 1991, and Lawrence White, *Free Banking in Britain: Theory, experience and Debate, 1800-1845*. Cambridge, Cambridge University Press, 1984. The period of plurality of issue banks (free banking) in Spain has been studied by José Luis García Ruiz, "La libertad de emisión en España, 1856-1874: una revisión", *Cuadernos de Estudios Empresariales*, 1, 1991, pp. 79-88. Pere Pascual and Carles Sudrià "Industrialización, desarrollo financiero y oferta monetaria en Barcelona a mediados del siglo XIX", *Investigaciones de Historia Económica*, 2008, 12, pp. 45-77 have offered a new look at the Spanish mid-nineteenth century monetary situation. For Cataluña there are a number of detailed studies of its financial position in mid nineteenth-century, Lluís Catañeda, "Sector financer i mercat de capitals al primer terç del segle XIX"; Pere Pascual "El mercat financer i el sistema bancari català, 1844-1864"; and Xavier Tafunell, "Banca i mercat de capitals, 1866-1914", all of them included in *Història Econòmica de la Catalunya Contemporània* (Barcelona, Fundació Enciclopèdia Catalana, 1991), pp. 339-421.

Table 1 *Spanish issuing banks in mid-nineteenth century*  
(thousand pesetas)

Banks	Paid-up capital		Notes in circulation	
	1857	1873	1857	1873
Bank of Spain	30,000	50,000	45,744.7	54,964.3
Balear	--	1,000	--	2,837.9
Barcelona	5,000	7,500	7,261.1	19,611.3
Bilbao	2,000	2,500	750.0	3,794.6
Burgos	--	--	--	--
Cadiz	3,437	--	9,045.7	--
Coruña	--	1,000	--	1,276.5
Jerez	--	1,500	--	1,113.6
Malaga	2,500	3,125	2,599.4	6,195.2
Oviedo	--	1,000	--	370.4
Palencia	--	--	--	--
Pamplona	--	1,125	--	363.0
Reus	--	625	--	438.1
San Sebastián	--	1,000	--	1,313.9
Santander	1,250	1,750	704.7	2,847.3
Santiago	--	--	--	--
Seville	1,500	--	3,222.3	--
Tarragona	--	750	--	265.8
Valladolid	1,500	--	1,618.5	--
Vitoria	--	1,000	--	644.8
Zaragoza	1,500	1,849	617.3	1,265.3
Total	48,687	75,724	71,564	97,302

Source: *Ensayos sobre la economía española mediados del siglo XIX*, appendix 1

Figure 1 *Banknotes in circulation, 1856-1873*  
(thousand pesetas)



Source: *Ensayos sobre la economía española mediados del siglo XIX*, appendix 1



### 1874: the end of free banking

On 19 March 1874 the Bank of Spain obtained the monopoly of issue, a privilege that it had been seeking since the law was passed in 1856<sup>16</sup>. The decree radically changed the Spanish financial system, and as such 1874 is a true milestone in Spanish financial history. The end of the plurality of issue saw the disappearance - not without some resistance - of fifteen institutions, which were given the choice between merging with the Bank of Spain or continuing as credit and discount companies<sup>17</sup>. Almost all chose the merger, but four of them decided to go their own way<sup>18</sup>. The granting of the monopoly was not a surrender to the Bank by the State, but the result of the Treasury's circumstances, as it was unable to finance its rising costs, which had increased from 678 million pesetas in 1868 to 789 million pesetas in 1873. Three simultaneous wars (civil, cantonal and colonial) had led to a considerable rise in military spending, from 111 million pesetas in 1870 to 329 million in 1873 (almost half the budget). The stagnation of public revenue, due to the rigid tax system, led to an increase in the budget deficit to 227 million pesetas (about 3 percent of GDP) and the public debt increased from 7,289 million pesetas in 1870 to 11,416 million pesetas in 1874 (145 percent of GDP)<sup>19</sup>. Political instability since the 1868 revolution and the proclamation of the First Republic in 1873 made borrowing abroad difficult and expensive, and the interest demanded by private Spanish bankers reached unsustainable levels. Although other measures had been taken, such as leasing the mercury mines at Almadén for around 42 million pesetas, and the Rio Tinto copper mines for 94 million pesetas, and the Bank of Paris and the Bank of the Netherlands had been authorized to establish a Mortgage Bank in return for a loan of 100 million pesetas, the Treasury was virtually bankrupt. Salvation was sought from the Bank of Spain: an urgent loan was requested in exchange for the monopoly of issue<sup>20</sup>.

The justification provided by the finance minister in the preamble to the decree granting the monopoly leaves no room for doubt that the Treasury's problems were what led to the end of the plurality of issue: "our credit has been lost due to abuse, taxes have been exhausted due to administrative vices, the payment of our debt is at present frozen, and as a result we are forced to use other means to consolidate the floating debt and to withstand the huge costs of the war that has afflicted most of our provinces for two years... ". The only possible solution sought was to "create a National Bank, based on the Bank of Spain ... as a new financial power that can assist the Treasury"<sup>21</sup>.

<sup>16</sup> Tedde, "The Bank of Spain", p. 88 et seq.

<sup>17</sup> On the resistance of the Banco de Santander, see Pablo Martín-Aceña, *Banco Santander. 150 years of history*. Madrid, Turner, 2007, pp. 34-41; and that of the Banco de Bilbao in Manuel-Jesús González, Rafael Anes and Isabel Mendoza, *BBVA ciento cincuenta años, ciento cincuenta bancos*. Madrid, BBVA, 2007, p. 58 et seq.

<sup>18</sup> Banco de Barcelona, Banco de Bilbao, Banco de Santander and Banco de Reus.

<sup>19</sup> These figures are taken from Francisco Comín and Daniel Díaz Fuentes, "Sector público administrativo y estado del bienestar", *Estadísticas Históricas de España*. Madrid, Fundación BBVA, 2005. An excellent study of the Public Finance of the period in Francisco Comín, *Hacienda y economía en la España contemporánea, 1800-1836*. Madrid, Instituto de Estudios Fiscales, 1988.

<sup>20</sup> On the establishment of the monopoly, see Anes, "El Banco de España", pp. 125-33. On the negotiations between the government and the Bank of Spain, see Gabriel Tortella Casares, *Los orígenes del capitalismo en España*. Madrid, Tecnos, 1973, pp. 314-17, and Lluís Castañeda (2001), *El Banco de España, 1874-1900. La red de sucursales y los nuevos servicios financieros*. Madrid, Banco de España. *Estudios de Historia Económica*, 41, 2001, pp. 11-19

<sup>21</sup> In France, the government's decision in 1848 to grant the Banque de France the monopoly of issue was also driven by the need for extra financial resources to fight domestic insurgency; see Charles A. Conant, *A History of Modern Banks of Issue*. New York, Augustus M. Kelley, 1969 (1<sup>st</sup>. ed. 1896), pp. 51-54; Vera Smith, *The rationale of central banking*, Indianapolis, Liberty Press, 1990 -1936, p. 33; the topic is well explained in Gabriel Ramon, *Historie de la Banque de France*. Paris, Bernard Grasset, 1929;

In exchange for granting the monopoly, the Treasury received an advance of 125 million pesetas at the low interest rate of 3 percent, which it agreed to return within two years, but which was never repaid and remained on the Bank's balance sheet<sup>22</sup>. The funds were used to avoid bankruptcy and free the Treasury from the greed of private bankers. For the Bank of Spain, this process was similar to being founded anew, and the privilege made it into a genuine national bank and an unequalled financial power. At a stroke, it had fourteen branches, enabling it to expand its operations as a credit and discount institution. The Bank was also authorized to double its share capital to 100 million pesetas, which it did a few years later, and to increase it to 150 million pesetas when the economic situation made this advisable (the increase took place in 1883). Its capacity for issue also significantly increased to five times the capital (instead of the three times established by the law of 1851), while the ratio of reserves to notes in circulation fell from 30 percent (as stipulated by the law of 1851) to 25 percent<sup>23</sup>.

The decision of 1874 made the Bank a true financial powerhouse, and placed it in an absolutely dominant position within the Spanish financial system. In 1900, the issuer's assets amounted to 2.706 million pesetas, which accounted for 68 percent of the country's entire credit system<sup>24</sup>. It also made the Bank into one of the country's most successful trading companies, as will be seen in the next section. The Bank of Spain became the most important public-private institution, and the only one present all over Spain by means of its branches and banknotes. It was a kind of (financial) State within the State.

### **The making of a national banking system**

The monopoly of issue changed the structure of the banking system. In the same way that the adoption of the peseta as the national currency in 1868 unified the monetary system, the centralization of issue in a single banking institution contributed to the integration of the financial market. This process of integration took place in three ways: the expansion of the network of branches, the adoption of a unified banknote throughout the country, and the establishment of a free transfer service between the Bank's current accounts. However, it was a decade before the national banknote and transfer service were introduced, and two decades before a majority of the Spanish provinces had a branch of the Bank. As well as these three ways that facilitated the construction of a national banking system, a fourth pillar which consolidated the position of the Bank of Spain as a national institution was its final conversion into the Bank of the State, financing the Treasury and expanding its role as a fiscal agent.

### The network of branches<sup>25</sup>

In 1874 the Bank of Spain only had a central office in Madrid and two branches in Valencia and Alicante that opened in 1858. This number is much lower than, for example, the Bank of France, which had 69, and the Bank of England, which had nine.

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Achile Dauphin-Meunier, *La Banque de France*. Paris, 1936, and Yves Leclercq, *La banque supérieure. La Banque de France de 1800 à 1914*. Paris, Editions Classiques Garnier.

<sup>22</sup> On the financial conditions of the loan and the contract between the Treasury and the Bank of Spain, see Eloy Martínez Pérez, *Banco de España. Sus orígenes, operaciones y situación*. Madrid, Gráficas Reunidas, 1922, p. 94

<sup>23</sup> Tortella, "El Banco de España", pp. 285-87; Anes, "El Banco de España", pp. 125-133

<sup>24</sup> Pablo Martín-Aceña, "Development and modernization of the Financial System, 1844-1935", in Nicolás Sánchez Albornoz (ed), *The Economic Modernization of Spain, 1830-1930*. New York, New York University Press, 1987, table 6.1, p. 113.

<sup>25</sup> The content of this section is taken from Anes, "El Banco de España", pp. 166-71, and Castañeda, *El Banco de España*, pp. 36-86.

After the monopoly decree, the network was expected to expand with the incorporation of the former issuers into the Bank, whose offices would become branches. The decree also stipulated that the Bank would soon establish branches "in the most important towns of the nation, to meet the needs of trade and circulation of the banknotes that must be issued" (art. 6).

The incorporation of twelve provincial issuers meant that the two existing branches had increased to fourteen by late 1874. Starting with Barcelona and Bilbao, branches began to open in various provincial capitals in the following years, and in these cities the existing issuers chose not to join and become credit and discount banks. It was agreed to classify the branches in three categories in the same year, based on the financial importance of each town. According to the Bank's by-laws each one was headed by a director, who formed the small board of directors with the auditor, the clerk and an official secretary.

In the 1870s, branches were opened gradually, as shown in table 2, so that in 1880 the network consisted of 22 branches. Three obstacles hindered a more rapid expansion of the network. The first was insufficient resources, which was not resolved until 1883, when the government authorized an increase in the Bank's capital from 100 to 150 million pesetas. Concern about opening and administration costs was another obstacle, as the directors of the institution thought that this would have a negative effect on the Bank's results and on the dividends available for distribution among shareholders; particularly taking into consideration the cost involved in monitoring each new agency by the central office and the cost derived from the regular inspections of their administration services. Third, the difficulties in finding qualified personnel to occupy management posts in each branch.

It was necessary to wait for the capital increase mentioned above and the arrival of a governor at the Bank in 1883 who was determined to fulfil the mandate of the decree granting the monopoly, to finally make the institution expedite and intensify the opening process; this can be seen by the fact that fifteen branches were opened in 1884, and twelve more in 1885-86<sup>26</sup>. The pace subsequently slowed once again, and only nine branches were opened between 1885 and 1900, making a total of the 58 branches listed in table 2. This number was still much lower than the 392 branches that the Bank of France had opened around France.

Notwithstanding the pace of openings and the density of the network proving excessively limited for the size of the country, the fact is that branches of the Bank of Spain contributed to the transformation of the former local Madrid-based institution into a true national institution, especially considering that it was the only bank with branches before the end of the century. Although the financial activities of the branches were limited and its cash reserves were its main asset, and these were used for the conversion of notes, a study of cash flows shows that Madrid generally occupied a creditor position, suggesting that the branches did their job of distributing credit from the centre of the country to its outlying regions. This did not prevent funds being moved from the network towards the centre when liquidity tensions became apparent in Madrid, mostly as a result of the Treasury's requests for funds. A more important contribution by the network of branches was the unification of interest rates, which had in practice been achieved by 1880. The fact that the central office discounted paper at the same price as

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<sup>26</sup> In addition, a body of branch inspectors was created in 1885. This body was essential for coordination between all the branches, and between the branches and the headquarters.

the offices in Barcelona, Bilbao and Valencia, to name the most important, meant that a national financial market was being created which had not existed a decade earlier<sup>27</sup>.

Table 2. *The branches of the Bank of Spain*

Year	Number of branches created in the year	Total branches
1858		2
1874	12	14
1875	3	17
1878	2	19
1879	2	21
1880	1	22
1884	15	37
1885	2	39
1886	10	49
1887	6	55
1889	1	56
1892	2	58
1900		58

Sources: Anes, "El Banco de España", p. 134

### The emergence of the national banknote

The decree of 1874 did not bring about the immediate unification of banknotes, which did not take place until 1884, when the decision was taken to issue the same type of banknote for the whole nation; i.e. a single banknote that was convertible in any branch in the country. Until then, convertibility had been local. The bills were sent from the central offices to each branch separately, and once the names of each one had been stamped on the specimens assigned to them, they were only convertible into cash at the branch concerned and in Madrid. This was because according to the monopoly decree, "the situation (of civil war) that the nation is now experiencing means that it is impossible to verify material transfers of flows with the speed required for reimbursement of the notes of the Bank of Spain upon presentation in the branches. For the present, each one will receive the amount of banknotes it requires due to the importance of its operations; these will be distinguished by a stamp indicating the branch to which they belong"<sup>28</sup>. Obviously, despite the existence of a national issue, local convertibility restricted the circulation of banknotes to the province where the branch was located and its area of economic influence.

After the war ended and problems with the physical production of notes had been solved, the introduction of the national banknote was delayed by another decade<sup>29</sup>. First, an increase in forgeries was feared. These were common and were a nightmare for

<sup>27</sup> Notwithstanding, in a pioneer paper Luis Castañeda and Xavier Tafunell have argued that before the Bank of Spain established its network of branches, the bill of exchange placed a paramount role contributing to the integration of the nation's financial market. They showed that price differences of the bill amongst cities were a reflection of their respective financial (credit-debit) position. They also showed that when the Bank began to open branches, the volume of the bills of exchange dropped and their role as a means of payment and as an instrument to transfer liquidity declined, "Un nuevo indicador para la historia financiera española: la cotización de las letras de cambio a corto plazo", *Revista de Historia Económica*, XI, 2, 1993, pp. 367-383.

<sup>28</sup> Article 7 of the 1874 Decree-Law

<sup>29</sup> Castañeda, *El Banco de España*, pp. 87-97

the directors of the institution. Locally-based notes had several drawbacks for counterfeiters. They were easy to identify if circulated in other provinces, and the amount that could be counterfeited was limited by the economic area in which the branch operated. A unique banknote would be more exposed subject to counterfeiting and discovering the fraud would also be more difficult. Second, as the Bank's services did not have accurate information about the geographic flows of the notes, they feared that the new banknote would lead to liquidity difficulties in some areas, especially if large sums were presented for encashment. To avoid this problem, each branch had to have in their vaults sufficient metallic cash, at the expense of other more productive and profitable investments. The cost of moving cash from one city to another within Spain and the financial cost of maintaining a high level of reserves were the arguments used to delay the introduction of an homogenous banknote. The advantage of the locally-based note was that the agency's officials knew the exact volume in circulation locally, enabling them to accurately manage their reserves. In Spain in 1874, when the monetary system was still based on coins, the use that would be made of notes was still an unknown factor, as was the extent to which they would replace traditional bills of exchange in remote payments. In addition, little was known about the seasonality of demand for money in cash. The discussions among the Bank's Board of Directors and the General Meeting of Shareholders were continuous, and set supporters of the national banknote against its detractors. In the end, it was pressure from the bankers, the governor and the Treasury department which forced the Bank to take steps to implement circulation on a national basis. The adoption of the free transfer service between current accounts for customers and a relatively cheap draft service for third parties undoubtedly contributed to this solution.

Table 3 shows the slow process leading to the implementation of national convertibility. During the first phase, agreement was reached on convertibility between adjacent areas. The process speeded up in the early 1880s, as branches opened in various cities. A major step forward was taken in March 1882, with the declaration of national convertibility of the 25-peseta note, the lowest denomination. The unified banknote for 50 and 100 pesetas was introduced in May of the same year. Finally, the banknotes for the remaining denominations arrived in 1884. It was therefore on this date when all the Bank's notes, without any specification, began to act as a means of payment throughout the entire country. In fact, the first "unified" or "national" issue came into circulation on October 1, 1886<sup>30</sup>.

Figure 2 shows the evolution of banknotes in circulation between 1874 and 1900. As expected, the trend is upwards from the year the monopoly was granted, but a faster rate of increase is noticeable after 1884. Circulation rose from 383 million pesetas, to 734 million and then to 1,592 million at the turn of the century. The causes of the increase are complex and we have studied them elsewhere<sup>31</sup>, but it should be stressed that the national banknote facilitated the adoption of paper money in the payment habits of the Spanish population. Evidence of this can be seen in the change that took place in the composition of the money supply between 1874 and 1900. While metal money predominated in 1874, by 1900 banknotes accounted for half of the total amount of money in circulation<sup>32</sup>.

<sup>30</sup> Teresa Tortella, "Billetes españoles, 1874-1939. De la Restauración al final de la guerra civil", *Billetes españoles 1874-1939*. Madrid, Banco de España, 2005, p. 26.

<sup>31</sup> Pablo Martín-Aceña, Elena Martínez and Pilar Nogues-Marco, "Maximizing profits or pursuing the public good? The Bank of Spain as a central bank". Unpublished manuscript, March, 2012.

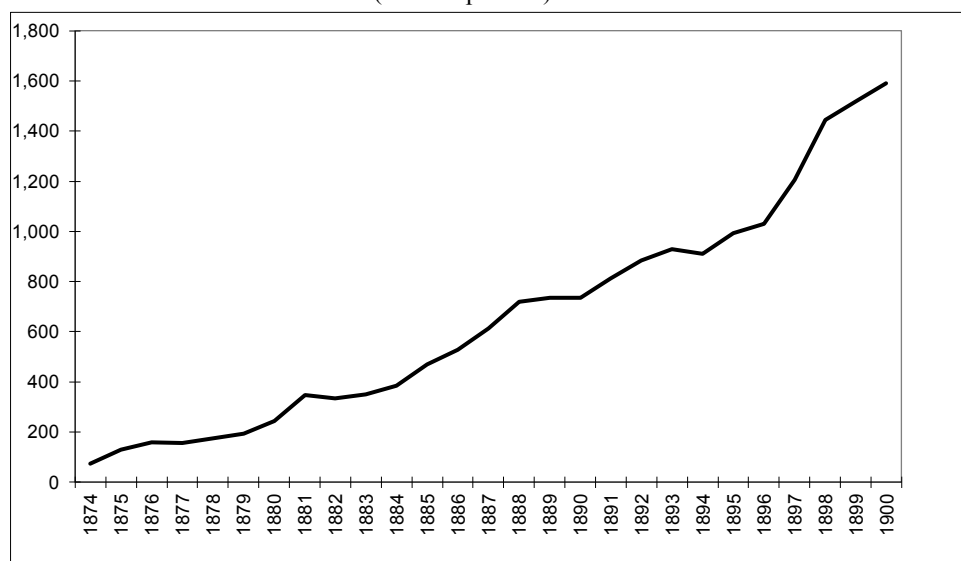
<sup>32</sup> Gabriel Tortella Casares, "Las magnitudes monetarias y sus determinantes", *La banca española en la Restauración. I: Política y finanzas*. Madrid, Banco de España, 1970, pp. 484-97

Table 3. *The Bank of Spain's notes: from local to national*

Date	Local convertibility
1878 September	Reus-Tarragona Cádiz-Jerez
1879 May November	Sevilla-Cádiz-Jerez Bilbao-San Sebastián-Vitoria-Pamplona
1880 March April	Córdoba-Sevilla Alicante-Valencia Málaga-Córdoba-Granada Coruña-Oviedo Santander-Valladolid Zaragoza-Pamplona-Vitoria-san Sebastián-Bilbao
1881 March May	Cádiz-Sevilla-Granada-Málaga Córdoba-Badajoz Málaga-Jerez Badajoz-Granada-Málaga-Sevilla
1882 March  April May	Málaga-Cádiz National convertibility of the 25-peseta note Badajoz-Jerez-Cádiz Santander-Valladolid-Zaragoza National convertibility of the 50- and 100-peseta notes
1884 February March	National convertibility for all notes (25, 50, 100, 250, 500 and 1,000 pesetas)

Source: Castañeda, *El Banco de España*, table 1.7

Figure 2: *The Bank of Spain's notes in circulation, 1875-1900*  
(million pesetas)



Source: Banco de España, *Memorias anuales*, 1875-1900.

### The transfer service: 1883<sup>33</sup>

In November 1833 the Board of the Bank of Spain, after a proposal by the governor, took a decision of great significance for the integration of the national financial market: to offer its clients a free transfer service between current accounts<sup>34</sup>. At the same time, it decided to offer the public a draft service with a fixed commission, which at that time was set at 1.5 percent. The success of the measure was immediate, as the new system attracted the attention of the public and was used by merchants, industrialists and bankers all over the country. Transfers increased exponentially, from 500 million pesetas in the first year to 1,600 million in 1890; by 1900 they had multiplied sixfold.

The innovation had major implications for the construction of the domestic market that are worth mentioning. First, it led to savings by substantially reducing payments and the transport of cash from one place to another. It also affected the volume of paper payments. As a consequence, the operating costs in the movement of money were substantially reduced. This can be deduced from the price of bills of exchange payable on demand in the Barcelona market. Bills of exchange not only ceased to play a central role as an instrument for transferring liquidity from one market to another, but the rate of discount applied also fell substantially between 1883 and 1900. The free transfer (and the draft service) displaced the bill of exchange, reduced financial costs and thereby contributed to the integration of the Spanish market, in the same way as the network of branches and the unified banknote.

### The Bank of the State

As we know, the Bank of Spain's relations with the Treasury were forged at the very inception of the institution in 1872, under the name of Banco de San Carlos. This relationship intensified over time, so that by the mid-nineteenth century the issuing bank was undoubtedly an official bank, despite its capital being in private hands. Long before 1874, the Bank had been advancing funds to the Treasury in exchange for bills on the provincial treasuries. In the short and medium term, it loaned funds with the guarantee of promissory notes or bonds for disencumbered assets and property, and assisted in the issue of a special debt, Treasury bills, assuming responsibility for a large proportion thereof. The relationship became so close that in 1873 the Bank's assets against the State already accounted for 70 percent of the total.

From 1867 onward, the Bank began to act as the Treasury's fiscal agent; it was responsible for the collection of direct and property taxes as well as for the collection of duties on property, industry and trade. From 1887, it undertook to advance the Treasury liquid funds charged to the collection of taxes every month. The Bank was also responsible for servicing the public debt, including making interest payments and repayments of the principal, and being involved in issues and in all negotiations affecting its volume and terms<sup>35</sup>. In return for all this, in 1891 the Bank persuaded the State to renew its privilege of issue for another thirty years. Furthermore, thanks to its financial services to the State, the institution presented exceptional levels of profit every year, and rates of return above those obtained by non-issuing banks and credit companies<sup>36</sup>. Table 4 clearly shows the relationship between the State's assets in the Bank's balance sheet, its financial performance and the price of its shares.

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<sup>33</sup> Castañeda, *El Banco de España*, pp. 97-99 and 161-68.

<sup>34</sup> The transfer service was already included in the Bank's Statute of 1876, but had not been put into operation.

<sup>35</sup> Anes, "El Banco de España", pp. 116-24; Tedde, "The Bank of Spain", pp. 88-108

<sup>36</sup> Martín-Aceña, Martínez and Nogues-Marco, "Maximizing profits".

Table 4. *Bank of Spain: Treasury assets and profitability*. In percentages

Year	Treasury assets	Return on assets	Share prices
1875	50.4	14.3	156.7
1880	40.7	20.2	281.0
1890	51.3	15.6	403.7
1899	63.2	25.0	420.2

Source: Anes, "El Banco de España", table III-9, III-12, III-13

### Conclusions

The current crisis of the European Economic and Monetary Union has highlighted the difficulties of financial stability that a monetary union without political unification entails. History shows that financial integration, with all its advantages, came about at the same time as the emergence of a central bank backed by nation states. The study we present here illustrates this with the Spanish case. In the nineteenth century, Spain experienced a radical change in its financial structure, with the transition from a regional plurality system to a monopoly system. The process of national financial integration accelerated when the Bank of Spain obtained the monopoly of issue. Although piecemeal, a "national banknote" circulating throughout the country was introduced, the network of branches expanded, accelerating the national convergence of interest rates, and a nationwide system of banking transfers was adopted that put an end to the archaic payment mechanism using bills of exchange.

The Bank of Spain's central role in the Spanish financial system dates from the late eighteenth century, and it did not relinquish this position during the era of plurality of issue. In 1856 as well as in 1873, it was the same size as all the provincial banks combined, in terms of both its paid-up capital and the volume of banknotes in circulation. Moreover, by that time it already administered a large proportion of the Treasury's fiscal affairs. However, it was the monopoly of issue in 1874 which truly brought about the consolidation of the financial integration process. The network of branches immediately expanded from two to fourteen thanks to the absorption of most of the provincial issuers, and there were 58 branches located throughout the country by the end of the century. The free transfer service between accounts was established in 1883, and it increased its volume sixfold in less than twenty years. Finally, the same model of banknote was put into circulation in 1886. The unified banknote facilitated the use of paper as a means of payment, and this quickly replaced metal in the composition of the money supply, so that by the end of the century half of the currency in the hands of the public consisted of banknotes. All these measures adopted by the Bank of Spain taken in the second part of the nineteenth century contributed to the nation-building process, as did the early adoption of the peseta in 1868 as the sole currency for the entire country.

However, the conversion of the Bank of Spain into a true central bank was not easy and was not without problems. The monopoly of issue did not lead *per se* to the adoption of the roles of a central bank: ensuring the convertibility of banknotes for gold and providing the system with liquidity in crises by acting as lender of last resort. The Bank of Spain did not perform either of these two functions, as it prioritized its private interests; it placed the maximization of its profits before the assumption of its responsibilities as a central bank.



When Francisco Cambó, the finance minister who in 1921 introduced in 1921 a sweeping reform of the Spanish banking system in the Congress of Deputies, he had no doubt that the issuing institution bore still little resemblance to a central bank. Cambó said bluntly that "even with all its glorious history and the very great services it has rendered to the country, the Bank of Spain, despite its position today among all the world's issuing banks, in its structure and its workings it is not what a proper central institution that must govern Spanish economic life should be". In the opinion of the minister, there was hardly any connection between the private banks and the issuer; and although they were both part of the financial structure with their various functions, the economy could not yet exploit the potential offered by a well organized credit system. In his view, the Bank and the banks were not properly "coordinated and linked." One of the objectives he wanted to achieve with his banking reform was to strengthen the links between the Bank of Spain and the banking system, so that the Bank could truly play the role of a Bankers's bank. He wanted to "coordinate the issuing bank with the private banks in the organization of a general system of credit," because he was absolutely convinced that "a bank of issue must be a bank of banks" and for the Bank of Spain in 1921, this was still not the case<sup>37</sup>

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<sup>37</sup> Speech by Francisco de A. Cambó, Finance Minister, in the Congress of Deputies", reproduced in the Ministry of Finance volume *Ordenación Bancaria en España* (Madrid, 1921), Part III, pp. 5-31. On the Bank of Spain's transformation into a true central bank, see Pablo Martín-Aceña and Olivier Feiertag, "The delayed modernization of the central banks of France and Spain in the twentieth century", *The emergence of modern central banking*. Ashgate Publishing, 1999; and Pablo Martín-Aceña, "El Banco de España entre dos siglos: de banquero del Estado a prestamista en última instancia", Antonio Morales (ed), *Las claves del siglo XX. Las transformaciones económicas*. Madrid, Sociedad Estatal Nuevo Milenio, 2001, pp. 95-139.

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