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A Case Study of Foreign Investment

Colin M. Lewis

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by

COLIN M. LEWIS

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CONTENTS

	Acknowledgements	xi
	Introduction	1
I	The early phase: assumptions, expectations and achievements	5
II	National consolidation	45
III	Crisis and recovery	73
IV	The railway guarantees: a retrospective reappraisal	97
V	Denationalization and reorganization	124
VI	Zonal amalgamation – 1	146
VII	Zonal amalgamation – 2	164
VIII	Integration and prosperity	192
	Conclusion	215
	Abbreviations	222
	Notes	224
	Bibliography	248
	Index	255

TABLES

1	Volume of produce entering the southern market of Buenos Aires	24
2	Principal Argentine exports: relative composition, by value	28
3	Central Argentine: operating data	47
4	BAGS: operating data and dividends declared upon ordinary stock	48
5	Argentine railways: London Stock Exchange quotations of select British-owned companies	49
6	BA&EP: operating data	59
7	Argentine Railways: expansion of the network	68
8	Argentine Railways: density of mileage in select provinces	72
9	BAGS: goods traffic	75
10	BAGS: earnings and expenditure	75
11	BA&EP: operating data	76
12	Argentine Railways: dividends declared on ordinary stocks by select British-owned companies	77
13	Argentine Railways: London Stock Exchange quotations of select British-owned railway securities	78
14	Argentine Railways: guarantee payments, total annual liability	82
15	Service required by national government debt, 1892	83
16	Argentine Railways: net earnings and ordinary dividends of select British-owned companies and global yield	85
17	Argentine exports: select arable products	87
18	Argentine Railways: operating data, BAGS and CA	90
19	BAGS: goods and animal traffic	91
20	Argentine Railways: total nominal investment	95
21	Argentine Railways: ordinary dividends declared by select British-owned companies	96
22	Argentine Railways: working ratios	116
23	Argentine Railways: aggregate guarantee payments	117
24	Argentine Railways: guarantee commutation payments	122
25	BAGS and *Oeste*: gross yield on capital	128
26	Argentine Railways: national government lines, 1889	134
27	Argentine Railways: major systems, 1889	138
28	BAW: distribution of *Oeste* track	139
29	Central Argentine: grain traffic	155
30	BA&R and CA: capital accounts, 1899	157
31	Argentine Railways: tariff schedules, 1897	170
32	Argentine Great Western: capitalization	171

33 Argentine Railways: expansion of British-owned lines 197
34 Argentina: area under cultivation, select arable products 198
35 Argentine Railways: global yield and ordinary dividends declared by major British-owned companies 199
36 BA&P: expansion of system 201
37 Argentine Railways: London Stock Exchange quotations of select British-owned stocks 202–3
38 Argentine Railways: rolling stock ratios of select lines, 1889 205
39 Argentine Railways: rolling stock ratios of select British-owned companies 208–9
40 Argentine Railways: operating data of British-owned companies 213
41 Comparative dividends declared upon ordinary stock by British and Argentine railway companies 218

GRAPHS

1 BAGS: capital account structure 81
2 CA and BA&R: net earnings 158

MAPS

1 The Argentine Railway Network, 1914 xii
2 Expansion of the Argentine Railway system 63
3 Disposal of *FC Oeste* track, 1890 140
4 The consolidation of the Pacific group, 1895–1910 167
5 Railway rivalry and amalgamation in mesopotamia, 1898–1914 181

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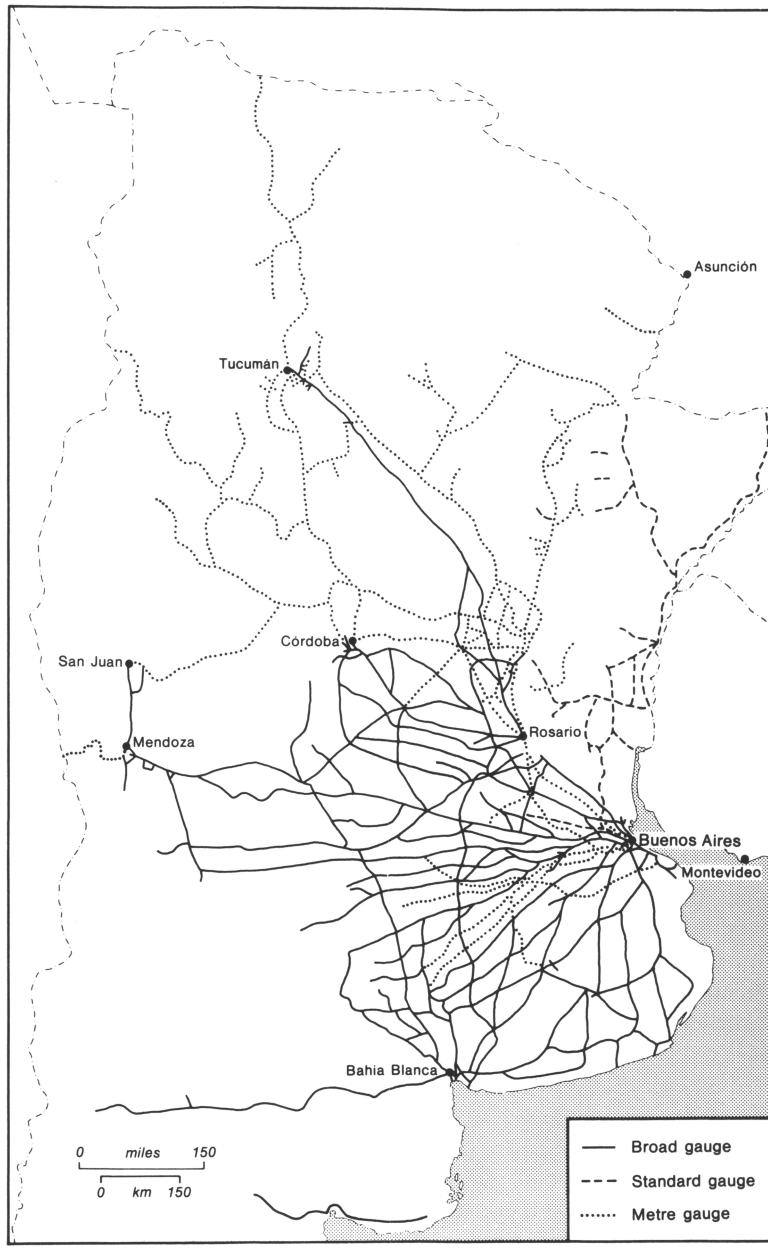

Map 1: The Argentine Railway Network, 1914

INTRODUCTION

The period between the fall of Rosas in 1852 and the election of Yrigoyen in 1916 has long been recognized as critical in Argentine economic history. These were the years which saw the formation of the modern Argentine Republic: the structure of the economy, the nature of society and the pattern of political processes were all clearly established, or profoundly modified, as the country underwent modernization in various forms. Between the mid-nineteenth and the early twentieth centuries Argentina passed from *la época del cuero* almost directly to *la sociedad de masas*, and its capital was transformed from *la gran aldea* of the creole age into the cosmopolitan Paris of South America. These were the years of the consolidation of the state, the expansion of the frontier and the evolution of a political structure sufficiently flexible to cope with the socio-economic changes wrought by rapid export-led growth. Opportunities generated by domestic diversification and the expansion of world demand were predicated upon factor endowment and the ability of the country to absorb those resources not available domestically. One of the key elements in this growth equation was the provision of social overhead capital which, in the Argentine case, was largely financed from external sources. The expanding railway network epitomized this process: not only did the railways express the characteristics of the economy, but the chronology, method and nature of railway construction provides an indication of the complex pattern of relationships which evolved at this juncture.

In part, it may be argued that the formation and evolution of the Argentine railway network between 1854, the date of the inauguration of work on the first line, and the First World War accurately reflect the nature and substance of structural change on a larger scale. The context within which railway companies were floated and operated, the phasing of expansion, the products

carried by the lines, the focus of activities – all mirror the dynamics of the growth process. The fortunes of the railways, moreover, represent in microcosm positive and negative aspects of the wider development programme. For the companies, the period possesses a basic unity. The decades between 1880 and 1914 were ones of expansion and, on the whole, prosperity. The economy at large began to grow rapidly during the period in spite of the hiatus of the Baring Crisis; this was followed by the re-vindication of the preferred development model associated with agricultural diversification, foreign trade and externally-derived factor flows — an environment in which the sheer scale of expansion inhibited any serious discussions concerning distribution and encouraged a facile acceptance of diffusionist tenets. But initial projection and financing of railways demonstrated that the dynamic of export-led growth was not to be easily achieved. As during the expansionist phase, so during the formative epoch, the railway companies' experience was representative, and illustrative, of larger events. The rhetoric and the assumptions associated with original railway concessions mark the contemporary expectations of dominant sectors in Argentine society and the preconceptions of a modernizing elite. In addition, the actual construction of the network and the problems which arose regarding the realization of these objectives, demonstrate the difficulties experienced by that elite in obtaining 'economic progress', albeit sectionally conceived. Essentially, it was a question of striking a balance between internal expectations and the requirements of external interests upon whom the dominant landed groups were dependent for technology, expertise and capital. The resolution of these conflicts, the implementation of a successful *modus operandi*, was the basic pre-condition upon which subsequent growth was founded.

This study is concerned with the nature of railway expansion in an area of recent settlement and the determinants of a pattern of infrastructural development in an agropecuarian economy. It will focus precisely — though not exclusively — upon the broad-gauge pampean companies. It will seek to investigate the nexus of domestic and foreign interests involved, the balance of the momentum for change (as between national opportunities and externalities) and the evolution of these relationships over time within the context of a specific international situation which will

be taken as given. In short, this volume considers the problems and profits of railway operations, the expectations of a 'modernizing elite' and the factors promoting and perpetuating a community of interest amongst apparently disparate groups. Railway construction was the catalyst which effected the transformation of the *pampas*. Argentine economic expansion during the late nineteenth and early twentieth centuries owed much to companies' detailed consideration of the infrastructural requirements most appropriate for specific productive sectors. Indeed, it was this concern which permitted individual enterprises to achieve profitable status. Yet the central position which had been acquired by several British-owned entities at the turn of the century contrasted sharply with earlier phases of Argentine railway development when many lines had experienced severe difficulty in establishing themselves upon secure financial bases, and the concept of large-scale external participation in this key area had not been unchallenged. Thus, prior to the First World War, Argentine railway history may be subdivided into a number of clearly identifiable periods: the formative phase of establishment and consolidation; the epoch of conflict and compromise between local and foreign interests; the emergence of a national network; the cataclysm of the Baring Crisis and its aftermath; resurgence and expansion which produced the era of 'golden' prosperity.

I

THE EARLY PHASE: ASSUMPTIONS, EXPECTATIONS AND ACHIEVEMENTS

By the early twentieth century Argentina possessed one of the most extensive, integrated railway systems in Latin America, the greater part of which was British-owned. Whether expressed in terms of route mileage or capitalization, the Argentine network was pre-eminent in the region: it was the tenth largest in the world.[1] Several Argentine railway companies enjoyed an international reputation for the excellence of their service; some had acquired an enviable reputation for financial rectitude and an ability to reconcile the disparate, and apparently contradictory, expectations of shareholders and consumers. During the years immediately prior to the First World War, contemporary opinion held that the Argentine case manifestly demonstrated the dynamic role then ascribed to foreign capital, and the appropriateness of the national railway system to the requirements of the expanding — and already diversifying — pampean economy. The scenario was one of harmony and expansion: of a close, lucrative relationship that had evolved between British capitalists and Argentine producers founded upon co-prosperity. This picture presented a sharp contrast to that of five or six decades earlier when Argentina was poised to enter the railway era. Then an initial optimism respecting railway projects and an enthusiasm for foreign investment had been dissipated by early difficulties. Problems of funding, the long gestation period involved — compounded by the underdeveloped nature of the local economy and political instability — conflicting interests and the often unrealistic expectations of various groups had engendered factious controversy. Notwithstanding original assumptions, it soon became clear that infant companies would require a substantial degree of government support, though no coherent consensus emerged as to the most effective means of according official aid. Confusion and dispute arose concerning the real cost of railway building;

disagreement — between foreign capitalists and the state, amongst promoters and financiers — became the norm as sanguine early expectations were confounded.

Problems and Prospects

Thus the dawn of the railway age in Argentina was far from auspicious, as events surrounding the inauguration of the country's first railway company, the *Sociedad Anónima Camino Ferrocarril al Oeste*, serve to confirm. A few days before 29 August 1857, the date of the official opening, a group of *Oeste* directors commissioned a special train in order to undertake a tour of inspection of the company's seven miles of track. The outward journey from the Buenos Aires terminus at Plaza Parque (Plaza Lavalle), in front of the Teatro Colon, to Flores was safely accomplished and, after suitable refreshments, preparations made for the return trip. Upon the homeward journey the party was somewhat nonplussed when the locomotive, *La Porteña*, left the track and one of their number was injured. Fearful lest knowledge of the accident might depress the earning potential of their company, the directors decided to suppress news of the event. They returned to Buenos Aires chastened by the experience.[2]

Such an incident was perhaps a fitting episode; it illustrates the precarious nature of railway projects then under consideration on the banks of the River Plate. Initial schemes were beset with the problems and difficulties that are usually associated with novel institutions struggling to achieve substance. Yet the concept of the railway as an adjunct of the modern state and the functions which it performed were already recognized in Argentina. The distinguished political philosopher, Alberdi, attributed to the railway an almost mystical symbolism; it was the acme of modernizing influences.[3]

> The railway is the means of over-turning the distorted system established by Spain in this continent. Spain made the heads of our countries where the feet should have been. This system evolved from her isolated and monopolistic perspective; it is lamentable for our expansion and commercial freedom. It is necessary to link the capitals and coast — to bring the littoral to the interior of the continent. Railways conquer distance: they work wonders better than any ruler of the land. The railway

> innovates, reforms and modifies — without official decrees and commotions . . . But for the railway, political unity would be impossible in countries where distance impedes the action of central government.

The railway, then, was not merely a metaphysical force but a fundamental pre-condition of political, economic and social change. The railway would open up and develop markets, facilitate the distribution of goods, and encourage migration to sparsely settled regions: it could provide the means of effecting social cohesion, of imparting a sense of community to widely scattered centres of population, and enable the writ of central government to run throughout the state. Little wonder that Alberdi should advocate the cause of the railways with such enthusiasm.

> These countries possess abundant means of procuring railways: we can float foreign loans, pledge our income and national wealth for enterprises that will redeem them with interest . . . At the same time we can foster private firms to build railways, heaping upon them all imaginable advantages and privileges . . .

Given Alberdi's influence in mid-nineteenth-century Argentina, it was hardly surprising that these sentiments obtained official recognition in the Argentine Constitution of 1853 which specifically enjoined Congress to provide the means necessary to encourage railway construction.[4] These views, however, were not confined to Argentines, but were shared by most foreign observers with interests in the River Plate at the onset of the railway age. An indefatigable English commentator upon the Argentine scene maintained that 'Railways must be established to drive the countries ahead, or they will recede into a state of semi-barbarism.' [5] Platitudes notwithstanding, there was no apparent lack of economic incentive for the construction of railways. Reporting in 1864, the *Brazil and River Plate Mail* employed terms which were soon to become the norm, although in this instance they referred exclusively to the Central Argentine Railway Company Limited: 'Few projects have ever been launched in the English money market more deserving of support than this railway.' [6]

The construction of railways in Argentina was seen as desirable and necessary by natives and foreigners alike, while the feasibility — in both technical and financial terms — of such projects does not appear to have been doubted: the local terrain was favourable and capital assumed to be abundant. Yet, within the South American community of nations, Argentina was but the fifth to enter the railway age. Brazil, Colombia, Peru and Chile possessed operational railway companies before *La Porteña* first steamed out of Plaza Parque.[7] An immediate explanation for this tardy development is not difficult to discover. The prevailing political situation during the 1850s was hardly likely to favour the fruition of costly railway projects. Given the latent hostility which existed between Buenos Aires and the other provinces of the Argentine Confederation, an antagonism which often resulted in protracted interhecine strife, it is little wonder that large-scale capital-intensive projects were long in the making. Indeed, it was surprising that any progress occurred at all.[8]

However, despite their disagreements and differences, both the merchants of Buenos Aires and General Urquiza's Confederation government recognized the advantages to be obtained from railway development. On the one hand the *porteños* considered the opening up of markets within the province; the national authorities, on the other, saw railways as an instrument for welding their factious and scattered territories together, and also of providing a viable link with the outside world that would circumvent the port and Customs House of Buenos Aires. In this fashion two railways were conceived; the *Oeste* in the province of Buenos Aires, and the Central Argentine, which was to link the Confederation port of Rosario with Córdoba, Tucumán and beyond.

The First Railways

Within weeks of the fall of Rosas, railway projects were under active consideration in Buenos Aires.[9] A plethora of schemes followed during the remaining years of the decade as the recently-installed 'liberal' oligarchy sought to give substance to long-cherished development programmes. The first concession for the *FC Oeste* was awarded in January, 1854.[10] Later the same year the government of the Argentine Confederation authorized an agent, José Buschental, to contract in Europe for the construction of the anticipated preliminary stage, from Rosario to Cór-

doba, of a trunk line to the north-west: the original Central concession was issued in 1855.[11] Further concessions were awarded in Buenos Aires two years later — for the Buenos Ayres and San Fernando Railway Company Limited (later renamed the Buenos Ayres Northern Railway Company Limited) and the Ensenada Port Railway Company Limited, initially known as the Boca Railway.[12] These schemes were not immediately successful: continuing political instability and unrealistic assumptions regarding the costing of railway construction meant that original optimism as to the ease of financing railway development was confounded. The *Oeste*, despite the amenable topography of the province, failed to gain adequate access to local private capital. After the first flush of success in obtaining a franchise, entrepreneurs connected with the project began to doubt their early enthusiasm. Initial forecasts of profitability were revised to such an extent that the company successfully applied for a revision of the concession to enable horses to be employed instead of steam locomotives as originally specified: horses were a cheap local commodity while coal was so expensive.[13]

From its inception the *FCO* relied heavily upon government aid. Although the original stock issue had been readily taken up, subsequent calls for capital were answered less enthusiastically. Consequently, before the line became operational the company had to make further demands on the provincial government. In the first instance, by the Law of 20 August 1857, the Governor was empowered to invest up to $4,000,000 *moneda corriente* in the line: this was additional to the $1,330,000 m/c which the provincial authorities had already subscribed to the *Oeste*'s original capital of $6,900,000 m/c.[14] Yet the province was soon called upon to provide further funds as the company extended its network. A year later the provincial congress authorized the local exchequer to disburse up to $6,000,000 m/c in favour of the company.[15] Thus the railway struggled to survive, becoming increasingly dependent upon official financing. When, in 1861, the main line reached Moreno and the provincial government pressed for continued extension of the network, private interests availed themselves of the opportunity to bow out of the enterprise. It was a logical consequence of the increasing reluctance of private capitalists to commit further funds to the line and the large stake already held by the provincial authorities. Nationalization was

effected by the Law of 26 December 1862: the province paid $20,000,000 for stock remaining in private hands.[16]

If the saga of the early history of the *FCO* was not encouraging, events in the Confederation were even less auspicious for the prospect of railway development in Argentina. Unlike the Buenos Aires provincial authorities, the national government was unable to accord its line any financial aid. The only negotiable asset possessed by the Confederation was land, which was offered as an inducement to stimulate investment in the Central. The original concession awarded the railway company, in addition to its right-of-way, a grant of half a league of land on both sides of the track for virtually the whole length of the route from Rosario to Córdoba. Despite this seemingly generous provision, Buschental's scheme aroused little interest in Europe.[17] The project was undoubtedly under-capitalized at £1,000,000, or approximately £4,000 per mile; a fact of which the line's promoters appeared entirely oblivious.[18] Such estimates were greeted with scepticism by European financiers and prospective investors, in whose experience — land grants notwithstanding — railway construction had proved substantially more costly. Although the actual cost of railway construction in Argentina has been hotly contested[19] this figure is out of line with contemporary estimates for other areas of recent settlement and bears little resemblance to the historic cost of railway building in more advanced economies as was demonstrated in official statistics published by the Argentine Railway Board.[20] Several adjustments were made to the original concession during subsequent years, but the most significant was that which occurred in 1862 when the government agreed to guarantee investors a return of 7 per cent per annum on capital placed in the company which was written up to £6,000 per mile.[21] Both of these amendments were critical, particularly the former.

Subsequently a guaranteed return upon investment was to become a feature common to all Argentine railway concessions successfully floated during the ensuing decades. The guarantee, however, was not an outright grant. It was rather a promise to subscribers that the state would ensure a reasonable return upon their investments. The guarantee usually offered by Argentine authorities — national and provincial — was 7 per cent per annum upon a fixed sum calculated at a specified cost of construction per mile, the recognized capital, as inscribed in a company's conces-

sion. It was not the intention of the state to subsidize inefficient or otherwise unprofitable concerns. The guarantee was envisaged as a means of attracting and safeguarding investment until an enterprise was capable of proving its profit-earning potential. Moreover, the state not only established a limit on the maximum guarantee allowed but, in addition, provided for repayment by the company of previous advances when earnings achieved a mutually agreed level.

Thus the guarantee may be seen as a major development in the course of Argentine railway history. As the provincial government of Buenos Aires had discovered, attempts to stimulate interest in railway projects could only be expected to bear fruit if the state was prepared to make some financial provisions. The creation of the guarantee system was little more than the realization of this fact. It was an attempt to establish on a formal basis the hitherto *ad hoc* allocation of state funds required to sustain the pace of railway expansion. The guarantee system, as instituted during the early 1860s, was an inevitable response evolved in the face of difficulties experienced by the provincial authorities of Buenos Aires and the government of the Argentine Confederation in the pursuance of their various railway schemes. On the one hand, domestic capital had manifested little real commitment to railway development; on the other, foreign interests had expressed serious reservations regarding the feasibility of railway projects in Argentina as initially costed and promoted.

The implementation of the guarantee system may be interpreted as a recognition on the part of Argentine ruling groups that they were competing for funds in an international market and as such had to apply incentives similar to those being granted by other countries which, lacking sufficient domestic funds to promote social overhead capital projects, had recourse to the world capital market. The experience of countries such as Russia, Brazil, India, and a number of European states indicated that, given the vast sums needed and the long gestation period required in such economies before railways could be expected to yield a reasonable remuneration, foreign investment might be procured only within narrowly-circumscribed conditions.[22] Basically there were two alternatives, though some variation was possible in terms of detail; either a state could obtain funds for the undertaking of such projects and itself bear directly the cost of