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The Latin Monetary Union Experience (1865–1926): French Views on Monetary Union and Lending of Last Resort in Retrospect

Die Erfahrungen mit der Lateinischen Währungsunion (1865–1926): Französische Ansichten zur Währungsunion und zu Lending of Last Resort im Rückblick

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Abstract: The Latin Monetary Union (hereafter LMU) was established in 1865 between France, Italy, Belgium and Switzerland. The agreement provided for the adoption of a common monetary base consisting of specie, and the adoption of the free circulation of gold and silver coins among them, whatever the issuing country. Despite its original goal, the minting of silver coins was subject to numerous restrictions (especially between 1874 and 1876) before being fully suspended by article nine of the convention of November 5th 1878. The necessity for a lender of last resort quickly appeared in practice, even though the 1865 convention, and its numerous amendments, did not mention it in theory. The present article looks at how the idea of the lender of last resort was discussed in the context of the Latin Monetary Union. Specifically, it focuses on two opposing views on the LMU and its problems, as adopted by French economists at the time. The article concludes that the Banque de France played a crucial role in safeguarding the LMU. Referring to Bordo’s 1990 typology of lenders of last resort, we also add a fifth type, that of converter of last resort, to characterise the specific role played by the Banque de France.

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Keywords: monetary union, lender of last resort, bimetallism, French liberal school, Währungsunion, Bimetallismus

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1 Introduction

Henry Thornton and Walter Bagehot are commonly regarded as the fathers of the concept of the Lender of Last Resort (henceforth: LoLR). Although Thornton’s “An Enquiry into the Nature and Effects of the Paper Credit of Great Britain” in 1802 is credited with the first formulation of the idea, it was in Bagehot’s “Lombard Street: A Description of the Money Market” (1873) that the policy was first clearly set out. Bagehot, a former editor of “The Economist”, proposed two rules by which the Bank of England could promptly halt an emerging liquidity crisis: (1) “[...] loans should only be made at a very high rate of interest. This will operate as a heavy fine on unreasonable timidity, and will prevent the greatest number of applications by persons who do not require it”, and (2) “[...] at this rate these advances should be made on all good banking securities, and as largely as the public ask for them [...] If it is known that the Bank of England is freely advancing on what in ordinary times is reckoned a good security[...] the alarm of the solvent merchants and bankers will be stayed.”¹ Bagehot wrote at a time in which recurrent money market crises threatened the British economy with dislocation and financial collapse. The 19th century was the heyday of debates about central banking, and they still reverberate in the aftermath of the great financial crisis in the early 21st century. In fact, the English currency vs banking controversy raised a core issue: the necessity to precisely define an institutional setup able to secure the international banking (and financial) system. The same question arose again in the context of the sovereign debt crisis in the European Monetary Union (EMU), which led to the creation of the European Stability Mechanism (ESM) in 2013. The Banking Union, which is still under construction, can be seen as a response to the Black Swan phenomenon that hit the interbank money market.²

The history of the concept of the LoLR shows us that a variety of alternative arrangements by central banks may be possible when liquidity crises emerge.³ Indeed, in his historical analysis of the concept of the LoLR, Bordo distinguished four different possible arrangements: (i) a Classical view (shared by Thornton, Bagehot, and the Monetarists) in which the LoLR should provide

liquidity freely to allay a panic, but to solvent banks only; (ii) an Open-Market view (supported by Goodfriend and King) according to which central banks should intervene by way of open market operations; (iii) the Central Banks’s Broad Assistance view (in the footsteps of Goodhart and Solow) where all banks should be (temporarily) assisted since it is impossible to distinguish between illiquidity and insolvency; and (iv) a Free Banking view (supported by Selgin, Gorton and Mullineaux) in which clearing houses were seen as more efficient in dealing with an emerging crisis than government authorities. Nowadays, the supporters of the LoLR consider it as a safety measure or liquidity backstop that every monetary union should adopt so as to safeguard financial stability, particularly in a context where the interconnectivity of commercial banks is increasing. By contrast, on the side of the detractors the LoLR is seen as a counterproductive idea that encourages moral hazard and thereby increases systemic risk. The latter argument has had numerous supporters in Europe in the aftermath of the great financial crisis and the crisis of EMU sovereign debt.

The EMU, which was constituted by the Maastricht Treaty in 1992 and began in 1999, is not the first experiment of its kind. The 19th century presents us with a range of stimulating examples of the same genre in terms of the Latin, Scandinavian and German monetary unions. The Latin Monetary Union (LMU) was established in 1865 between France, Italy, Belgium and Switzerland. Being intended as a means to boost exchanges among its members, the setting up of a common (and stable) coinage system became a priority. Prior to the LMU convention in 1865, French coins already circulated in Belgium, Italy and Switzerland, and vice versa. What changed was the adoption by the member states of a common monetary base consisting of specie, and the adoption of the free circulation of gold and silver coins among them, whatever the issuing country. Despite its original goal, the convention brought about exchange rate differentials from 1867 onwards due to the fluctuation of the silver price mostly. As a consequence, monetary instability among the union’s members became the rule, especially following the restriction of the circulation of silver coins imposed in 1874. The necessity for a lender of last resort – or an alternative arrangement – quickly appeared in practice even though the 1865 convention, and its numerous amendments, did not mention it in theory. The only solution mooted was the adoption of legal restrictions. The minting of silver coins was thus subject to numerous restrictions (especially between 1874 and 1876) before being fully suspended by article nine of the convention of November 5th 1878. From that time on, intense debates took place among French economists concerning the

4 Ibid., pp. 19-22.
goal and the sustainability of the LMU. Two opposing camps emerged: one arguing in favour of the LMU while supporting a monometallic monetary system as a final goal, here represented by Félix Esquirou de Parieu; the other, here represented by Henri Cernuschi, defending a bimetallic regime and not regarding the abolition of the free minting of silver as good news.

Unfortunately, the French economists did not take advantage of the experiences of other monetary unions, such as in Germany or the Scandinavian countries. Unlike Swedish economists – Knut Wicksell or Gustav Cassel, to name a few – who were well known for their intense engagement in scientific as well as public debates even at the international level, the French economists at the time tended to be rather parochial, lacking international recognition due to their having confined themselves to local political and institutional issues.5

The present article looks at how the idea of the lender of last resort was discussed in the context of the Latin Monetary Union. Specifically, it focuses on two opposing views on the LMU and its problems, as adopted by French economists at the time. This article uses the resources available in the archives of the Banque de France in Paris as well as the Gallica database, an encyclopaedic library that holds printed documents from the 19th century which are relevant for this article.

The article is structured as follows: section two provides a brief history of the background behind the adoption of the LMU in France. Section three presents the mode in which the LMU was intended to function, as well as its achievements and failures. Section four presents two opposite views on the evolution of the LMU, by reference to the writings of Félix Esquirou de Parieu and Henri Cernuschi: this helps us to gain an understanding of how the lender of last resort was discussed within the leading country in the LMU, France. Section five concludes.

2 The Latin Monetary Union: a Natural Outcome or an Opportunity for French Supremacy?

The history of the Latin Monetary Union cannot be disconnected from the context of mid-19th-century western Europe, characterized by rapid industrialisation. The creation of the Banque de France was driven by the necessity to serve

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the needs of business with the help of a persistently low level for the discount rate. As production rapidly expanded in Europe, international trade did the same, and the necessity to adopt a common and sustainable coinage system quickly arose in the public debate. The making of the Latin Monetary Union was thus seen as a natural consequence of the economic context. However, the personality of Napoleon II – and his thirst for power – was also a major factor behind the adoption of the 1865 monetary convention, which was led by France.6

2.1 The Banking Unification and the Creation of the Banque de France

Following the 1789 French Revolution, and after a period of political instability under different political regimes, France succeeded in setting up a stable unit of account in 1803, when First Consul Napoleon Bonaparte came to power. The new authoritarian political regime defined the Germinal franc which was valued only by its silver weight: one franc, worth five grams of silver (9/10 fine silver).7 The Germinal franc's coins took the form of both silver and gold coins, notably for coins worth 20 francs. De facto, a bimetallic monetary system emerged, due to the terms defining the conditions of the issuance of coins under monetary law.8 Thus, we can deduce that a fixed silver-gold ratio amounting to 15.5 held between the two precious metals. In addition to that monetary reform, Napoleon created the Banque de France so as to unify the monetary practices and expand the banking system nationwide. In fact, owing to the strong competition of the Banque de France, the French banking sector for a long time remained under-developed and locally concentrated in Paris. In spite of its specific status as the official bank of issue, for a considerable amount of time the Banque de France retained its commercial activity at the expense of its central bank activity. Goodhart’s 1988 “Evolution of Central banks” described the French banking sector as one in which competition and hostility prevailed. The Banque de France

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6 Charles Louis Napoleon Bonaparte, known as Louis-Napoleon Bonaparte, born 20.04.1808 in Paris and died 9.01.1873 in Chislehurst, UK, was the only president of the Second Republic, the first French head of state to be elected by universal suffrage (10.12.1848), the first president of the French Republic, and, after the proclamation of the Empire on 2.12.1852, the country’s last monarch under the name Napoleon III, Emperor of the French.
7 The name was a reference to its date of creation: the 7th Germinal an XI, i.e. 28.03.1803.
was officially created in 1800 (January 18th) by Napoleon Bonaparte. It was designed to serve the needs of commerce at a low discount rate. The Banque de France was a private joint stock company with a share capital of 30,000,000 francs, part of which was subscribed by Napoleon Bonaparte himself and members of his network. Private ownership of the Banque de France was not something particular to France; a parallel situation existed in Great Britain or Sweden, for instance. By a law of 1806, private ownership became substituted by a governor and two deputy governors appointed by the head of state and advised by the Minister of Finance, and from that time on the Banque de France became a state bank with its capital provided by private individuals. In 1803 the Banque de France was assigned the privilege of issuing bank notes in Paris. As a counterpart to this exclusive privilege, the Bank also had to pay royalties and superdividends to the French government, while financing the budget deficit at a low discount rate via a system of advances to the French Treasury. According to the legal status of the Banque de France (established by decree in 1808), it aimed to serve the needs of commerce by providing liquidity for the development of the entire country. Discounting activities were the numerous and more profitable for the banks. The official conditions that prevailed for discounting paper money were at that time quite demanding: first, the term could not exceed three months; secondly, the paper should come from dealers or solvent people; thirdly, the paper had to be signed by three different people; and fourthly, the commercial paper had to have been created for an economic operation that could serve the economy, as the real bills doctrine prevailed.

9 More precisely, the creation of the Banque de France dates back to 1796 when two bankers, Le Couteulx de Canteleu and Perregaux, decided to set up a private bank in Paris that could discount commercial papers and increase the circulation of money within the country. This project failed, and it was only after the coup d’état by the first Consul Bonaparte that the Banque de France was officially born. Another financial institution, called Caisse des Comptes Courants (which also provided quasi-central banking functions including the issue of notes) preceded the Banque de France but mostly at a local level. Thus, the Caisse des Comptes Courants merged with the new Banque de France. The same scenario happened with the other French note-issuing banks in that time, such as the Caisse d’Escompte de Commerce. Due to this oligopolistic strategy and owing to the weight and size of the Banque de France’s networks and its numerous branches, many other private banks were forced to closed during that time.


2.2 The Background Behind the LMU

The adoption of the 1865 convention in Paris – which gave birth to the LMU – was mainly driven by natural forces such as the economic context and the experience of market failures. However, the LMU was first and foremost the outcome of an initiative by French politicians who saw in monetary integration an opportunity to expand French supremacy and domination over its neighbours.\textsuperscript{13} Indeed, there are three major reasons behind the adoption of the LMU. The first of these was the context of expanding industrialisation in Europe between 1815 and the 1870s, which encouraged national and international economic integration. Faithful to the dogma of the Classical school, rampant industrialisation and the increasing scale of trade made nations more interdependent, and monetary integration became the second and natural step of that broader process.\textsuperscript{14} This opinion is shared by Flandreau, according to whom “the 1865 Treaty would then be the final step in a path leading to greater integration between the four countries, which were already closely related through trade, commercial treaties and financial flows.”\textsuperscript{15} In fact, the first four countries (France, Belgium, Italy and Switzerland) that took part in the LMU were already economically close, and thus monetary integration was eased. France had already set up a kind of franc zone before the LMU. Owing to the strong stability of the Germinal franc, the Banque de France therefore succeeded in imposing its currency within Europe. And not only did France export its main monetary rules and conditions of issue, but it also established its supremacy, as Napoleon had expected. De facto, French francs circulated in countries like Italy and Switzerland, to name only a few, mainly due to the result of the Napoleonic conquests. This experience of monetary cooperation pushed the Banque de France into periods of major instability due to the activity of speculators. In contrast to the Italian and Swiss reactions, the Banque de France refused to devalue the silver weight of its coins as a reaction when instability (and speculation) prevailed. A monetary devaluation could have been seen as a sign of weakness, and this was not compatible with the prevailing idea of political power at that time, nor with the mission assigned to the Banque de France.

\textsuperscript{13} M. Flandreau, Was the Latin Monetary Union a Franc Zone? in: J. Reis (Eds.), International Monetary Systems in Historical Perspective, London 1995, pp. 71-91; Einaudi, Historical Perspective. Flandreau, Franc Zone, p. 71, quotes de Cecco on this subject: “One cannot forget that those were the years of the greatest glory of the Second Empire, when it was the emperor’s express desire to see all Continental Europe united in a franc-area.”

\textsuperscript{14} The adoption of an Anglo-French trade treaty in 1860 is a prime illustration of that international integration.

\textsuperscript{15} Flandreau, Franc Zone, p. 72.
Secondly, the necessity for monetary integration among western European countries became a key issue when monetary instability began to increase. The discovery of gold mines in California (1847) and Australia (1851) was transformational. The production of gold quadrupled, causing the value of gold to diminish, which in turn affected the (steady) silver–gold ratio which had prevailed up to that time. From that time onwards it was profitable to speculate by way of the silver coins. On the commercial markets one kilo of gold amounted to 15 kilos of silver, while the (official) rate of exchange between the two at the central bank of issue was 1/15.5. This speculative opportunity affected France strongly, as many French francs were in circulation in Europe. The Banque de France faced a risk of a drain on its metallic reserves, which once more motivated France to pursue monetary integration among its closest neighbours. The bimetallic system suffered from problems which were rooted in its foundational principles, namely the instability of the metallic values (i.e. gold and silver) which served both as a monetary unit and as raw materials. Knut Wicksell saw the LMU as being the result of market failures within the bimetallic system that had forced those European countries to adopt the same currencies:

"These movements in the market for precious metals became the immediate cause, in 1865, of the so-called Latin Currency Union between France, Belgium, Switzerland and Italy [...] Other European countries had at that time, either a silver currency, as in Germany and Scandinavia or a depreciated paper currency, as in Austria and Russia. If those countries had gradually attached themselves to the Latin Union, with its free minting of silver and gold at a legally established ratio then the traditional ratio between gold and silver might possibly have been preserved. Adhesion to the Latin Union was, in fact, contemplated by Germany shortly before the outbreak of the war in 1870, but owing to the war the plan never came to fruition."16

Finally, the LMU had been driven by a strong political desire for hegemony on the part of France. Napoleon III had aimed at restoring French supremacy in Europe and worldwide.17 The prospective unified monetary zone was seen as a good opportunity for France to establish supremacy in Western Europe, especially faced with England’s hegemony.18 Its very name is a prime illustration of that desire for hegemony. According to Flandreau, the LMU constituted a Latin counterpart to the Austro-German union (the Miinzverein) formed in 1857 and

17 Napoleon III led the country between 1851 to 1870 under different political regimes.
18 H.P. Willis, A History of the Latin Monetary Union, Chicago 1991; see also Flandreau, Franc Zone.
the Scandinavian union in 1873.\textsuperscript{19} Even though France had already experimented with monetary integration with Belgium, Switzerland and Italy, the official creation of the LMU can be seen as the first true effort at monetary integration by France, as it became the longest-lasting experiment.\textsuperscript{20}

### 3 The Latin Monetary Union in Action

The LMU officially launched in 1865 (December 23\textsuperscript{rd}) with the Convention of Paris between France, Belgium, Italy and Switzerland; but in practice the LMU became operational only from 1866. The name Latin Monetary Union was not included as part of the 1865 convention, it was the British press that nicknamed the 1865 agreement the Latin Monetary Union in order “to highlight how this continental experiment could not possibly involve the United Kingdom.”\textsuperscript{21} The number of countries within the LMU expanded over the course of its existence (1865–1926) and the lifetime of the LMU was marked by many periods of monetary instability due to the opportunities to melt down specie that followed the fluctuations in the silver price.\textsuperscript{22}

#### 3.1 The Monetary Convention in Paris (1865)

Through diplomatic channels, Belgium asked France to organize a meeting in order to find a solution to the speculation on divisional specie that had been ongoing for several years. Belgium had suffered the most from this speculation on divisional coins, which was emanating in particular from monometallic countries such as England (gold) and Germany (silver).\textsuperscript{23} The situation became particularly tricky when the gold price became persistently low after the discov-

\textsuperscript{19} *Flandreau*, Franc Zone, p. 72.

\textsuperscript{20} The first French Empire (1804-1815), led by Napoleon, set up homogenous standards for silver and gold coins expressed in francs for several countries (namely France, Belgium, Switzerland and Italy) “whose shape, weight and metallic content were identical, even if the images and symbols were different for every country” (*Einaudi*, Historical Perspective, p. 17).

\textsuperscript{21} *Einaudi*, Historical Perspective, p. 18.

\textsuperscript{22} For a full list of the official members and candidates during its lifetime: see *Einaudi*, Historical Perspective, p. 18.

The California gold discoveries brought about a relative appreciation of silver bullion over gold. As a consequence, the fixed official mint price of 15.5 grams of silver for every gram of gold no longer held. This official ratio had formed the basis of the French (and Italian) Germinal franc bimetallic system since 1803.

The Latin Union was successful over a long period of time (1865-1926) owing to the number of countries (32) that joined the LMU after 1866. The enlargement took the form of full adhesion or bilateral agreements. The total number includes the colonial states of the signatories’ countries as well.

Tab. 1: Major Rules of the Latin Monetary Union (Excerpts from 1865 Convention).

| Art. 1 | France, Belgium, Italy and Switzerland are constituted in a state of union as regards the weight, the denomination and the rate of their gold and silver coinage; |
| Art. 2 | The countries undertake to issue (or to have manufactured in their imprint) only the following gold coins: 100 French franc, 20 French franc, 10 French franc and 5 French franc coins according to specific conditions of diameter and weight with a clearly defined maximum tolerance (given by a table included in the convention). They shall admit without distinction into their Treasury offices gold coins manufactured under the foregoing conditions in any of the four States, subject, however, to the exclusion of coins whose weight has been reduced by the milling of half a percent below the tolerances indicated below, or whose imprints have been lost. |
| Art. 3 | Refers to the same as article 2 but for 5 French franc silver coins only. Thus, countries undertake to manufacture (or to have manufactured in their imprint) only 5 franc silver coins according to specific diameter and weight conditions with a clearly defined maximum tolerance (given by a table included in the convention). The governments will reciprocally receive the silver coins mentioned beforehand in their Treasury offices, subject to the exclusion of those whose weight has been reduced by spawning by one per cent below the tolerances indicated above, or whose imprints have disappeared. |
| Art. 4 | Refers to the same as article 3 but for silver coins of 2 French franc, 1 French franc, 0.5 French franc and 0.2 French franc. The countries undertake to manufacture only 2 franc silver, 1 silver franc, 0.5 silver franc and 0.2 silver franc coins according to specific diameter and weight conditions with a clearly defined maximum tolerance (given by a table included in the convention). These coins shall be melted by the governments which have issued them, when they are reduced by spawning by five per cent below the tolerances indicated, or when their imprints have disappeared. |
| Art. 5 | The silver coins defined in article 4 which differed from conditions defined in article 4 should be withdrawn from circulation (before January 1st, 1869) |
| Art. 6 | The coins stipulated in article 4 will be legal tender between the private individuals of the State which manufactured them up to a maximum of 50 French franc per payment. |
| Art. 7 | The Treasury offices of each of the four countries will have to accept the silver coins manufactured by one or more of the four countries of the Union according to article 4 up to a maximum of 100 French francs per payment made to the Treasuries. |
| Art. 8 | Each of the States undertakes to withdraw from the circulation of the other States the silver coins (divisional coins) which it has issued and to exchange them for an equal value of current currency (gold coin or 5 French franc silver coin) on condition that the sum is not less than 100 French francs. This obligation will be extended for two years after the expiry of the present treaty. |
| Art. 9 | The issue of coins listed in article 4 is limited to a maximum of 6 French francs per inhabitants. |

ing that it acted as a sort of clearing house for the LMU.\footnote{L. Gillard, L’Union latine. Une expérience de souverainetés monétaires partagées (1865-1926), Paris 2017, p. 249.} As long as the countries respected articles two and three, then, the gold and silver coins could freely circulate within the union no matter where they were issued. The divisional coins, those defined in article four, were only limited legal tender as stated by articles six and seven. In order to prevent speculative strategies, article eight commits each country to assume its own monetary issuances (for divisional silver coins only). Unfortunately, the 1865 convention did not forecast all the possible events that would ensue, and many additional arrangements were necessary to preserve the LMU.

3.2 The Challenges of the LMU

From 1870 onwards the LMU faced difficult times due to the fluctuation in the commercial price of silver, which resulted in speculative opportunities, as predicted by Gresham’s law. The mechanism at play was as follows: when the supply of gold or silver increased or decreased, the relative price of the two metals changed, and it became profitable to exchange the gold and silver coins at the official theoretical rate assigned by the 1865 convention (1/15.5). As the coins were accepted outside their issuing country, it became profitable – in Italy, for instance – to export (devalued) silver coins to France and convert them to gold at the official rate which was higher than its commercial (intrinsic) value. As a result, the Banque de France was forced to take in a huge number of Italian coins, albeit indirectly, while accommodating a drain in its gold reserves. Owing to these speculative strategies and the internal disequilibrium in the balance of payments which resulted, many countries saw their metallic reserves fluctuating in inverse proportion to the free circulation of foreign (silver) coins. Thus, Switzerland and particularly France were strongly involved in pushing the other countries to respect article eight of the 1865 convention. Unfortunately, speculative strategies continued to be followed, and the countries’ partners had no choice other than, first, to impose quantitative limits on the (free) coining of silver coins (approximately one fifth of the previous amount of issue) and, second, to stop the issue of silver coins. But it remained to decide whether and how each partner would respect the rule (article eight) that was meant to govern the functioning of the union. Table 2 summarizes the major amendments and conventions adopted by the countries (France, Belgium, Italy, and Switzerland, and
later Greece in 1868), sometimes through conferences or sometimes through diplomatic channels alone.

**Tab. 2: Reforms of the Latin Monetary Union.**

<table>
<thead>
<tr>
<th>Date of Convention</th>
<th>Rules and Main Terms</th>
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<tbody>
<tr>
<td>1865 (December 23rd)</td>
<td>First Monetary Convention</td>
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<tr>
<td></td>
<td>- Birth of the Monetary Union between France, Belgium, Switzerland and Italy for a renewable period of 15 years.</td>
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<td></td>
<td>- Definition of the foreign currencies (only coins) which have legal tender within the union.</td>
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<td>1867 (July)</td>
<td>International Monetary conference on Bimetallism (22 countries)</td>
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<td></td>
<td>Bimetallism is called into question.</td>
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<td></td>
<td>Many countries called for a monometallic system, as operated by many other countries at that time.</td>
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<tr>
<td>1868</td>
<td>Greek membership</td>
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<tr>
<td>1874 (January 31st)</td>
<td>Additional Convention:</td>
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<td></td>
<td>- Limit the issue of silver coins to the amount of 120 million of French Francs.</td>
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<td>1878 (November 5th)</td>
<td>Additional Convention:</td>
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<tr>
<td></td>
<td>- Renewal of the monetary union for a renewable period of 6 years</td>
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<td></td>
<td>- of the issue of silver coins</td>
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<tr>
<td>1885 (November 5th)</td>
<td>Second Monetary Convention:</td>
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<tr>
<td></td>
<td>- Renewal of the monetary union for a new period of 5 years</td>
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<td></td>
<td>- Specific rules concerning the reimbursement on the silver coins (specific to the country considered).</td>
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<tr>
<td></td>
<td>- Additional convention</td>
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<tr>
<td>1885 (December 12th)</td>
<td>- Limit the reimbursement in gold of foreign currencies (from Belgium and Italy) in case of liquidation/dissolution of the monetary union.</td>
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<td>1891</td>
<td>- The members decide upon the renewal of the monetary union on a yearly basis with tacit agreement.</td>
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<td></td>
<td>- Discussion on a <em>universal currency</em> among the countries</td>
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<tr>
<td>1893</td>
<td>Additional Convention:</td>
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<td></td>
<td>Abolish the intercirculation of Italian silver divisional coins.</td>
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<tr>
<td>1897</td>
<td>Additional convention (made by diplomatic channels without meeting or conferences)</td>
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<tr>
<td></td>
<td>- New rules on the minting of silver coins</td>
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<tr>
<td>1902</td>
<td>Additional convention (made by diplomatic channels without meeting or conferences)</td>
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<td></td>
<td>- New rules on the minting of silver coins</td>
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</tbody>
</table>
Continuation Tab. 2:

<table>
<thead>
<tr>
<th>Date of Convention</th>
<th>Rules and Main Terms</th>
</tr>
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<tbody>
<tr>
<td>1908</td>
<td>Additional Convention:</td>
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<td></td>
<td>– Abolish the intercirculation of Greek silver divisional coins</td>
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<td></td>
<td>– New rules on the minting of silver coins</td>
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<tr>
<td>1914–1918</td>
<td>– Abolish the circulation of gold and silver coins</td>
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<td></td>
<td>– Imposition of forced currency for banknotes</td>
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<tr>
<td>1926 (December 31st)</td>
<td>Official dissolution of the LMU (on Belgium’s initiative)</td>
</tr>
</tbody>
</table>

The LMU faced liquidity crises in its early years which some saw as demonstrating its resilience, and others saw as a sign of its weakness. Which of these was true depended primarily on the behaviour adopted by central banks. In this respect, the Banque de France quickly distinguished itself from the others by acting as a type the LMU clearing house.

### 3.3 The Banque de France’s Unofficial Missions within the LMU

Due to reasons of national sovereignty, most of the central banks in Western Europe had been reticent concerning the LMU. In his thorough analysis of the LMU, Gillard stressed that the central banks involved in the monetary union showed a lack of enthusiasm to fully coordinate their monetary policies.\(^{28}\) This argument particularly fits with the Banque de France’s behaviour, which sought to maintain its full discretionary power.\(^{29}\) Despite the lack of official rules in the 1865 convention concerning central banks per se, the Banque de France really did take part in the LMU. Indeed, it is true that people and private banks were free to accept – or refuse – the foreign coins, unlike the State Treasury. However, if the Banque de France had refused to accept the foreign coins, the free circulation would automatically have stopped. Moreover, the Banque de France also played a crucial role in the safeguarding of the LMU, especially during the two crises that LMU faced: one in 1879 with Italy; and the other in 1885, following the additional convention, involving all the members of the LMU. Most specula-

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\(^{28}\) Gillard, Union latine, p. 19.

\(^{29}\) Two examples can be given to illustrate the lack of a truly collective mindset. Firstly, the Banque de France refused to support the creation of a common reserve fund which was planned to protect the metallic stock of currencies. This project was thus cancelled. Secondly, it also used its veto when Belgium and Switzerland asked for the adoption of a rule to jointly mint divisional coins.
tive and arbitrage transactions on foreign coins – Italian or Belgian silver divisional coins – took place through banknotes or deposits with the Banque de France, the sole intermediary for accessing gold for silver. The divisional silver coins (from Belgium or Italy) came to the Banque de France indirectly from private agents (businessmen or other private banks). Thus, from 1874 the Banque de France quickly became the clearing house of the LMU – this expression being the one used by Einaudi to summarize the behaviour of the Banque de France during the Italian crisis.  

Indeed, the abolition of silver coinage had been enacted in the additional convention of 1878. A new government took over in Italy in 1879, which denounced the additional convention agreed the year before, and especially the condition imposed upon Italy whereby it had to return the divisional currencies circulating with the partners.  

Such unexpected behaviour would have brought about a risk liquidity for the Banque de France, which collected 90 percent of the Italian divisional currencies circulating outside Italy. For that reason, France and its diplomatic delegates were engaged in finding a compromise which would be to the benefit of the others. Thus, the Banque de France agreed to reimburse the Italian divisional silver coins which circulated in Belgium, Switzerland and Greece in exchange for reimbursement from Italy with a two-year delay. This credit made to Italy was to be charged at three percent interest for this liquidity service. It was for that reason that Einaudi considers that the Banque de France played the role of the LMU central bank, owing to “the unconditional acceptance of all metal currencies of the associated countries (including silver), making the bank a sort of ultimate receiver.” In the introduction we referred to Bordo’s 1990 fourfold typology of LoLR; in this context it is tempting to consider that the LMU functioning was in accordance with free banking principles, since the member countries “[...] denied the need for any government authority to serve as lender of last resort.” More precisely, the role played by the Banque de France was close to that of a clearing house. The latter consisted in “[...] issuing loan certificates which served as a close substitute for gold (assuming that the clearing house itself was financially sound).” However, the way the Banque de France was the LMU clearing house relied on its abil-

30 Gillard, Union latine, p. 248.
32 Gillard, Union latine, p. 88.
33 Ibid., p. 248.
34 Bordo, Lender of last Resort, p. 21.
35 Ibid., p. 22.
ity to be a converter of foreign coins into gold. All of that leads us to propose a fifth type in addition to Bordo’s four: namely as a converter of last resort. Indeed, the Banque de France clearly assumed the risk of default emanating from one of the countries that might default on its own obligation to reimburse the divisional coins, or might devalue them by reimbursement at a lower value (disconnected from the official face value). To avoid such a risk, the converter of last resort issued a type of foreign coin’s certificate which served as a close substitute for gold to the others.

When the LMU faced its second liquidity crisis, in 1885, it was forced to address the necessity to reimburse all the silver coins that circulated outside their country of manufacture. At that time, Switzerland denounced the 1878 convention and Belgium was reluctant to pay out at the official value defined by the 1865 convention (article three). The legal corpus that had been adopted in the preceding years was by no means appropriate, as article eight from the 1865 convention, the only rule that was relevant for solving the problem, concerned divisional silver coins and in any case all the silver coins, notably the 5 francs silver coins called ecu (defined by article three in Table 1). The problem was twofold: not only did countries need to agree on the value at which reimbursement would be made (official gold face value vs depreciated commercial value), but they also had to decide on the means of payment. Belgium favoured letting market forces do the work, calling for a natural liquidation process through exchanges of the balance of payment.36 The French were at first inflexible, asking only for gold as they were a net creditor of Belgium and Italy.37 In the end, in 1885 a compromise was reached by adding a new additional convention (on December 12th). The countries agreed under a bilateral agreement that only 50 percent of the silver coins would be reimbursed in gold at the official value (with a maximum of 1,000,000 French francs), and the remaining 50 percent would be paid by way of bills of exchange. The period of repayment was to be spread over five years. During that dark period, the Banque de France also played the role of converter of last resort by agreeing to convert the liquidity of the debt within the LMU. France also maintained its supposed supremacy on the basis of the bimetallism that had been inherited from the Germinal franc. Although nothing was anticipated in the legal status of the LMU, the Banque of France and the French delegates succeeded in drawing up the main lines for Lending of Last Resort for the LMU.

The various crises and the numerous concomitant reforms were interpreted in different ways by the French Liberals. The positions defended by Felix Esquirou

36 Gillard, Union latine, p. 91.
37 Ibid., p. 178 (Fig. 9).
de Parieu and Henri Cernuschi gives us a clear picture of the French debates at that time, especially concerning instability risks in a bimetallic monetary regime.

4 French Views on the Lender of Last Resort

As mentioned by Silvant, in the mid-19th century the French Liberal school was divided concerning bimetallism. On one side (the most numerous) were the monometallists, led by Michel Chevalier and including Felix Esquirou de Parieu (henceforth: de Parieu); on the other side were the supporters of bimetallism, with Henri Cernuschi being a strong supporter alongside Louis Wolowski and Emile de Laveleye. The first side underlined the impossibility of maintaining a fixed ratio between the two metals, since there was no (theoretical) reason why their market values should stay at a perfect fixed ratio. Indeed, such a prospect was totally contrary to the market mechanism. According to Joseph Garnier: “one wanted to fix each of the two values in relation to the other, i.e. to solve a problem which is completely impossible or even absurd in political economy.” By contrast, the other side took the endurance of the bimetallic regime (specifically, the one established in 1803 by the Germinal franc) as prime evidence of its superiority. Moreover, the fact that a monometallic regime had been established in a few countries required that others adopt a bimetallic regime, which would serve as a foreign exchange platform for them. Within the two sides, certain leaders emerged, namely Felix Esquirou de Parieu and Henri Cernuschi, whose positions fundamentally diverged regarding the LMU and its utility.

4.1 Félix Esquirou de Parieu (1815–1893)

Félix Esquirou de Parieu was a Napoleonic republican (parliamentarian, senator and Minister) mostly during the Second Empire (1851–1860) and the Liberal

38 M. Chevalier, De l’établissement d’une monnaie universelle, in: Journal des Economistes, Novembre, 1868, pp. 178-211.
Empire (1860‒1870) led by Napoleon III. He was not involved in the coup d’état mounted by Napoleon III in 1851. He was particularly known for his involvement in fiscal policy reform and for his prophetic views on Europe that anticipated the European institutional corpus.

De Parieu had graduated in Law (doctorate) in Paris in 1844. He was a former lawyer who had turned to politics and became one of the youngest parliamentarians of the French Assembly (called the Assemblée Constituante). His lifelong political career was served under different mandates and in various positions within several governments, mostly on the side of the legislative power, and notably within the State Council between 1855 and 1870. He was particularly involved concerning the reform of French fiscal policy and education policy. He was in favour of a fair progressive income tax and took strong positions against the other parliamentarians when debating the cancelation of various “unfair” taxes.

While not an academic, de Parieu was a successful writer who was widely read including beyond the borders of France. He never saw himself as a theorist but rather as an enlightened civil servant who sought to guarantee welfare and justice. He published extensively on fiscal policy, on which subject he adopted both a historical and an analytical point of view. Between 1856 and 1864 he published the “Histoire des impôts généraux sur la propriété et le revenu” (History of General Taxes on Property and Income) and the “Traité des Impôts considérés sous le rapport économique, historique et politique en France et à l’étranger” (Treatise on Taxes considered from an economic, historical and political point of view in France and abroad). In the monetary field he mostly published on monetary policy and on monetary regimes. All of his publications aimed at demonstrating the superiority and viability of a monometallic system based on gold. Among his publications, the article “Politique Monétaire en France et en Allemagne” (“Monetary policy in France and Germany”) in 1872 illustrates his own views in favour of international monetary cooperation. The article quotes the thesis defended by Maurice Mohl in 1871 concerning the

42 Esquirou de Parieu was Minister of Public Instruction (1849-1851), member of the advisory board in Finance, Vice President and President of the State Council (1855-1870) and Senator (1876-1885).
44 De Parieu succeeded in turning the tide of the majority of the French Assembly concerning the cancellation of the taxes on salt; see B Burlot/Cougny/Robert, de Parieu, p. 8-9).
“Monetary question” in Germany. De Parieu blamed the Germans for their bad choice on the monetary question in 1871 when the monetary regime was concerned. Instead, he would have preferred to see Germany adopt the florin metric of 2.50 francs already adopted by Austria in 1867. The latter standard would have enabled: “[...] conciliation and rapprochement with the system of 94 million souls (i.e. the Franc zone) grouped in principles around the 1865 convention.”

In view of his positions, de Parieu has been characterized as an early proponent of the vision of a European union. His book “Principes de la science politique” in 1870 anticipated the institutional setting of the EU by almost a century. The book dealt with the creation of a (European) Parliament or European Commission in which members would be selected from national governments. Concerning de Parieu on this matter, Gillard wrote: “[...] as a utopian visionary of the European future, he saw monetary union being extended to other areas, with the creation by the associated governments of specialized institutions which would then merge into a European Commission, an emanation of the various parliaments which would endow it with extended powers.” As a Vice President of the State Council, de Parieu was the negotiator for France at the 1865 convention and a fervent supporter of the Latin Monetary Union, which he thought could be “[...] the first serious step towards monetary unification.” His position might be seen as tricky – or misleading; however, he always stood by the same position: “At the International Monetary Congress of 1867, he nonetheless advocated the demonetisation of money, joining for the occasion the vote of France with that of England (and the other members of the LMU) for a common currency (gold) which he would have liked to see called Europe.” In spite of his being supporter of a gold monometallic system, the LMU project combined two of his main goals: the adoption of a monometallic system and the establishment of a European union which went beyond the scope of the monetary field.

45 M. Mohl, Zur Münzfrage, Tübingen 1871.
46 F. Esquirou de Parieu, La politique monétaire en France et en Allemagne, 1872, p. 10, https://gallica.bnf.fr/ark:/12148/bpt6k5802060t.r=esquiroupercent20depercent20parieu?rk=21459;2, 06.05.2022.
48 Gillard, Union latine, p. 79. This opinion is also shared by Einaudi, Money and Politics, p. 197.
50 Gillard, Union latine, p. 79.
51 Ibid.
He was clearly an optimist, although also perfectly aware that he was perhaps too far ahead of his time. For instance, in 1870 he declared in the Senate: “[…] in human history, yesterday’s generous utopia can be transformed into tomorrow’s practical and feasible creation, because the world has progressed.”\footnote{Bourloton/Cougny/Robert, Felix Esquirou, p. 9.}

For that reason, Einaudi saw him as “[…] the right man for monetary diplomacy […] a curious mix of political realism and utopian aspirations.”\footnote{Einaudi, Money and Politics, p. 49, 54.}

De Parieu addressed the issue of the LoLR only indirectly, through his support for a gold standard regime. In his view, such a convergence of all existing monetary regimes into one standard would minimize the risks of monetary and financial instability. Like many advocates of monometallism, de Parieu considered the LMU crisis to be the perfect illustration of the impossibility of maintaining a fixed ratio between silver and gold as the base for a monetary regime. Since gold and silver are both (raw) material goods as well as money, it is not surprising that their relative prices fluctuate, thus creating discrepancies and arbitrage opportunities between their commercial and their legal values. This weakness would disappear when all countries had adopted the same gold monetary regime. It was for that reason that de Parieu saw in the construction of European unity the best way to solve the problems of monetary, financial and economic instability. His enthusiasm stood in contrast with the position developed by Henri Cernuschi.

4.2 Henri Cernuschi (1821–1896)

Henri Cernuschi was an Italian patriot who had taken part in the liberation of Milan during the Austrian occupation in 1848. He was a former deputy during the short Roman Republic (1848–49) that was led by the triumvirate composed by Carlo Armellini, Giuseppe Mazzini, and Aurelio Saffi. Following the political collapse in Italy, he moved to France as a political refugee. He became a French naturalized citizen with the help of the French minister Emmanuel Arago at the end of 1870 when the Third Republic was declared in Paris on September 4th. Cernuschi was a man of many talents. He became a reputed banker and economist within the circles of Parisian economists and businessmen, but was mainly known as a politically committed journalist, not to say pamphleteer. He published his opinions and positions mostly in the French newspaper “Le Siecle”, which he bought in April 1870 with the help of his magistrate friend Gustave
Chaudey. Cernuschi quickly became wealthy by way of numerous investments in firms and through the investment advices that he sold to his friends. At the end of the Second Empire in 1870, Henri Cernuschi’s wealth was valued at two million gold francs. From 1871 until 1873 he went on a world tour with a young art critic, Théodore Duret (1838–1927), who helped him to build an impressive art collection of 4,000 drawings and various sculptures. Meanwhile, he bought from Émile Pereire the last available plot of land in Paris, on Avenue Vélasquez, where the architect William Bouwens van der Boijen had built his town house residence. When he died in 1896, Cernuschi bequeathed his residence to the Paris city hall, which transformed it into a museum of Asian art.

Cernuschi wrote many books and articles, mostly in the banking and monetary field: “Mécanique de l’échange” (Mechanics of exchange) in 1865, “Contre le Billet de Banque” (Against Banknotes) in 1866, “Le Grand Procès de l’Union Latine” (The Great Trial of the Latin Union) in 1884, and “Les Assignats Metalliques” (Metallic Assignats) in 1885 to name a few. Cernuschi advocated bimetallism and he, like other French supporters of that regime, deployed empirical arguments to defend it.\(^{54}\) They saw bimetallism as the only viable regime, insofar as the adoption of a monometallic regime would suffer from a quantitative insufficiency of precious metals, and would, thus, be a deflationary monetary regime. Cernuschi stood out within this group, as he did not partake of the same ideas as most other French bimetallists. For instance, he was a strong supporter of bimetallism, but not a supporter of the monopoly of issue assigned to the Banque de France.\(^{55}\) To paraphrase the title of his 1866 book, Cernuschi was against the issuing of banknotes by the Banque de France, considering this means of payment to be a sort of magic trick. The issue of banknotes by the Banque de France was based on supposed gold reserves, not on gold reserves per se as the Banque de France did not hold the needed amount of gold reserves to cover all the banknotes in circulation.\(^{56}\) More specifically, Cernuschi was in favour of the development of depository banks, such as in England, which would be in charge of the discounting activities as he saw them as “the floating

\(^{54}\) Cernuschi was the French representative at the International Conference in London organized by the Bimetallic League in 1894 (May 2-3).

\(^{55}\) Many of the supporters of bimetallism were in favour of the monopoly granted to the Banque de France. The idea was that monetary integrity could only be guaranteed by a monopoly of (metallic or fiduciary) issue, as money is an important element of order in the country. See for instance L. Wolowski, La Question des Banques, Paris, 1864, p. 12.

\(^{56}\) H. Cernuschi, Contre le billet de banque, Paris, 1866, p. 199.
capital tools.”57 By contrast the issuing banks only “issue fictitious currency”, i.e currency disconnected from capital.58

Cernuschi took an extreme position in the public debate, such as on October 25th 1865 when he was invited to make a statement to the Agriculture and Trade Council in which De Parieu took part on the side of the High Council of Agriculture and Commerce.59 During the hearings Cernuschi declared: “[...] I don’t like the intervention of the law in matters of exchange. I believe that, in the near future, it will be the law of common sense that will prevail over fiat money, i.e. bank notes, which are not represented by deposited gold [...] In France, the freedom of banks would lead to the abolition of the bank note [...] I think the best system is mine: no bank of issue.”60

Cernuschi became strongly critical of the LMU’s functioning when its internal weakness appeared, and particularly following the limitation and later the suspension of the free coinage of silver. For instance, in 1874 he called for the dissolution of the LMU so as to preserve the bimetallic regime in France. He condemned the professors of political economy who supported the reforms that restricted the free minting of silver coin.61 As well as and beyond those academics, Cernuschi blamed the French Liberal school for the crisis, and particularly Esquirou de Parieu, though without naming him, as they had taken part in the drafting of the LMU resolutions. By adopting the 1878 resolution that suspended the minting of silver coin, the LMU became in his view a lame bimetallism. Despite the 1878 resolution, the silver coins in practice still circulated outside their issuing country, and without connection to gold thanks to the specific role played by the Banque de France. This feature explains why Cernuschi named the LMU a Metallic Assignats system.62

57 Ibid., p. 53.
58 Ibid., p. 54. On this point, Cernuschi declared “[...] It is through capital that one must discount, not through the creation of fictitious money” (ibid).
59 The High Council of Agriculture and Commerce was asked to carry out an investigation into the principles and general charges governing the circulation of money and currency in which 42 questions were put to certain personalities in the banking field.
60 Cernuschi, Contre le billet, p. 54-55.
61 Idem, Assignats, p. 12.
62 The reference to the Assignats refers to a dark episode in French monetary history, being a paper-money issued by the National Constitutional Assembly during the French Revolution in 1789. This paper-money served to liquidate the public debt as its was accepted as legitimate payment by domestic and international creditors. However, the excessive issue of the Assignats depreciated the paper-money while creating a confusion with the legal currency in circulation. That episode had left an enduring mistrust of non-metallic forms of money at large. Ibid., p. 13.
The risk of illiquidity in the LMU had become a seminal issue following the Italian and Belgium crises, as already mentioned. To Cernuschi the Italian position was insane, as the liquidation rule or clause was already included de jure in the first and eighth article of the 1865 convention. When the countries decided to start a monetary union, they at the same time accepted an inherent liquidation rule as a counterpart. He declared: “According to them [the Italians], as there is no mention of liquidation in the Convention, liquidation is not a right. It is true that the Convention did not mention liquidation, but there was no need for it to do so; the right to liquidation is inherent in the Convention itself.”

Cernuschi strongly reacted against the second convention on the LMU in 1885 (November 5th and December 12th). He called for each country to have full responsibility for assuming its own (nationally issued) currency (or reminded his audience that this was in fact the case anyway), while rejecting any form of solidarity between countries:

“The Latin Convention was neither a random contract, in which the parties speculate between themselves on chances, nor a cumulative contract, in which the parties exchange things which they regard as equivalent, nor a charitable contract, in which one of the parties provides a gratuitous advantage; the Latin Convention had as its sole object to circulate from one State to another the currency of the concordant States for a fixed number of years. None of the parties could think of benefiting the others or of passing on to the others the reduction in value which the currency of its manufacture might suffer.”

The position developed by Cernuschi was not so far from the moral hazard argument which is commonly raised nowadays when the LoLR is discussed. In fact, when referring to – and criticizing – Italy’s behaviour, Cernuschi stressed that there was a risk that an increasing number of countries would pass their duties over to the others, which in practice would sound the death knell for any bimetallic regime.

5 Conclusion

One of the major weaknesses of the LMU lay in its founding principles: to adopt a common agreement on divisional specie only. In contrast to the other experiments in monetary unions, banknotes – and all other substitutes of money – were not included. In that sense, the agreement was not strongly binding for the
participants and speculation quickly appeared, as we have explained in the article. From its birth until the end, the LMU’s members had always assumed a disconnect between banking money and metallic money, mostly for a necessity to keep their discretionary power.65 This rhetoric reflected the fact the (private) banking sector sold IOUs to its clients, whereas the official banks of issue were responsible for the legal tender money, meaning gold and silver. However, this disconnect enabled the central banks to issue banknotes outside the monetary union rules. Thus, rules and discretion matched.

The lack of cooperation among the LMU members, whether this was for political or economic reasons, explains en passant the many rearrangements that the LMU was subjected to over its lifetime. On these matters, the Banque de France took the leadership and always tried to maintain dialogues and meetings as it collected huge silver reserves from its partners. Our analysis led us to propose a fifth type in addition to Bordo’s four: namely as a converter of last resort. The Banque de France had, thus, a good reason to preserve the LMU in order to be reimbursed and prevent the emergence of systemic risk. If the Banque de France played a role in safeguarding the LMU, it was mostly to preserve its own interests.

Einaudi’s analysis of the LMU perfectly summarizes the conclusion of this article: “The LMU should be correctly defined as a coinage union, rather than a full monetary union, it lacked the most basic common institutions”.66 To paraphrase Einaudi, the LMU experiment demonstrated the full necessity to adopt basic common institutions where monetary unions are concerned; and the EMU has recently come to understand this, as shown by the creation of a Banking Union and its associated toolset (Single Supervisory Mechanism, Single Resolution Mechanism with a Mutual Resolution Fund) initiated in 2012.

Bionote

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65 Gillard, Union latine, p. 228.
66 Einaudi, Historical Perspective, p. 17.