

A foreign perspective on national public finance: Leroy-Beaulieu on the Spanish debt troubles of the end of 19th century

Preliminary version

Introduction

The history of the public finance of Spain in the 19th century is the history of the struggles of the government to rein in public deficit, solve the problem of the excess of public debt, and stabilize the currency. One of the most important episodes in this regard was the establishment of a fiat money regime based on non-convertible paper issued by the Bank of Spain at the end of the century.¹ When virtually all European countries were restoring convertibility and turning to the gold standard, Spain's monetary circulation consisted on paper and silver coins. The causes for this were two: An excess of silver coining, and, above all, the resource of the Treasury to cheap loans from the Bank of Spain, which, in turn, obtained permission to issue paper money of legal tender. The consequence was a depreciation of the currency. This circumstance was aggravated by the uprising in Cuba and subsequent war with the United States. Spain could not enter the gold system, even if (at least formally) this was an aspiration of policymakers, conservative and progressive.² Economists in general criticised this monetary regime (and the special relation between the Bank and the Treasury), as it meant manipulating monetary supply and rendered currency unstable and depreciated. Investors, foreign in particular, getting their income in pesetas, were not happy either.

Little attention has been placed to the views that foreign economists had on this question, even if in an increasingly globalised world these decisions had presumably big influences on foreign actors. This paper therefore analyses the view of the French economist Leroy-Beaulieu on the controversy of forced paper circulation in Spain at the time of the Cuban crisis (1898-1899). A chief economist of huge reputation, Leroy paid much attention to this matter, publishing in the fortnightly journal *L'Économiste français* (of which he was the editor) a series of articles in 1898-1899.³ The opinion of Leroy was far from unimportant: He was one of the most influential economists of the French liberal school, which was predominant in the main economic institutions in France. In fact Leroy had strongly contributed to the building of the theoretical orthodoxy in public finance of this group, he emerging in the last decades of the

¹ See Carreras and Tafunell (2010) for details. The Bank of Spain had the monopoly of banknotes issuing since 1874.

² For instance, this was the case of Villaverde, the minister of finances who would manage to balance the budget with a series of reforms, mostly in taxes, which eventual objective was the accession of Spain to the gold Standard. See San Julian (2012), 52

³ This controversy has been addressed earlier by economic historians (Maluquer de Motes 1997, Chastagnaret 2000), but our perspective focuses more on the ideas behind Leroy's position, and the surroundings of the debate, still to be at least partially unveiled.

century as “the new classical master concerning public finance, since no other liberal economist had such an interest and expertise in this topic”.⁴ Therefore, his authorised views had a potentially big audience, not only in France, but also in countries of highly French influence, as it was the case of Spain.⁵

French liberal economists showed in general mistrust for government borrowing, following J.B. Say’s position. Puynode, in the *Dictionnaire de l’économie politique* (1852-1853), veritable economic Bible of the school, grounded this suspicion on its expensiveness, crowding-out effects, distortion in capital markets and excessive power bestowed to the government. Only three circumstances could justify an increase in public debt: war, public works and urgent repayment of past debts. According to Silvant (2016), Leroy was less apprehensive to public debt than his predecessors: Public loans had advantages, making them a “convenient and elastic” means of financing. Debt burden on taxpayers could become lighter with increases in the level of prices, increases in metallic circulation and depreciation of the value of money. Besides, the state could convert bonds to reduce the cost of paying interests. However, he warned that public loans might be dangerous if they were massively financed by the national bank and there was the risk of getting into a fiat money system. But if this risk is non-existent, “then they constitute a good option, as the case of the Bank of England exemplifies. A big banking institution with an outstanding background and large assets, holding the monopoly on banknote issuance, can lend with no inconvenience many hundred millions to the government on a permanent basis”. The key for a successful loan from the Bank to the government lied in a credible plan of amortisation or of conversion of that credit into consolidated debt.⁶

Although he felt sympathy for the particular circumstances of Spain during the war against the US, in *L’Économiste français* Leroy strongly attacked the policy of the Spanish cabinet, bound to create big disturbances to the exchange rate and economic stability. A firm sponsor of the gold standard, Leroy would support *ad nauseam* the need of reimbursing the advances made by the Bank of Spain as the highest priority for the country in order to restore the nominal parity of its currency (to the franc – 1 to 1 – or the sterling – 1 to 25) and thus join the gold system, the key for a healthy, prosperous and credible economy. It is arguable whether Spaniards could have acted otherwise. Some literature states that paper circulation conferred liquidity to the ongoing process of economic growth after the war, even if repatriation of capitals from Cuba played an important role too. The debate remains open whether Spain resulted benefitted for not entering the gold, as depreciation of the currency and flexible monetary policy stimulated growth (Sardá 1987, Serrano 2004, Ródenas and Bru 2006, Carreras and Tafunell 2010), or on the contrary, entering the gold would have brought higher long term profits (Martín Aceña 2000 and 2017). Leroy would have stood for the second.

⁴ Silvant (2016), 2 and 16.

⁵ See in this regard Lluçh and Almenar (2000).

⁶ Leroy-Beaulieu (1874), 28-29, quoted in Silvant (2016), 15. Leroy had analysed extensively the loan issued by the Bank of France to the government after the 1870 war. The experience had been – rarely – successful. The Bank had rendered “immense services” to France, and it had been “magnificently rewarded”. The public had trusted the Bank’s notes, not impressed by past experiences of banknote massive circulation ending in disaster, or by the effects of fiat money on neighbouring nations. The key for this success was a credible plan of amortisation set by the government. To Leroy, public loans should never take the form of perpetual loans but of obligations periodically redeemable. Leroy-Beaulieu (1874), 22 and 35.

This paper has four parts. The first section set the scenery of the debate, the circumstance of the Treasury in the Cuban war. Second section refers to Leroy's criticism to countries with fiat money regimes. Third section deals with Leroy's articles on the financial situation after the war; and fourth analyses his comments on the government's plan to restore Spanish finances. Lastly, some conclusions will be delivered.

The scenery: The Treasury, the Bank and the war

A good starting point for Leroy's vision on the monetary controversy can be the report on the economic situation of Spain published in *L'Économiste français* by Henry Vergé in March 1898. He exposed the situation bluntly: Since 20 years there was deficit in the budget ranging between 5 and 12 % of expenses over income, so that the service of debt was taking two thirds of public revenue. Vergé believed that Spain was not able to increase taxes or create new ones.⁷ The Treasury had issued loans to pay for peacekeeping forces against insurrection in Cuba and the Philippines: a part of these bonds had been bought by Spanish investors, and the rest was handed over to the Bank of Spain as collateral for its advances to the government. The consequence was that the Bank was "in a quite difficult situation, with reserves of 500 million [pesetas], hardly half of it in gold, and money in circulation for 1.250 million; so 750 million are guaranteed by government bonds. It is not necessary to insist on the danger of this excessive circulation which raises the gold premium to more than 33%, and we fear it will go on mounting". The consequence, naturally, would be that "at the time of liquidation" Spain would have to impose its creditors a haircut, eventually depending on the cost of the war.⁸ But not everything was bad news: The report highlighted that in the last years the trade balance was positive, thanks mostly to the exports of mineral (although ownership of companies was foreign, meaning that profits were expatriated), and industry and internal trade had increased.

These gloomy circumstances were confirmed by A. Houghton, the correspondent of *L'Économiste français* in Spain, in his periodical account "Lettres d'Espagne", from which Leroy extracted data for his analysis. His report of March 26 summarised the situation of the Bank of Spain, from its annual report on the operations of 1897. As a consequence of the war and the advances to the Cuban Treasury,⁹ issuance of banknotes had increased largely. The government had allowed the Bank to increase the limits for paper issuing in several occasions. The Council of the Bank said that they had attempted to temper down the effects of paper issuing buying gold to strengthen reserves. In all, the war was draining resources, leading the government to sell bonds and to ask the Bank for advances, guaranteed by the Cuban and the Spanish Treasuries.

With this panorama in mind, Leroy-Beaulieu started his campaign on the Spanish case, economic and financial, but also political. On the political side, Leroy condemned the American ultimatum demanding Spain to submit Cuba after the incident of the Maine cruiser and saluted Spanish proposal of augmenting Cuban autonomy. American ambitions over the island were

⁷ According to *The Economist* of 20 January 1898, the Cánovas cabinet got in 1897 permission to raise taxes in 80 million pesetas. Only 20% of this amount was effectively collected.

⁸ Vergé (1898), 336.

⁹ Cuba had its own Treasury, separated from the Spanish, which issued and managed its own bonds.

probably impossible to fulfil, so Spain should go to war, to defend its honour and increase its credibility. But not only that: Leroy feared that leaving Cuba might raise a huge political crisis in the peninsula and even end the regime.

But it was the economic panorama after the war that concerned Leroy most. At first sight, he was optimistic about the consequences of the war on the Spanish financial assets. An unsigned article in *L'Économiste français* said that war would be probably short, and despite uncertainty, from a financial standpoint Spain should not suffer much. Rentiers having Spanish sovereign bonds will be bound to “make sacrifices”, but, if public order was kept, and although presumably some extra taxes would surcharge industry temporarily, recovery could be quite fast as far as the exporting sectors continued being the engine of the economy.¹⁰ Leroy agreed with that analysis: In an article written one week later he uttered that the war might have minor effects on speculative assets in Europe. The US was likely to reimburse its credits in gold to pay for the war, and the UK had increased its discount rate significantly (from 3 to 4 %; France would follow). As for Spanish securities, he was inclined not to believe that the situation was hopeless. Economic resources plus a certain government “respectability” would suffice it to keep securities’ values intact. To Leroy, the true danger for Spanish financial markets was the possibility of an internal political crisis.¹¹

So, Leroy was not really worried for the financial effects of the war, but for the manoeuvres of the government and the Bank leading to increases in paper circulation and quick depreciation of the exchange rate, which would have an impact on profits of foreign investors and bondholders. His concerns were reflected in the fact that, apart from making extensive references in the successive editions of his books, in the time span of one year and a half, he wrote ten articles on the subject in *L'Économiste français*. The Spanish case would allow him to exemplify the evils of fiat money and the virtues of the gold system.

Leroy's campaign against fiat money (*les pays à finances avariées*)

On May 7 1898, Leroy wrote an energetic article against countries with fiduciary circulation, the “countries of faulty finances”, as he called them.¹² Leroy departed from the fact that the premium of bills of exchange on London or Paris in Madrid or Barcelona had skyrocketed to 110-115 %. This entailed a big detriment for shareholders of companies making their business in Spain that paid dividends abroad (railroads, utilities, insurance firms, etc.). Even if Spain was

¹⁰ Unsigned (1898), 515. This idea would be hammered down again in *L'Économiste Français* at the end of April: Once the war broke off, the price of shares of mining firms did not fall; even they have increased their value. Unsigned (1898, 30 April), 596.

¹¹ Leroy (1898, 23 April), 537-539. In any case, there were some signs of deterioration of the Spanish credit. For instance Spanish “4% foreign bonds” prices had fallen dramatically in the previous decade (in 1890 quotation was 78 francs; by 1898 it was 33 francs).

¹² This expression he had coined in an article in 1891, to refer to countries with budget deficits and problems in their exchange rates. The article title was “Finances avariées: République Argentine, Brésil, Portugal, Espagne, Grèce, etc.”. This expression would become widespread. Already in 1891 Leroy warned the Spanish government that paper circulation was excessive, arguing that the Bank's mission was not to print paper money to lend the government.

not an isolated case (Italy, Greece, Portugal, Brazil and Argentina suffered from similar problems), Leroy stressed the importance of the “genuine debacle” of Spain.

What were the reasons for this depreciation of the Spanish exchange rate? It was not speculation, as many in these countries said (here Leroy charged against “the absolute ignorance or immense weakness of the financiers of these countries of faulty finances. They do not understand anything, or pretend not to understand, in a matter in which economic laws are as true as physical laws”). No, depreciation had two main causes: the amount of paper money in circulation (the “material” cause) and the expectations people had on whether paper in circulation would increase or decrease (the “moral” cause). Leroy judged that it was the second cause affecting Spain: The public expected circulation to increase beyond the statements of the government, and expectations linked to the predictable defeat in the war and the fear of internal turmoil played a role too. Consequently, everyone tried to get rid of paper. Leroy despised the belief that enough reserves would prevent paper depreciation (the Bank had bought gold). Although Spain fulfilled the conventional rule of reserves (they reached one third of paper in circulation), this did not have any influence on the value of paper because convertibility was suspended and there was not short-term perspectives of it being resumed.¹³

Who was the culprit? Cánovas del Castillo, the old conservative prime minister “has an enormous responsibility”. It had been him who entangled the Bank of Spain in the business of advancing money in the early nineties, instead of resource to standard borrowing. Leroy advised the government not to allow issuing more paper. As it was difficult to borrow abroad then, he suggested an internal loan without an increase in paper circulation: It was preferable to use gold reserves or temporarily suspend amortisation of internal bonds and reduce the interest of foreign bonds 25 or 30 % than increase circulation. This should be the very last resort.¹⁴

This was not the first time that Leroy had warned of these practices. In his *Traité théorique et pratique d'économie politique* (1896) Leroy highly encouraged issuing banks of countries “of faulty finances” not to use their resources to make loans to their governments. The reason was that sovereign bonds of these countries tended to oscillate excessively, which might result in risk of bankruptcy to the banks. Issuance of paper would be safe depending on the bank reputation and the nature of its customers, but as a rule, banks should be circumspect in this business. Eventually, however, there was an “automatic mechanism” to restrain issuance: convertibility: “A prudent administration should never attain the point of saturation of banknotes. If convertibility has been suspended, it is imperative to contract circulation in order to lead notes to the par. In fact, biggest banks – the Bank of England, the Reichsbank, the Bank of France and the pool of banks of New York – tend to match circulation to reserves”. Actually,

¹³ Leroy-Beaulieu (1898, May 7), 613-614. In effect, at that time paper in circulation amounted to 1.305 million pesetas, and reserves were 463 million (245 in gold; the rules of the Bank allowed reserves to be half in gold and half in silver). However convertibility was suspended.

¹⁴ If it was eventually the case, Leroy claimed that this “artificial depreciation of the currency”, caused by the action of the government, should be accompanied by compensations to the firms potentially affected. Leroy-Beaulieu (1898, May 7), 615.

with non-convertible paper big reserves cannot prevent depreciation unless resumption of convertibility is credible to the public. Only then, reserves turned important.¹⁵

“Loans, conspicuous or concealed, made by issuing banks to governments, are the biggest danger to these banks and to the entire financial system of a country”. This apparently beneficial association between the Bank and the government entailed the risk of bankruptcy: frequent advances to the government led to intense crisis. “Some striking examples of madness in this matter have emerged in peacetime recently in some governments, particularly the Spanish government”. Leroy regretted that Spanish finances were always managed in a “certain nonchalant manner”, he referring to constant budget deficits. At the beginning of the decade of 1890, this accumulation of debt required fresh financing. A public loan could have been issued, at a reasonable effective rate (around 5,25% Leroy calculated). If this proved not possible, the government had the possibility of a moratorium, delaying the maturity of its bonds (even if this was financially disappointing). But the government preferred to make the Bank of Spain lend it enormous sums allowing it to issue notes. This plunged the nation into “all sorts of evils”, including – notably – a fiat money regime, set almost immediately.¹⁶ The circumstances of the Bank of Spain in 1894 were that virtually all its assets (capital, reserves and deposits) were engaged in a series of loans to a single borrower, the Treasury. Interests were paid, but the capital lent was probably unrecoverable. Circulation of banknotes fulfilled the reserve rule, but – as he said – this did not prevent suspension of convertibility and a strong devaluation of notes (23 % in 1894). Leroy denounced that through this malicious operations the Bank shareholders attained some profits (the interests of the loan), but non-convertible paper might in the medium term jeopardize the future of the Bank and the monetary circulation in the country. This was then misconduct of the banks, triggered by pressures from the government: “They throw the country into a complete state of confusion for some years or decades”.¹⁷

Fiat money regimes were extensively analyzed in the successive editions of Leroy’s praised *Traité de la science des finances*.¹⁸ As it has been said, his feelings were twofold. He compared issuing banknotes to money falsification, as they produced the same effect (even worse, false coins did not affect the value of other coins, but banknotes depreciated existing paper), but he acknowledged that, to prudent nations, paper issuing could render big services to face a crisis supplying the state with resources impossible to attain otherwise. The problem emerges when banknotes are forcefully legal tender. This breaks the condition that banknotes should be redeemable to gold at sight. It turns into a forced loan with no interests made ultimately by the public, who is constrained to accept banknotes in exchange for goods or services. The

¹⁵ Leroy-Beaulieu (1896), III, 483 and 670-676. Evidence was provided by the Bank of Spain: Even if the between 1893 and 1894 the ratio of circulation to reserves had improved, the rate of exchange of notes had depreciated. The conclusion was that, under a regime of fiat money, their value did not depend on reserves, but on the “general financial and conditions of the country”. Actually Leroy deemed conventional reserve rule a “whole falsehood”.

¹⁶ Leroy-Beaulieu (1896), III, 682-683. Leroy had warned of this in *L’Économiste français*.

¹⁷ Leroy-Beaulieu (1896), 683-686.

¹⁸ Since the first edition of this book in 1877, the question of the fiat money was profusely treated. In this first edition the case of Spain was not contemplated, but naturally the process of debt monetization and the flood of inconvertible paper in the last decade of the century made Leroy to analyse this particular case in successive editions.

issuing bank is now just an intermediary between the state and the public, and the interest it gets is just a commission for its role of intermediary, or a premium for the risk it runs in case the state defaults. Three reasons made states go into a fiat money regime: Government's most urgent need for resources not available from taxes or ordinary loans; the need of getting resources to a very low interest rate (this is, out of capital markets); or when metal is too scarce. He added a fourth – regrettably – reason: “The bad habit that the majority of countries have acquired of regarding big banks as institutions aimed in part to lending to the public Treasury”. The effect of fiat money is to widen fiduciary circulation beyond the limits that it might have (according to reserves), so increasing means of payment in the economy. When a state decrees the establishment of a fiat money regime and gets big loans from the Bank, which in turn issues banknotes that go to the public, this intruding increase in circulation is excessive, as it has no correspondence to the real activity of the country. The consequence is that metal vanishes and is hoarded, whereas the value of banknotes can change abruptly.¹⁹

A problem of fiat money regime is that it “is particularly insidious. When it is established, it finds many partisans, some for weakness, others by ignorance [Leroy insisted much that governments establishing it had a complete ignorance of economic principles], some others for a real interest”. Governments not willing to impose harsh measures accept it with pleasure. Some businessmen also support it as it creates inflation (this was the case of farmers and manufacturers in the US). Leroy understood well the mechanism through which fiat money creating inflation might benefit local production in front of imports, payable either in gold or in convertible notes at par. Speculators also benefitted from inflation, buying cheap and selling dear, or taking credits that later were easier to repay. Speculators on securities and bankers receiving deposits were *inflationist* too. All debtors profited from depreciation. However, Leroy insisted that these particular interests were nothing compared to the inconveniences of fiat money for the prosperity of the country: Instability in the value of the means of exchange leading to uncertainty, exchange rate risk, economic isolation. Even if it might boost exports through a fall in cost prices (essentially wages), it ended up being harmful to internal trade, as it promoted speculation and discouraged long-term economic projects (also imports became more expensive). This was why countries under this regime suffered more crisis than the rest.²⁰ However, as he said, in some occasions fiat money had big advantages, as in France after 1870. So, rare successful cases led Leroy not to be entirely pessimistic.²¹

Once in a fiat money regime, the wise thing to do is to abandon it. How? Re-establishing the budget balance, and leaving a surplus in the budget to pay back the debt to the issuing bank; this is, create true expectations that convertibility will be restored. A positive trade balance is advisable, although not indispensable, because the consequence of stabilisation would probably cause a surplus in the balance of capitals. The essential point is to have a stable

¹⁹ Leroy-Beaulieu (1906), 675-684. In any case, it is always better that the bank issues notes and not the government directly. At least managers of the bank have an interest in controlling issuance so that the value of banknotes is preserved. Finance ministers change frequently and their commitment to keep notes value is weaker. Almost every state that had directly issued notes had ended in bankruptcy. This is why fiat money regime was a disaster in the US, France (with the exception of 1870) and Austria and not in England. Leroy-Beaulieu (1906), 696-697.

²⁰ Leroy-Beaulieu (1906), 730-751.

²¹ Leroy-Beaulieu (1906), 747-748. In wartime fiat money regime was virtually unavoidable.

exchange rate: Financial equilibrium and exchange rate close to par are the two conditions to suppress fiat money. Other considerations, such as expenses in public works, should be postponed.²² So, Leroy's perspective was long-term, sponsoring present sacrifices to restore the gold parity.

The 5th edition of the *Traité* (1891) included an appendix examining fiat money in Spain, with an illuminating title: "The enormous mistakes made by Spain". At that time, Leroy explained, the whole South America, Greece, Portugal and Spain were on their way to fiat money. Why? "Complacency, negligence, corruption, and an inexplicable and inexcusable ignorance of economic principles".²³ Leroy exonerated the young American republics on behalf of their inexperience, but not Spain, the quintessence of the evils of fiat money. Spain was trapped in a depreciated circulation and a declining and unstable rate of exchange. The reasons were two: Big public expenditure (some redundant or useless), and – naturally – the Bank's lending to the Treasury.²⁴

Coming down to his contributions in *L'Économiste français*, some weeks after his article on countries with faulty finances Leroy stroke back. This time he was tougher to the governments allowing money issuance and depreciating the currency: "counterfeiters, with no excuse at all" ... "insane and criminal issuances" ... "detestable practices", claiming for balanced budgets indispensable to exit from the situation on non-convertible paper money systems.²⁵ Leroy's theoretical positions obviously pushed him to this attack, but it is not to discard that he was particularly concerned for the case of Spain, on behalf of the readers of his journal. In this framework, Leroy wrote a series of three articles on the specific circumstances of the Spanish finances in august 1898, after the war with America. Some months later, he came back to assess the plan of rearrangement of the Spanish finances. This long contribution in instalments was not very common in the journal. This can be seen as a sign of that concern.

"La situation de l'Espagne et les finances espagnoles"

²² Leroy-Beaulieu (1906), 753-755. The case was, however, the opposite. All countries with fiat money had preferred to increase their expenses (especially for public works) instead of making sacrifices during a few years to eliminate paper: Russia, Austria, Italy, the US, and many Latin American republics. The only exception was France in the seventies.

²³ It is interesting the case of Argentina, a country without metal where money supply was composed almost entirely by paper. In this case Leroy supported a "monetarist" policy so that paper circulation only increased as much as population, so money supply per capita remained stable. The effect would be stable prices. Leroy-Beaulieu (1906), 758.

²⁴ Leroy-Beaulieu (1906), 760-761. In 1891 the Parliament passed a bill so that the Bank would lend 150 million francs to the Treasury and was allowed to increase notes in circulation considerably, up to 1.500 million. This bill was "the maximum of negligence, weakness and ignorance"; its consequence was a depreciation of the Spanish currency of 7-8 %. If the exchange continued its depreciation "the country would be delivered to all calamities of a depreciated and unstable currency".

²⁵ Leroy-Beaulieu (1898, June 11), 801-803. Leroy warned that, if war proceeded for a long time, Spain would head to a silver standard. Leroy acknowledged that silver could provide some advantages at that precise moment, but would constitute a problem in the future. Instead, he advocated for a suspension of bonds interest payments.

The first article of the series dealt with the burden of the old Cuban public debt that the newly independent country should assume, and its protector, the US, should guarantee. Leroy supplied here with a plan for the reimbursement of this debt.²⁶ The predictable economic development of Cuba (if “under a liberal regime”, Leroy stressed), thanks to new capitals accruing from the US, and the increase in its trade, would produce big revenues from custom duties, enough to pay for the debt. As for Spain, Leroy envisaged a general rearrangement of the public debt, in which creditors would be bound to make very important sacrifices, temporary (at least 50% of their rights, in Leroy’s calculations) but also definitive. Leroy’s main concern (again) was the privileged creditor of the Spanish state, the Bank. It was necessary to reimburse it the debt as urgently as possible, so that paper could stop its process of depreciation. But circumstances had worsened: A new decree had authorised an increase in the limits of paper issuance from 1.500 to 2.500 million pesetas. “This is the biggest black spot of Spanish finance”, he uttered. In his calculations, paper should be reduced to 1.000 million to redress national finance.²⁷

But how was this to be done? In the second article Leroy said it plainly, it was impossible that Spain could pay all interests and amortisation in due time. According to his calculations, the annual service of the debt would be of around 523 million pesetas (perhaps a bit less if Cuba and the US assumed the part of the Cuban debt non attributable to the expenses of the war). The average of the public revenues of the Spanish Treasury was around 750 million pesetas. Perhaps new taxes could be implemented making this amount increase slightly, up to 800 million pesetas, and in 5 or 6 years, when the country would recover from the shock, this amount could reach 850 or 880 million. But this was an upper limit. It was evident that a budget of 800 million could not bear a debt service of 523 million; at most, debt service could attain 260-280 million pesetas. This meant that debt service should be halved (even taking into account amortisation of debt in successive years, annual debt service would continue to be too high, close to 500 million pesetas). And again Leroy warned of the importance of reimbursing the Bank of Spain as quick as possible so that the amount of paper in circulation should decrease and the currency stabilised. This meant that the rest of creditors of Spain should be ready to accept a haircut (at least temporary) of around 50%.²⁸

It was about the extremely urgent need to repay the Bank of Spain for the advances made to the Treasury the object of the third part of Leroy’s long contribution on the situation of Spanish finances, from the standpoint of the creditors and the sacrifices they would be bound to make. Why was that? According to Leroy, the promises to refund the creditors are just empty words, unless guarantees that this promise will be fulfilled are solid enough. And this led to the problem of excess of paper circulation. First guarantee to creditors of the payments of their interests and eventual reimbursement of the principal was “to escape from the plague” of depreciated paper-money and resume payment in specie, in order to counteract

²⁶ Leroy himself said that his proposal had been telegraphed to some big American journals, but did not mention reactions.

²⁷ Leroy-Beaulieu (1898, Aug 13), 209-211.

²⁸ Leroy-Beaulieu (1898, Aug 20), 241-243. Leroy however kept his faith on a relatively quick recovery of the Spanish economy, so that these creditors could be repaid at least up to 65 or 70 % of their rights, depending on the category of their credits.

the deterioration in the rate of exchange of the Spanish currency.²⁹ Non-convertible paper money in circulation in August 1898 amounted to 1.400 million pesetas, and it was expected to increase, as the mentioned decree had authorised a new threshold. As he had said in many occasions, an increase in reserves could not prevent depreciation when paper is not convertible, so this was not a guarantee strong enough to keep the value of the currency. Leroy advocated a dramatic reduction in circulation (a half of it), so that paper money would be valued approximately at par with gold, and not with current depreciation. This measure would be the key to the restoration of the credit of Spain and the safety of its creditors: "It is to this objective that everything, absolutely everything, must be subordinated".³⁰

Again Leroy regretted this "enormous financial mistake", recalling his denunciations five years earlier. Between 1890 and 1895 the Bank of Spain was transformed into the lender to the Treasury (the rest of its activities were minor, in comparison), it having borrowed 400-500 million pesetas which turned into paper money that circulated. By 1895, 1.000 million pesetas in paper money were in circulation, with a discount of 19%. Leroy had warned against these manoeuvres, qualified of "financial madness" in *L'Économiste Français* and in his *Traité théorique et pratique*. And the big villain was perfectly identifiable: "The true grave digger of the Spanish *grandeur* has been, it must be said, M. Cánovas del Castillo, who, due to financial ignorance and financial presumption, [...] has surpassed all that a modern head of State is allowed".³¹

In August 1898, when he was writing, circumstances were difficult and pressing: the government had to pay urgently other 600-700 million pesetas for the costs of the war. Leroy warned that asking for a new loan to the Bank of Spain and increase circulation "would be an enormous imprudence". What could be the solution? Leroy said that, first of all, the government should delay as much as possible the payment of debts in the next few months. For the operations that it should absolutely pay, it had to find other resources, for instance renegotiation of the concessions of mines. Other advances could be obtained from banks on behalf of operations to be made soon. Last resource, but in any case preferable to issuing more paper, should be to take gold out from reserves. Besides, in order to reduce circulation to around 800 million pesetas, the government should look for another 600-700 million pesetas to redeem debt in the hands of the Bank. Taking care of other bonds was secondary; eventually it would be necessary to consolidate the debt in order to make it payable along time.

Leroy acknowledged that, at this point, it was impossible for the government to ask for a new loan to repay all its debts. So he supported a new loan emission of 1.000-1.100 million pesetas, in order to reimburse the Bank and to pay the urgent war debts. If a reasonable debt consolidation was made, in which all kind of Treasury bonds were merged and yield annually around 3% with an amortisation period of 15 years, it would still be possible to pay 2% interest

²⁹ The decree authorising the Bank of Spain a new ceiling in paper issuing from 1.500 million to 2.500 million pesetas had the effect of deteriorating the price of the Spanish bonds abroad.

³⁰ Leroy-Beaulieu (1898, Aug 27), 274.

³¹ Leroy-Beaulieu (1898, Aug 27), 274.

to the rest of debt.³² Even if Cuba and the Americans refused to take over the Cuban bonds, Spain still could ensure a certain interest to the holders of those bonds. Spanish creditors, whose interest payments would have been reduced and amortisation suppressed, should have the right to link a part of the revenues of the state to the repayment of their credits.

This was Leroy's outline of a financial arrangement for Spain, lying on the reimbursement of all public debt to the Bank of Spain and a restoration of a par exchange as essential points. This should be supplemented with increases in some taxes or the creation of new ones (particularly on consumption of special commodities, as sugar or alcohol), and a reduction in expenses. If Spain followed these pieces of advice, Leroy believed that circumstances in Spain could gradually redress. If, on the contrary, the Treasury resourced to the Bank again, instead of following a scientific rule, lying on observation and data of the financial science, the chances of improvement would considerably decrease.³³

“The necessary solution”: Get into the gold standard

The treaty of peace of December 1898 opened a period of expectation on the plans to re arrange public finances.³⁴ Leroy wrote another series of three articles on it. To Leroy, situation was dismal: New debts from the war plus former Cuban debt repudiated by the new government meant a debt service higher than all the rest of expenses in the budget. It meant a deficit of almost 30% (1.050 million pesetas of expenses, of which 550 for the debt, and 750 million -of expected revenues). The capability of Spain to increase revenues in such short time was simply non-existent: revenues could reach a maximum of 800 million, increasing some tax rates). Cutting expenses had also limits, even for a strong cabinet intending to reduce expenditure and improve administration. Deficit would always remain over 20% in the most optimistic calculations. The only solution was to rearrange debt. Leroy proposed suspend debt amortization, and start a process of negotiation with creditors so that the level of interests to pay could be sustainable in the short run (he suggested a reduction of 40% in interest). In exchange, the government would attach some precise revenues (as custom duties) to the payment of these interests, and would give a credible promise that this reduction would be attenuated as soon as possible. Then, a new loan should be issued in order to extinguish the floating debt and reimburse the advances of the Bank of Spain. The final objective was, naturally, to reinstate payments in gold. But Leroy was fearing an alternative plan (that eventually was enforced), “much more complicated and indeed iniquitous”, consisting on the establishment of an “enormous” tax (20-25%) on the yields of all Spanish private securities in order to pay all the charges of the Treasury, so that it was possible to alleviate holders of public debt. To Leroy, this would be an extremely unfair solution, because it rendered private firms co-responsible for the bankruptcy of the Treasury, the consequence of government

³² Leroy had a very good opinion of the operations of conversion of public debt into new securities with a lower interest rate, in order to reduce the burden of the debt service, when circumstances allowed it. Leroy (1874), 31.

³³ Leroy-Beaulieu (1898, Aug 27), 275.

³⁴ Houghton witnessed this expectation and reproduced it in his chronicles. It was his information that Leroy handled. Houghton (1899, Jan 28).

mismanagement. Leroy pointed out that this would drive capitals out for a long period. He would only accept a tax on dividends of 5 or 6%, not more.³⁵

When new minister Villaverde unveiled his financial plans, Leroy's reaction was not complacent: That plan did not rest on true principles, because the need to reimburse the Bank and re-establish the value of the currency was not at its forefront. The big point was to gradually reduce circulation, so that the exchange rate of the peseta (then losing 25% to the franc) increased at least partially towards the par.³⁶ And to make this policy credible, Spain should fix a certain amount in its budget (he suggested 100 million pesetas) to reimburse the Bank. This would, in three or four years, lead the peseta close to the par value. This measure should be supplemented with a suspension in amortization of debt and a reduction of 40% in the interest of the Spanish bonds, in the fashion of the recent cases of Argentina or Brazil.

Leroy regretted that, instead of following this advice, Villaverde had made two mistakes. First, he decided that the Spanish bonds quoted in Paris (the so-called "Renta Exterior") continued paying its interests in gold. This had increased their prices and made of them the object of speculative movements. Second, as a consequence of that decision, Villaverde had been constrained to set new taxes on the revenues of private firms in Spain, not only overcharging them, and creating a hostile environment to new businesses. True, a certain increase in taxes on incomes from corporations was acceptable in those circumstances, but Villaverde "seems to fall into formidable exaggeration". Leroy complained particularly about the new "tax on utilities" (income) which charged interests and dividends of private companies, which came to join old "industrial tax", all this resulting in an excessive charge on businesses. In all, to Leroy, the Spanish government was favouring foreign bondholders (those holding "Renta Exterior") and chastising shareholders of industrial firms. Why should railroad firms bear the burden of government's mismanagement? Leroy pointed out a key: there were rumours that the French government had kept talks with the Spanish so that holders of "Renta Exterior" were privileged, passing over shareholders of Spanish railroad companies. Naturally Leroy wrote that he did not give credit to that,³⁷ but uttered that, different from holders of Spanish bonds, "by far, French financial interests predominant in Spain is that of holders of shares of railway companies; it is them that the government should support". So he claimed that the Spanish government gave a preferential treatment to foreign shareholders of companies in Spain, allowing them to get their dividends in gold, as with the "Renta Exterior".³⁸

Leroy's second article of this series updated Villaverde's plans, but criticism remained the same. As for fiscal policy, new taxes resulted in an excess of burden to industry, trade and transport sectors, in comparison to agrarian sector (especially land rents). As for debt, the plan for rearrangement was even worse than before. First, the government had passed a reduction in the yields of the majority of public bonds, together with a tax of 20% on those same yields.

³⁵ Leroy-Beaulieu (1899, Apr 1), 405-407. Leroy presumed that his calculations were "quite exact".

³⁶ Villaverde had proposed a reduction to the limits of issuance of banknotes and in the interests of the advances, but this was not enough. Leroy claimed for a reduction in circulation from 1.500 million pesetas to 1.100 or 1.200, required for the government to have credibility in its policy of restoring convertibility.

³⁷ In any case, Leroy warned the French government that it should not be lobbied by speculators in Spanish public securities...

³⁸ Leroy-Beaulieu (1899, Jun 24), 849-851.

For this to be acceptable, the government should see to reduce the depreciation of the currency, or provide a solid promise to resume payments at the primitive rate of interest. In any case, reductions in interest and suspension of amortization were acceptable. Second, in order to compensate this suspension of amortisation, Villaverde had increased the rate of interest of some kinds of bonds. Instead, the right thing to do should be reimbursing the Bank, redressing exchange rate and eventually resume payments in gold, using a new loan to this end. As for the external debt, Leroy continued pushing for an agreement with creditors, acceptable if efforts to restore the value of the currency were credible. Leroy denounced that holders of “Renta exterior” bonds (big, speculative investors) were lobbying to avoid haircuts, whereas small savers, having obligations on Spanish railroad companies were bound to suffer big reductions in their revenues: Not only they were paid in (depreciated) pesetas, but also these revenues would be taxed.³⁹

In his last text on the Spanish crisis, of August 1899, Leroy regretted the procrastination of the solution to Spain’s financial troubles. The projects were still stuck in the Parliament, and the budget project had included increase in expenses, when a policy of retrenchment and of sacrifice from taxpayers was required. This was a mistake, showing that the parliament was making make party interests prevail. Leroy forecasted the consequences: First, a big deficit for 1899-1900, as new taxes had not been passed yet, and some extra war taxes had been eliminated. Second, the convention between the Treasury and the Bank avoided the most important operation: reimburse the Bank advances, reduce banknotes and improve the rate of exchange. The Bank has agreed to a small reduction in the interest rate to the Treasury, but there was no plan for reimbursement: On the contrary it seemed that advances could resume as far as the permission to increase circulation was not revoked. This “detestable policy” – interest rates lower than market’s but causing depreciation of the currency –, started by Cánovas in 1895, had condemned Spanish finance.⁴⁰

The performance of Spanish finances and monetary regime was recorded and judged with more perspective and circumspection in the 7th edition of the *Traité de la science des finances* (1906). Leroy criticised again the policy of the government, but his opinion on Villaverde changed considerably: He was now the hero, and Cánovas still remained the villain. The mantra did not change: Too much paper circulation render a currency inconvertible and so untrustworthy.

Leroy blamed financial misconduct (“the behaviour of Spain, in what refers to the relations of the State with the Bank, has been of extreme madness”) for the “debacle” of 1898. Having exhausted during peacetime resources that should be only used during wartime, the war forced Spain to issue new paper, when borrowing was not possible, and naturally the value of Spanish paper sank. It was during wartime that printing money was justified; if only then this resource had been used, paper would not have depreciated so much and Spain would have been able to hold the fight, and recovery would have been easier.⁴¹ The peace gave an

³⁹ Leroy-Beaulieu (1899, Jul 1), 1-3.

⁴⁰ Leroy-Beaulieu (1899, Aug 12), 233-235. One year later, in July 1900 Leroy would compare the circumstances of Spain and Brazil to praise the financial recovery of Brazil and the hopeless situation of the Spanish finances. Leroy-Beaulieu (1900, Jul 21), 81-83.

⁴¹ Leroy-Beaulieu (1906), 764. Again the example was France in 1870.

opportunity for Spain to redress its “faulty finances”: depreciation of the peseta to the franc reduced to 20% (it had reached 100% in 1898), even if circulation of paper continued increasing albeit at a slower pace (which proved that expectations and credibility – “moral influences” – affected the value of money as much as amount of it in circulation). However, repatriation of capitals was essential for this improvement (which Leroy recorded only in a footnote). Leroy said that Spain could have restored convertibility then: Villaverde’s tax reform increased revenues, budget attained equilibrium (Leroy’s forecasts of August 1899 were wrong). It was time to amortize the debt to the Bank with new loans. Even with large circulation of banknotes the value of the currency could attain the par, if the public trusted the government policy, the budget remained in equilibrium and there was not fear of the Treasury resourcing back to the Bank. In a few years Spain would be in the gold.

But unfortunately finance ministers since then did not have a solid plan in this direction, and ignored the fact that the only way to restore the value of the currency was reducing paper circulation. As a result the exchange rate of the peseta remained depreciated between 25 and 38%. Only one minister deserved Leroy’s credit: The formerly despised Villaverde. Leroy praised his plan of 1903 to enter the gold standard.⁴² Among other measures, it included a reduction in the circulation of silver (and limiting payments in silver) and an attachment of a part of the budget to repay the advances of the Bank (in the 1870 French fashion). Leroy recommended that Spain should not adopt a pure gold standard, but emulate the system of France and the Latin Union, which rested on gold as international currency and main currency inwards, but which allowed the Bank to ration the gold that it releases. Leroy also did not recommend going back to convertibility at a depreciated parity; this is, consolidating the recent depreciation of the peseta. By 1910 convertibility could be restored.

However, Leroy pointed out, Villaverde could not stand the opposition of powerful vested interests: First, the shareholders of the Bank, who were getting enormous profits from the circulation of its paper money. Then, some businessmen and proprietors, who profited from inflation and depreciation. Leroy accused them of trying to match their interests to those of the people: “All sophisms from inflationists and bimetalists [...] expand carefully in a naturally not very enlightened people”. Villaverde lost the political battle. Ensuing finance ministers followed an incoherent policy, and did not compel the Bank to reduce paper even if a part of the advances was reimbursed. Convertibility was not restored and depreciation remained, even if by 1904 a slight revaluation happened.⁴³

But, at that time, Leroy insisted on the excess in paper circulation and the abnormal circumstances of the Bank. In 1903 the Bank had credits on the Treasury for 1.219 million pesetas, whereas its commercial operations amounted only to 469 million: “normal” operations were just one third of the operative of the Bank. Paper circulation was 1.650 million. According to Leroy the consequence cannot be but a big depreciation. The final

⁴² Villaverde pointed out two long-run big mistakes that Spain had committed which explained the depreciation of the exchange rate of the peseta: First, coining too much silver in spite of the increasing depreciation of this metal (which rendered a profit to the Treasury). Since 1899 the government stopped coining silver. Second mistake: Increasing circulation of paper money from the Bank, especially since 1885, due to loans from the Bank to the Treasury. Leroy-Beaulieu (1906), 768-769.

⁴³ Leroy-Beaulieu (1906), 771-774.

message was, as usual, the need for a gradual but vigorous reduction of paper, as the only remedy to restore the exchange rate. A “good monetary situation”, this is a stable currency with a reasonable exchange rate, would attract foreign investment to the Spanish industry, Spanish bonds will be trustworthy and therefore in high demand, and this supply of foreign capitals would render the balance of payments positive. Besides, with a convertible system, the balance of payments would harmonise automatically (as the price specie mechanism would work).⁴⁴

Concluding remarks

Several scholars have stressed the fact that, by staying in a regime of non-convertibility, the Spanish government could force the Bank of Spain to issue banknotes, thus leaving in practice (albeit not in theory, nor in political statements) the objective of entering the gold standard system, and avoiding restrictive policies to that aim. This policy, completely against orthodox financial theory, deeply shocked Leroy-Beaulieu. In his view, as in the view of the majority of economists, this was not but irresponsible behaviour, leading to the depreciation of the currency and subsequent instability and lack of credibility. Besides, it harmed the interests of foreigners receiving incomes in a depreciated currency. Leroy denounced relentlessly this attitude in his journal, and especially targeted Spain, for, in front of other countries less stable, the monetary policy of the Spanish government was simply “madness”. The war with the US was the right time for this, as it was unveiling completely the mistakes of this policy. Leroy’s mantra was return to convertibility, taking loans as expensive as they would be.

In his articles, Leroy shows as a pure metallist, to whom monetary stability was hand in hand to the gold standard, the key to a healthy, successful and globally integrated economy. The same can be said of his stances in his *Traité théorique et pratique* and *Traité de la science des finances*, where he confined to a strict criticism derived from a clean theoretical position. However, Leroy’s articles had a second aspect. Spanish heterodox policy was harming the interests of many French investors, especially small ones, having Spanish securities and Treasury bonds, as Leroy himself pointed out on at least three occasions. These investors’ revenues were paid in depreciated pesetas. Leroy’s comments in *L’Économiste français* might well be lobbying for the improvement of the exchange rate and eventual resumption of convertibility of banknotes, on behalf of the interest of his audience. His bitter protests against monetary policy of the Spanish government and against Villaverde’s plan for not giving pre-eminence to that objective point in that direction. It was totally unthinkable that remaining in a fiat money regime could have any benefit. At least part of the historiography has arrived to the opposite conclusion.

⁴⁴ Quoting Villaverde, Leroy denounced that paper circulation per capita in Spain was (in nominal value) 70% over that in Italy (whose monetary situation “has become excellent” – Italy had restored convertibility). Leroy-Beaulieu (1906), 769-770.

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