study of these competencies, in turn, is very different from that of the financial transaction involved in the range of portfolio investments. Seventh, international investment by definition is risky – because of unfamiliarity; the gold standard sharply reduced the risks of losses based on currency fluctuations; it did not reduce commercial or political risks. Conduits for capital exports were designed to do that.

3

The Gold-Exchange Standard

A Reinterpretation

STEPHEN A. SCHUKER

The gold-exchange standard of the 1920s, at least among economists, has suffered an infamous posterity. "There are few Englishmen who do not rejoice at the breaking of our gold fetters," Keynes declared when Britain elected to abandon the system in 1931.[1] In the current era, when monetary authorities have institutionalized flexible exchange rates with a modicum of success, most analysts looking backward tend to agree. The attempt to re-constitute the status quo ante by reestablishing the gold standard after World War I proved "a dreadful mistake," opines Peter Temin.[2] Barry Eichengreen insists that only when the monetary authorities repudiated the principles of "orthodox finance" could recovery from the Great Depression begin.[3] Allan Meltzer sees no compelling evidence that a gold-standard regime offers superior price stability to compensate for the easier transmission of shocks or the potential variability in output and employment.[4]

The classic older treatment by Charles Kindleberger does not fully echo those criticisms. Kindleberger concedes that monetary adjustment mechanisms did not work properly in the Depression, but he faults a cumulation of policy failures as much as insurmountable structural problems. Still, Kindleberger views the monetary regime of the 1920s as fatally impaired by the absence of a hegemon. Great Britain no longer possessed the financial clout to clear the market of distress goods, lend counter-cyclically, or

1 John Maynard Keynes, *Essays in Persuasion* (New York, 1932), 288.
2 Peter Temin, *Lessons from the Great Depression* (Cambridge, Mass., 1989), 37.
3 Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression* (New York, 1992), 21. See also Eichengreen's systematic comparison of the interwar gold-exchange standard with the pre-1914 gold standard and the postwar Bretton Woods arrangements in *Globalizing Capital: A History of the International Monetary System* (Princeton, N.J., 1996), esp. 45–92.
4 Allen H. Meltzer and Saranna Robinson, "Stability under the Gold Standard in Practice," in Michael D. Bordo, ed., *Money, History and International Finance: Essays in Honor of Anna J. Schwartz* (Chicago, 1989), 163–202.

discount in a crisis. The United States did not yet acknowledge a responsibility proportionate to its economic means to serve as the global stabilizer.[5] Although Kindleberger differs in emphasis from his Keynesian successors, he, too, regards the gold-exchange standard regime as inadequate in practice to the challenges of post–World War I reconstruction.

Every international monetary regime, however, reflects the political and cultural circumstances that attend its birth and sustain it. That proved true after both military cataclysms of our century. The familiar events of the more recent past illustrate the point. They provide a normative template by which we can measure the 1920s in retrospect. The shape of the Bretton Woods arrangements adopted after World War II did not turn mainly on the theoretical principles in contention, still less on the respective drafting skills of Harry Dexter White and Maynard Keynes. When the hostilities ended in 1945, the United States boasted half of global manufacturing capacity and two-thirds of world monetary gold. Those hard facts, as interpreted by policymakers with specific life experiences, bureaucratic loyalties, and economic preferences, inevitably determined the outcome.[6] The Bretton Woods system eroded in the 1960s when the disproportion between American resources and those of the rest of the world altered fundamentally.[7] The floating-rate system that developed after 1973 has also continued to evolve. The current regime retains the outward form but not the inner content of dispositions obtaining two decades ago. In the 1970s, central banks and treasuries could, and frequently did, manage rates in the service of domestic objectives. Today, outside regional groupings that have opted out of floating, exchange-rate movements largely register the

5 Charles P. Kindleberger, *The World in Depression, 1929–1939* [rev. ed.] (Berkeley, Calif., 1986), xv, 288–305.

6 Alfred E. Eckes, Jr., *A Search for Solvency: Bretton Woods and the International Monetary System, 1941–1971* (Austin, Tex., 1971); Robert Solomon, *The International Monetary System: An Insider's View* (New York, 1977); Harold James, *International Monetary Cooperation since Bretton Woods* (New York, 1996). The point emerges clearly from those who take a biographical approach, e.g., D. E. Moggridge, *Maynard Keynes: An Economist's Biography* (London, 1992), 721–55, and from those who approach the problems from the standpoint of political science, e.g., John S. Odell, *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change* (Princeton, N.J., 1982).

7 The most insightful overview remains David P. Calleo, *The Imperious Economy* (Cambridge, Mass., 1982). Among contemporary American economists, Robert Triffin was perhaps the first to draw attention to the paradigm shift; see *Europe and the Money Muddle* (New Haven, Conn., 1957); id., *Gold and the Dollar Crisis* (New Haven, Conn., 1960); idem., *The World Money Maze* (New Haven, Conn., 1966). Jacques Rueff, as financial adviser to President Charles de Gaulle of France, early advanced the theory that the United States had begun using its seignorage under the dollar-based Bretton Woods system to run a chronic balance-of-payments deficit. See Maurice Vaïsse, *La Grandeur: politique étrangère du général de Gaulle 1958–1969* (Paris, 1998), 396–412; note Rueff's polemic exposition of the theme in *L'Age de l'inflation* (Paris, 1963); and *Le Péché monétaire de l'occident* (Paris, 1971).

uncoordinated expectations of multinational corporate treasurers and bank arbitrageurs.[8]

To sum up, monetary arrangements and institutions represent an implicit bargaining framework for organizing international economic relations. Those arrangements and institutions may work more or less efficiently. When they fail, however, one should examine the political as well as the technical reasons for their breakdown. The gold-exchange standard ultimately collapsed because the leading nations of the Western world could not settle their intertwined domestic distributive controversies and international political conflicts after the most destructive of all wars up to that time.[9]

I

Among economists there currently exists a fair degree of consensus about the way monetary arrangements worked between the wars. One might describe that current orthodoxy with mild irreverence as the Gospel according to Saint Peter and Archangel Barry.[10] A gold-standard regime involves fixed currency values in terms of gold, the free flow of gold between countries, and the absence of a structured forum for international coordination. Adjustment is supposed to take place automatically. Deficit countries must contract their currencies and deflate until they balance external accounts. Surplus countries may expand their currencies, raise consumption, and import more. Significantly, however, they pay little penalty for not doing so and accumulating gold instead. The burden of adjustment thus falls asymmetrically on debtors. The latter must deflate rather than devalue. When labor-union power and a democratic ethos render wages inflexible downward, adjustment implies the fall of output and employment. Such a process transmogrified the severe but manageable downturn of 1929–30 – originally not qualitatively different from the recession of 1920–1 – into a catastrophic depression.[11]

8 Eichengreen, *Globalizing Capital*, 137–87; John H. Makin, *Capital Flows and Exchange-Rate Stability in the Post-Bretton Woods Era*, Essays in International Finance No. 103 (Princeton, N.J., 1974); Emmanuel Apel, *European Monetary Integration, 1958–2002* (London, 1998), 94–186.

9 This conclusion emerged implicitly even in the early analyses by William Adams Brown, Jr., *The International Gold Standard Reinterpreted, 1914–1934* (New York, 1940); and League of Nations [Ragnar Nurkse], *International Currency Experience: Lessons of the Interwar Period* (Princeton, N.J., 1944). Michael D. Bordo and Barry Eichengreen elaborate the notion that monetary regimes respond to historically specific factors in *The Rise and Fall of a Barbarous Relic: The Role of Gold in the International Monetary System*, National Bureau of Economic Research Working Paper 6434 (Cambridge, Mass., 1998).

10 Temin, *Lessons from the Great Depression*, 1–88; Eichengreen, *Golden Fetters*, 3–66.

11 Temin, *Lessons from the Great Depression*, 8–9.

When the guns fell silent in 1918, the United States remained the only major country with a currency still tied to gold, although severe price inflation had taken place even there. Yet the Cunliffe Committee in Great Britain expressed no doubt that that country should return to the gold standard as soon as feasible. Reputable authorities in London and New York differed only on the pace of the transition and the modalities of the return.[12] Russell C. Leffingwell of J. P. Morgan & Co. argued typically that, despite the temporary maladjustment of prices, "the way to resume is to resume." Maynard Keynes and his fellow publicist-economists seemed to think that price changes were "a disease rather than a symptom." In fact, the overriding issue, said Leffingwell, was to restore confidence. "When a bank's doors open again after a period of trouble, there are always heavy withdrawals at the outset by people who have been prevented from making withdrawals by the suspension. The trick is to pay everybody very promptly, and . . . to assure the world that the bank is open to stay."[13]

By early 1925, Governor Montagu Norman of the Bank of England and his Federal Reserve Bank of New York (FRBNY) counterpart, Benjamin Strong, had concluded that a failure to resume would lead to a long period of unsettled conditions, the recrudescence of paper-money expedients and uncontrolled inflation in Europe, the progressive deterioration of other currencies against the dollar, and a hemorrhage of gold to the United States.[14] Temin considers that view "tragically flawed." He contends that a sterling rate of $4.35 rather than $4.86 would not have improved British trade prospects decisively; the fixed-rate regime itself proved unacceptably rigid. He notes additionally that other countries returned to gold at misaligned parities: The Germans arguably overvalued the mark in 1924, and the French demonstrably undervalued the franc in 1926.[15]

Echoing the contemporary view of the British-dominated League of Nations Financial Committee, Temin claims that the United States and France, the two major nations with undervalued currencies, failed to expand

12 D. E. Moggridge, *British Monetary Policy, 1924–1931: The Norman Conquest of $4.86* (Cambridge, 1972), 21–8.

13 Russell C. Leffingwell to J. P. Morgan, 10 Sept. 1923, J. P. Morgan-Partners file, J. P. Morgan Papers, J. P. Morgan Library. Morgan stood in the middle of discussions about timing the return with his partner E. C. Grenfell and Governor Norman of the Bank of England.

14 Benjamin Strong Memorandum, 11 Jan. 1925, Benjamin Strong Papers, Federal Reserve Bank of New York; substantially reprinted in Lester V. Chandler, *Benjamin Strong, Central Banker* (Washington, D.C., 1958), 309–13. On the discussion between central bankers on the return to gold, see also Steven V. O. Clarke, *Central Bank Cooperation, 1924–31* (New York, 1967), 75–105.

15 Conclusive evidence now suggests that Finance Minister Raymond Poincaré deliberately undervalued the franc in 1926. See Kenneth Mouré, "Undervaluing the franc Poincaré," *Economic History Review* 49/1 (1996): 137–53; see also H. Clark Johnson, *Gold, France, and the Great Depression, 1919–1932* (New Haven, Conn., 1997), 44–62.

their economies sufficiently in the later 1920s. A maldistribution of gold resulted. Sterling suffered chronic weakness after the French began to convert their foreign currency holdings and to move toward a gold bullion standard after 1928. That fact assumed particular salience since the Bank of England had played the leading part in the financial reconstruction of other Continental countries; most central banks in Europe and the British Empire held sterling as a key reserve currency. Hence, the whole system rested on shaky foundations.[16]

The peculiar difficulties of German financial management added further complications. Germany financed reparations outpayments and its current-account deficit by long- and short-term borrowing abroad. Recalling the ravages of the 1923 hyperinflation on bondholders, domestic lenders insisted on a risk premium to hold government obligations. After a disastrous experiment in 1927, the Reichsbank found that it could attract foreign funds only by keeping the discount rate high, and that imparted a deflationary bias to the German economy. When in mid-1928 the United States allegedly curtailed capital exports and raised the discount rate to discourage stock market speculation, the weaknesses of the system stood dangerously exposed.[17] In other words, an unyielding policy regime constrained output and employment even before the downturn of 1929–30. Caught in the grip of economic orthodoxy, treasuries and central banks subsequently raised interest rates and balanced budgets in order to defend their currencies instead of expanding the money supply and embracing deficit finance to spur the real economy. When Britain abandoned the gold standard in September 1931, it nevertheless sought to accumulate reserves and thus transmitted deflation elsewhere. And when the United States finally depreciated its currency against gold in late 1933, it missed a chance to bolster the economy by expanding the money supply proportionately. Eichengreen, Temin, and their ideological bedfellows do not hesitate to embellish their ex post facto analysis with occasional heuristic grace notes. Eichengreen voices satisfaction that, after World War II, "the hegemony of the Keynesian model endowed policymakers in different countries with a common conceptual framework, facilitating efforts at international cooperation."[18] And Temin deplores the monetarist zeal displayed by "Fed" Chairman Paul Volcker in 1979 with the

16 See also Richard H. Meyer, *Banker's Diplomacy: Monetary Stabilization in the Twenties* (New York, 1970); and R. S. Sayers, *The Bank of England, 1891–1944* (Cambridge, 1976), esp. ch. 7–8, 15.

17 Eichengreen, *Golden Fetters*, 13–14, 392. For the details of German policy, see Harold James, *The Reichsbank and Public Finance in Germany, 1924–1933* (Frankfurt a.M., 1985); and Theo Balderston, *The Origins and Course of the German Economic Crisis, 1923–1932* (Berlin, 1993).

18 Eichengreen, *Golden Fetters*, 396.

aim of breaking the Jimmy Carter inflation. Volcker's "sharply deflationary" policies, he expostulates, almost led to an "economic meltdown."[19]

II

The financial history of the 1920s looks rather different to the archival historian who reads history forward rather than with Argus-eyed hindsight. The nineteenth-century version of the pure gold standard turns out not to work so differently from the gold-exchange variant as textbook models lead one to suppose. Bloomfield and Triffin show that countries violated the supposedly automatic rules for the adjustment of surpluses and deficits before World War I as well as after it. Export and import fluctuations, as well as relative prices, tended to move in parallel rather in contrast. Surplus countries sometimes neutralized gold inflows rather than expand; deficit countries rarely induced major downward wage adjustments. Nor did changes in discount rates play a uniform role in forcing cost discrepancies into line. Instead, huge international capital movements accommodated deficits or surpluses for decades at a time without compelling any correction on current account.[20]

While single-crop commodity producers on the periphery suffered periodically from capital shortages, the core industrial nations preserved exchange stability without restricting trade or frequently shipping gold. The system worked smoothly because of policy harmonization and substantial cooperation by central bankers, who shared a common outlook and a commitment to sound money, and because of the felicitous coordinating function played by the London City in extending credit and financing trade. By 1913, Triffin reminds us, paper currency and bank deposits accounted for nine-tenths of world monetary circulation, gold for only one-tenth. Moreover, central banks held sterling and other hard currencies as a substitute for gold reserves, although the prewar share of Devisen in total reserves amounted to only two-thirds the proportion reached in 1928.[21] Finally, the monetary authorities in advanced countries had already begun experiments in stabilizing silver currencies at the periphery through a gold-exchange standard. Britain introduced that arrangement in India in 1893; the United

19 Temin, *Lessons of the Great Depression*, 39–40.

20 Arthur I. Bloomfield, *Monetary Policy under the International Gold Standard, 1880–1914* (New York, 1959).

21 Robert Triffin, *The Evolution of the International Monetary System: Historical Appraisal and Future Perspectives*, Princeton Studies in International Finance no. 12 (Princeton, N.J., 1964), 15; Peter H. Lindert, *Key Currencies and Gold, 1900–1913*, Princeton Studies in International Finance no. 24 (Princeton, N.J., 1969), 12–15.

States did so in the Philippines in 1903 and studied its further use in the Caribbean.[22]

The floating exchange-rate regime that developed when pegging of key currencies ended in 1919 proved an unmitigated disaster. Unlimited fiat-money creation and hyperinflation brought the economies of the former Russian and Austrian empires to their knees. Speculative rings in Vienna and Amsterdam operating on forward exchange spurred the process on by turning their destructive ministrations successively to one gyrating currency after another. Heedless of the long-term social costs, Germany deliberately failed to arrest currency depreciation in 1921–3 in order to avoid the payment of reparations.[23] The ignominious collapse of European exchanges led the United States to protect its manufacturers from dumping through the emergency tariff of 1921 and through more permanent legislation a year later. Currency devaluation appeared not as a possible solution to underutilization of capital and labor, as Keynesians would see it a decade later. Rather, economists and business leaders in the sounder-money countries regarded currency instability elsewhere as a generator of chaos and the chief obstacle to trade revival.

Yet a return to a gold-bullion standard did not seem immediately practicable. Having fallen steadily during the war, gold production reached its lowest point in 1920–2.[24] Although the gold price had not changed, the dollar had inflated by about 60 percent since 1913; thus, with the dollar as the standard unit of account, a given quantity of gold would buy proportionately fewer goods. Those conditions did not provide much incentive for additional gold exploration. Output at the mines rebounded relatively slowly; for the whole period 1914–28 monetary gold stocks increased on average only 2.5 percent annually, compared with 3.2 percent in the quarter-century before the war.[25]

A pure gold standard would therefore usher in a liquidity shortage. Nations recovering from war would perforce have to reestablish banking relationships on either dollars or sterling. Much international monetary debate

22 Elisabeth Glaser-Schmidt, *'Die Philippines den Filipinos!': Die amerikanische Debatte über die Wirtschafts- und Verwaltungspolitik auf den Philippines, 1898–1906* (Frankfurt a.M., 1986), 226–8; idem., "Amerikanische Währungsreform in Ostasien und im Karibischen Raum, 1900–1918," *Amerikastudien* 33 (1988): 359–75.

23 Stephen A. Schuker, "Finance and Foreign Policy in the Era of the German Inflation," in Otto Büsch and Gerald D. Feldman, eds., *Historische Prozesse der deutschen Inflation, 1914–1924* (Berlin, 1976), 343–61. Gerald D. Feldman, in *The Great Disorder: Politics, Economics, and Society in the German Inflation, 1914–1924* (New York, 1993), declines to concede the general point, yet brings one thousand pages of evidence to support it.

24 Eichengreen, *Golden Fetters*, 199.

25 See the figures in Triffin, *Evolution of the International Monetary System*, 79–80.

in the first postwar years turned on the rivalry between the two currencies. Governor Norman offered his "Genoa proposals" in 1922 with the hope that as many countries as possible would hold reserves in sterling and that London would resume pride of place as what Keynes later called (with characteristic national hubris) "the conductor of the international orchestra."[26] Although Strong wished to cooperate with Norman, he nurtured growing reservations about the key-currency idea. He worried about accepting responsibilities for stabilization abroad that might conflict with his primary responsibilities at home. He did not want to hand a "blank check to some of the impoverished nations of the world, or to their banks of issue, and especially to those whose government finances are in complete disorder and quite beyond control."[27]

Beneath the flowery language about central-bank cooperation, Norman pursued a tenacious rivalry with Strong over the basis for stabilizing European currencies in 1922–4. Norman talked the talk of cooperative endeavor with his FRBNY colleague, but revealed more nationalist inclinations to his European interlocutors. That is why he nurtured a cozy friendship with the arch-inflationist Rudolf Havenstein in Germany and why he labored indefatigably to line up the Dutch and Scandinavian central-bank governors on his side. Norman schemed relentlessly in the winter of 1923–4 to defeat the idea, implicit in the Dawes Plan, of stabilizing the new German currency on gold. Norman would have preferred to base the Reichsmark exclusively on sterling so that the Reichsbank would hold its external balances in London. Tempers ran high on the British and American sides; Hjalmar Schacht of the Reichsbank played the middle duplicitously against both ends. In the final analysis, Robert Kindersley and his fellow negotiators at the 1924 London Conference discreetly fudged the matter. But the fine print of the German banking law in essence linked the new Reichsmark to gold. That settlement magnified the pressure on London to resume its prewar parity as well.[28]

Sayers and Moggridge have detailed the extensive policy discussions that Chancellor of the Exchequer Winston Churchill orchestrated in early 1925

26 Clarke, *Central Bank Cooperation*, 73; quotation in Eichengreen, *Golden Fetters*, 8. There is much evidence for Norman's political motives at Genoa in files G8/55 (Committee of Treasury), and G30/8–9 (Governor's Misc. Correspondence), Bank of England.

27 Benjamin Strong to Montagu Norman, 14 July 1922, File 1116.3, FRBNY.

28 Clarke, *Central Bank Cooperation*, 45–67, provides a sanitized version of these events. The biographer Andrew Boyle, *Montagu Norman* (London, 1967), 157–78, also smooths the rough edges. The Bank of England files on German monetary reconstruction, OV34/117–120, and also the correspondence files with the Reichsbankdirektorium, OV34/71–72, provide evidence of a far less cooperative environment. See also Hans Otto Schötz, *Die Kampf um die Mark, 1923/24* (Berlin, 1987).

before agreeing to resume gold payments at $4.86 to the pound. The high-level expert debate that preceded resumption, carried on within the bureaucracy as well as the public prints, has few models or parallels in diligence.[29] No doubt policymakers lacked the statistical knowledge that might have led to better forecasting. Yet it is far from obvious, even today, whether as a political matter the decision to go back on gold was right or wrong.

A. W. Phillips later claimed that, by examining experience over the half-century before the war, one could fairly accurately have predicted the level of unemployment that would persist given the average decline of wage rates in 1925–9. But Samuelson and Solow offer a generally persuasive response.[30] One cannot easily separate the effects of cost changes and demand shifts on the price level. Hence, Governor Norman and his colleagues in the Treasury could not have predicted the high unemployment and sluggish growth rate of the later 1920s without supplementary data on the mobility of labor markets and without knowing how international trade would develop once other trading countries had returned to stable currency values. Perhaps the British should have realized that German coal mines, idled during the Ruhr occupation, had modernized sufficiently to drive British coal from international markets. But such details seemed to hold at most peripheral significance.[31]

Compelling political reasons mandated an early return to gold. The key Dominions, as well as several European nations, had already determined to resume gold payments. In effect, Britain could merely choose to lead the movement or to bring up the rear. If Britain lagged behind, the gold bill would ineluctably replace the sterling bill as the chief medium of exchange. The country would lose on revenue from invisibles what it potentially gained on export trade.[32] Josiah Stamp, one of the Dawes Plan architects in 1924, articulated the fear of the average manufacturer lest overseas political pressure price British goods out of world markets. "New York cracks the whip," he complained, "and London obeys the signal." His fellow expert Owen Young, a director of the New York "Fed," articulated the broader vision that

29 Moggridge, *British Monetary Policy*, 37–112; details in his earlier study, *The Return to Gold 1925: The Formulation of Economic Policy and Its Critics* (Cambridge, 1969). Sayers, Bank of England, chap. 7.

30 See A. W. Phillips, "The Relation Between Unemployment and the Rate of Change of Money Wages in the United Kingdom, 1861–1957," *Economica* 25 (Nov. 1958): 283–99; and the reply by Paul Samuelson and Robert Solow in *American Economic Review* (1960): 177–94; also Robert M. Solow, "Recent Controversy in the Theory of Inflation," in Stephen W. Rousseas, ed., *Inflation: Its Causes, Consequences, and Control* (Wilton, Conn., 1968).

31 See, however, the continued debate in John Redmond, "The Sterling Overvaluation," *Economic History Review* (1984): 528ff. Barry Supple, *The History of the British Coal Industry*, vol. 4, *1913–1946: The Political Economy of Decline* (Oxford, 1987), 214–67, provides useful sectoral analysis.

32 See Sir Otto Niemeyer memorandum, 2 Feb. 1925, cited in Moggridge, *British Monetary Policy*, 264.

actuated the transatlantic proponents of a return to gold from the Dawes Plan deliberations onward. Both countries, Young replied, would have to take discernible risks to foster stability of the international structure:

> Quite apart from the question of whether the gold standard is the best, I am satisfied . . . that it is unwise to introduce . . . the speculative elements of any new experiment. . . . We should use, so far as we can, well-known and well-understood machinery in order that we may the more quickly, and with a greater certainty, get back to stable exchanges, and thereby take the first step toward freer international markets.[33]

III

The historical record reveals that sterling remained a weak link in the key-currency chain throughout the later 1920s. We can plausibly classify that development, however, as a contingent political outcome rather than a systemic flaw in the monetary regime. After all, the London City had smoothly coordinated discount markets before World War I with relatively slender reserves. And Montagu Norman deliberately misstated gold holdings and secretly sterilized the inflows in order to make the situation seem more precarious than it was.[34] Precisely as predicted, moreover, Britain's return to gold in 1925 paved the way for an ambitious program of central-bank cooperation to stabilize currencies and revive trade on the European continent over the next three years. The respective central banks of France and England cultivated an unseemly rivalry over the details of financial reconstruction that burst into the open in the Rumanian case.[35] The struggle had political overtones, for beneath a diaphanous banking figleaf Norman allied himself with Schacht and covertly sought to undermine French political influence in Eastern Europe. Nevertheless, after numerous excursions and alarms, most nations in Europe (as well as Latin America) heeded the prescriptions of the "money doctors" and returned to stable rates.[36]

Poincaré admittedly undervalued the franc when France stabilized de facto in 1926 at one-fifth of the 1914 par. One can argue, however, that a middle-sized country faced with containing Germany and upholding the Versailles treaty virtually alone might bolster international security,

33 Owen D. Young to Josiah Stamp, 3 March 1925, Owen D. Young Papers, St. Lawrence University.

34 See J. R. Garrett, "Market Control Techniques and the Bank of England," *Journal of Economic History* (Sept. 1995): 612–36.

35 Sayers, *Bank of England*, 195–9.

36 For the readoption of gold in Latin America, see Paul Drake, *The Money Doctor in the Andes: The Kemmerer Missions, 1923–1933* (Durham, N.C., 1989); also Paul W. Drake, ed., *Money Doctors, Foreign Debts, and Economic Reforms in Latin America from the 1890s to the Present* (Wilmington, Del., 1994).

broadly conceived, by modestly underpricing its tradeables to spur domestic economic growth. True, the consequent gold inflow into France outpaced most expectations. Yet that need not have resulted in gold maldistribution if Paris had developed more sophisticated money-market institutions allowing it to recycle resources outward, or if the political menace that Germany posed to the status quo had not made it imprudent to do so.[37]

The evolution of the British domestic economy reflected policy choices as well. Prime Minister Stanley Baldwin aimed to dish the Diehards and refashion the Conservative Party as a center party attractive to the skilled working class.[38] He therefore preferred an indecisive end to the 1926 General Strike that would promote class unity to an open defeat for organized labor that would keep the lid on wages. For similar reasons, the Baldwin government did not dare tackle an overgenerous welfare system that fostered labor immobility by allowing the long-term unemployed to remain in their familiar social settings within the Depressed Areas. In light of later experience, it seems implausible that any untargeted macroeconomic policies could have overcome the specific regional problems of declining industries in the Midlands, Scotland, and Wales.[39] Nor did world trade generally expand as fast as optimists had hoped. The World Economic Conference of 1927 deadlocked between British advocates of open markets and French proponents of cartel restrictions and failed to produce a practical result.[40] What seer could have foreseen all that?

By 1927, both Strong and Norman acknowledged that they were presiding over a managed-currency system and not one that could adjust to shocks automatically.[41] For various reasons, however, the notable Central Bankers meeting of July 1927 did not consolidate the movement toward closer monetary cooperation. Instead, each country pursued national objectives with renewed zeal. This did not demonstrate a regime failing so

37 On the problems created by the influx of foreign money into France, see particularly the 1927–8 exchanges between Norman and Siepmann of the Bank of England with Moreau and Quesnay of the Banque de France in file G1/34, Bank of England. For a more critical account of Banque de France monetary policy than the one advanced here, cf. Kenneth Mouré, *Managing the Franc Poincaré: Economic Understanding and Political Constraint in French Monetary Policy, 1928–1936* (New York, 1991), ch. 1–4.

38 On Baldwin's strategy, see Philip Williamson, *National Crisis and National Government: British Politics, the Economy, and the Empire, 1926–1932* (Cambridge, 1992); also Stuart Ball, *Baldwin and the Conservative Party: The Crisis of 1929–1931* (London, 1988).

39 Bentley B. Gilbert, *British Social Policy, 1914–1939* (Ithaca, N.Y., 1970); Sean Glynn and Alan Booth, "Unemployment in Interwar Britain: A Case for Relearning the Lessons of the 1930s?" *Economic History Review* 36 (Aug. 1983): 329–48.

40 Robert Boyce, *British Capitalism at the Crossroads: A Study in Politics, Economics, and International Relations* (Cambridge, 1987), 119–22.

41 See Benjamin Strong to Montagu Norman, 19 Oct. 1927, in Benjamin Strong Papers 1116.7, FRBNY.

much as a failure to practice the regime. Contrary to received opinion, the United States did not substantially drain net gold from the rest of the world in 1925–8.[42] However, when selective credit controls failed (as they almost always do), the "Fed" saw no alternative to raising interest rates in 1929 in order to curb the New York stock market boom. That inevitably put pressure on sterling. The French and Germans also added to Britain's secular problems by reducing their sterling balances toward the end of the period.[43]

From their own point of view, given popular preferences, French monetary authorities had sound reasons for moving toward a gold-bullion standard after 1928. With open-market operations restricted by the stabilization law, the Bank of France believed that it could control domestic finance better by reducing holdings of Devisen.[44] In addition, given Anglo-French divergencies over German affairs, politicians in Paris saw no compelling reason to finance John Bull's alleged financial imperialism on their own centime. While expert opinion differed whether a true gold shortage had developed by 1929, international cooperation could have solved the putative problems within the four corners of the existing monetary regime. During the Young Plan negotiations of 1929, W. Randolph Burgess of the New York "Fed" adumbrated plans for a type of special drawing rights as a feature of the prospective Bank for International Settlements. Ideally, the BIS could serve as an intermediary in the payment of reparations, and reparations deposits could serve as the basis for an expansion of international liquidity.[45] The BIS did not wholly fulfill its promise. Plans for paper gold never came to fruition. But the obstacles were political, and not technical.

A political explanation for the breakdown of the gold-exchange standard must focus primarily on Germany. It must track that nation's resolve, at virtually any cost, to repudiate the strictures of Versailles. The Reich fulfilled the Dawes Plan for reparations only so long as the partial moratorium continued. By a very large margin, it imported more foreign capital than it delivered in reparations. It utilized that capital not in productive plant and equipment, but largely on the amenities of public infrastructure and in financing a higher living standard than domestic productivity could justify. Owing to political pressures and Socialist domination of the arbitration process run by the Labor Ministry, hourly wage rates rose to the point where German industry became internationally uncompetitive. In 1928, Germany demanded another investigation of its capacity to pay reparations, although

42 Brown, *International Gold Standard Reinterpreted*, 1: 542–3.

43 Clarke, *Central Bank Cooperation*, 123–41.

44 Mouré, *Managing the Franc Poincaré*, 46–79.

45 See the several Burgess memoranda to Owen D. Young in the "International Bank" files for Feb.–June 1929, Owen D. Young Papers.

the real variable remained as always German will to pay. The Young Plan negotiations of 1929, envisioned as a final liquidation of the war, led instead to bitter acrimony. Right-wing nationalists mounted a demagogic campaign against the Young Plan, even though that plan reduced Berlin's annual obligations by one-quarter.[46]

In fact, the German economy turned down in 1929 before that of the United States.[47] Yet the world recession that began in that year need not have proven substantially worse than the 1920–1 downturn except for one factor: It happened to coincide with a last-ditch German attempt to repudiate its obligations under the Versailles treaty. Contrary to the general impression, President Herbert Hoover slightly cut U.S. taxes in 1930. The full-employment budget proved mildly stimulative in that year; it grew even more expansive in 1931 (when it reached 2 percent of GNP).[48] The Labour government in Britain similarly declined to take more than a modest dose of the prescribed deflationary medicine.[49]

As Temin has pointed out, most of the traditional explanations for the depth of the American downturn in 1930 do not fully work. The stock market plunge of October 1929 did not initially go further proportionately than the crash of 1987. Many qualified observers considered the first jolt downward a salutary correction, and the limited decrease in private wealth it engendered cannot fully account for the autonomous fall in consumption.[50] The collapse of commodity prices hurt commercial farmers, but benefited city dwellers. The Smoot-Hawley tariff had at most marginal consequences.[51] The first round of bank failures in late 1930 really featured the insolvency of the pushcart peddlers' bank in New York and did not produce a significant shock to the quantity of money.[52]

46 Stephen A. Schuker, *American 'Reparations' to Germany, 1919–33*, Princeton Studies in International Finance no. 61 (Princeton, N.J., 1988), 14–46; see also Philip Heyde, *Das Ende der Reparationen. Deutschland, Frankreich und der Youngplan, 1929–1932* (Paderborn, 1998), 35–98.

47 Peter Temin, "The Beginning of the Depression in Germany," *Economic History Review* 24 (May 1971): 240–8.

48 Figures in E. Cary Brown, "Fiscal Policy in the Thirties: A Reappraisal," *American Economic Review* 46 (Dec. 1956): 857–79.

49 Robert Skidelsky, *Politicians and the Slump: The Labour Government of 1929–31* (London, 1967); Williamson, *National Crisis and National Government*, 255–424.

50 Contemporary observers, who did not suffer from exposure to the sirenic prose of John Kenneth Galbraith, realized this perfectly well at the time. See Joseph S. Davis, *The World between the Wars, 1919–39: An Economist's View* (Baltimore, 1975), 189–223; cf. Galbraith, *The Great Crash, 1929* (Boston, 1955).

51 Alfred E. Eckes, *Opening America's Market: U.S. Foreign Trade Policy since 1776* (Chapel Hill, N.C., 1995), 100–139; Barry Eichengreen, "The Political Economy of the Smoot Hawley Tariff," *Research in Economic History* 11 (1989): 1–44.

52 Excellent analysis in Temin, *Did Monetary Forces Cause the Great Depression?* (New York, 1976); also in idem., *Lessons from the Great Depression*, 45–63.

By contrast, contemporaries abandoned hope of a normal recovery in the spring and summer of 1931. Deflationary expectations – the so-called Mundell effect – then began to feed on themselves. This second leg of the Depression had its primary roots in international politics. Trying to draw right-wing opinion away from the Nazis by outflanking them in nationalist fervor, Chancellor Heinrich Brüning launched a customs union with Austria as a prelude to political union and the extension of German economic dominance in the East.[53] The Versailles treaty had strictly forbidden such an *Anschluss.* The French reacted with predictable dismay. The ensuing crisis exposed the fact, already known to insiders, that Austria's largest bank had made improvident agricultural loans and become insolvent. The Austrian banking crisis led to a banking crisis in the Reich, in which the dependence of the universal D-banks on short-term foreign loans to finance long-term equity investments became patent.

At this point, it was far more important for the Reich to maintain the confidence of short-term private lenders than to obtain relief from its modest reparations obligations. State Secretary Fritz Schäffer of the German Finance Ministry forcibly reminded Brüning of the relative magnitudes involved. Yet the chancellor felt that to satisfy public opinion he had to manipulate the crisis to obtain reparations relief as his highest goal.[54] Largely owing to German rigidity and incredibly poor management by Reichsbank President Luther, the French dragged their feet in accepting the Hoover moratorium for reparations and war debts. By the time that international bankers had put together a rescue package for Germany, the forces of deflation elsewhere had spun out of control. No smoking gun has yet emerged from the Threadneedle Street archives to prove that the Bank of England voluntarily abandoned gold in September 1931. But Labour leaders crudely observed that their constituencies would decline further sacrifices for the sake of sterling's world role. And the Bank of England handled its market intervention in defense of the pound with unwonted inexpertise. Governor Norman remained on holiday while the crisis mounted. Younger Bank officials like Kershaw, Siepmann, and Clay expressed no great sorrow to see Downing Street throw in the towel.[55]

53 Andreas Rodder, *Stresemanns Erbe. Julius Curtius und die deutsche Aussenpolitik, 1929–1931* (Paderborn, 1995); Edward W. Bennett, *Germany and the Diplomacy of the Financial Crisis, 1931* (Cambridge, Mass., 1961); Aurel Schubert, *The Credit-Anstalt Crisis of 1931* (New York, 1991). For Brüning's emphasis on the primacy of foreign policy, see the ingenious defense in William L. Patch, Jr., *Heinrich Brüning and the Dissolution of the Weimar Republic* (New York, 1998), 172–219.

54 Balderston, *Origins and Course of the German Economic Crisis*, 296–326.

55 Diane B. Kunz, *The Battle for Britain's Gold Standard in 1931* (London, 1987). The present writer attempted without success to find a "smoking gun" in the Bank of England archives. It seems clear, however, that Whitehall faced a virtual "workers' ramp" in the summer of 1931 and concluded that it could not ask the nation to make further domestic sacrifices to save the nation's international position; archival citations in Schuker, *American 'Reparations' to Germany*, 55n.

Once Britain had abandoned the gold parity, retrospective wisdom suggests that other countries should have followed to obviate the propagation of deflationary forces. Still, the possibilities for rescuing the gold-standard regime were not wholly exhausted. After an initial panic, sterling did not depreciate radically owing to gold dishoarding in India. The Treasury therefore set up an Exchange Equalisation Account to "keep down the pound," although it would not trumpet that rationale so bluntly in Parliament.[56] Manipulation of sterling – leaning against the wind harder than the wind was blowing, as Howson delicately puts it – figured as only one of several interlocking British schemes to beggar their neighbors.[57] In 1932, Whitehall created the Ottawa system and constructed a tariff wall around the British Empire. Those challenges fairly invited a nationalist response elsewhere.

In Germany, however, Brüning quickly realized that he could not possibly follow Britain with a competitive devaluation. A trained and able economist, Brüning surveyed the possibilities more keenly than later critics suggest. Brüning knew that uncompetitive wage rates in Germany would have to come down, one way or another. But, unlike Britain, Germany had no empire. Other countries could and would retaliate if he openly devalued. Moreover, not only did the Young Plan legally require Germany to retain gold parity; a weaker mark would also increase the real weight of the foreign debt that the country had run up with open eyes. Above all, Brüning realized that, after Germany's experience with the 1922–3 hyperinflation, there could be no such thing as a controlled devaluation in the Reich.[58] Indeed, all European nations that had suffered from high inflation in the early 1920s hesitated to repeat the experiment. As the Italian finance minister explained colloquially in 1933: "A man who has drunk too much must be a teetotaler, while the ordinary man can take his wine without danger."[59]

56 Howson, *Sterling's Managed Float: The Operations of the Exchange Equalisation Account, 1932–39*, Princeton Studies in International Finance No. 46 (Princeton, N.J., 1980), 6.

57 Ibid., 56. Howson observes, however, that even "clean" floating requires targets, and she maintains that Britain managed the float more vigorously in support of domestic policy goals from 1935 onward than earlier.

58 The classic treatment is by Knut Borchardt, "Zwangslagen und Handlungsspielräume in der grossen Wirtschaftskrise der frühen dreissiger Jahre: Zur Revision des überlieferten Geschichtsbildes," in Bayerische Akademie der Wissenschaften, *Jahrbuch 1979* (Munich, 1979), 87–112; also id., "Zur Frage der währungspolitischen Optionen Deutschlands in der Weltwirtschaftkrise," in Knut Borchart and Franz Holzheu, eds., *Theorie und Politik der internationalen Wirtschaftsbeziehungen. H. Müller zum 65. Geburtstag* (Stuttgart, 1980), 165–82. Carl-Ludwig Holtfrerich attempts – without notable success – to poke holes in the argument in "Zu hohe Löhne in der Weimarer Republik? Bemerkungen zur Borchardt-These," *Geschichte und Gesellschaft* 10 (1984/1): 122–41.

59 Per Jacobsson Diary, 5 July 1933, London School of Economics Library.

Undoubtedly the Federal Reserve deepened the American Depression by raising rates in the fall of 1931 to prevent speculators from attacking the dollar after they had finished with sterling. The Fed had little other choice, other than an abrupt devaluation, when the Bank of France peremptorily withdrew all its earmarked gold from New York. Courageously, however, the Fed carried out vast open-market operations in the spring of 1932 despite the lack of clear technical data on their effects. That open-market intervention essentially brought the worst of the American deflation to an end.[60]

The prospect of international cooperation for recovery had still not wholly disappeared. As Robert Mundell has recently reminded us, fixed exchange rates have obvious advantages – at least when they prove feasible.[61] Transparency of pricing, stability of expectations, and lower transaction costs foster trade. When countries accustom themselves to fixed currency relationships, wages, prices, and interest rates tend to harmonize across borders. The integration of commodity, factor, and capital markets strengthens the ability of all trade partners to promote comparative advantage. Per Jacobsson and his colleagues in the Monetary Division of the Bank for International Settlements had those benefits firmly in mind when they advocated the restoration of fixed rates with a coordinated joint devaluation against gold to overcome the existing shocks in 1932–3.[62] At the World Monetary Conference of June/July 1933, neither the British nor the Americans expressed genuine interest in stabilizing at a rate that the other would find acceptable.[63] But it would be erroneous to blame what Franklin Roosevelt called "the old fetishes of so-called international bankers" for the result. Although Keynes lauded Roosevelt's bombshell message torpedoing the conference as "magnificently right," the president expressed more concern to his newspaper friends to appear ideologically left.[64] One cannot examine the tiny scraps

60 Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton, N.J., 1963), 362–419. The Fed also took the lead in setting up Banking and Industrial Committees that could spur housing construction, offer mortgage relief, fund self-liquidating public works, and stabilize the bond and commodities markets. It is nevertheless broadly true that monetary rather than national fiscal policies turned the tide. For a nuanced appreciation of the B&I Committees, see Josephine Young Case and Everett Needham Case, *Owen D. Young and American Enterprise* (Boston, 1982), 575–96.

61 Editorial page, *Wall Street Journal*, March 24–5, 1998.

62 The successive memoranda by Jacobsson and his staff received wide circulation among Central Bankers. See especially G1/51–33 (Governor's files on League of Nations Monetary and Economic Conference, Nov. 1932–July 1933); also OV4/28, 73–74 (BIS files), Bank of England.

63 Herbert Feis, *1933: Characters in Crisis* (Boston, 1966).

64 For Keynes's comment in context, see D. E. Moggridge, *Maynard Keynes: An Economist's Biography* (London, 1992), 577; for Roosevelt's candid remarks to journalists, consult Charles Hurd, *When the New Deal Was Young and Gay* (New York, 1965), 146–71.

of paper on which Roosevelt instructed his fellow "chicken farmer" George Warren about monetary-policy preferences in the fall of 1933 without concluding that he had no theoretical grasp of the economic issues involved.[65] The World Economic Conference demonstrated, as a practical matter, that international monetary cooperation was dead. Yet the outcome tells us less about the principles of the gold-exchange-standard regime than about the politicians who ran it into the ground.

65 George W. Warren Papers, Cornell University Archives; also Frank Freidel, *Franklin D. Roosevelt: Launching the New Deal* (Boston, 1973), 454–89; bombshell message quoted in ibid., 483.

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