Introduction

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In the aftermath of the First World War, international politics focused primarily on two sets of issues: security concerns (with discussions about the principles of collective security as contrasted with alliance and guarantee systems built by individual nation-states); and financial questions. In finance, politicians faced the same problems as in the case of security. How could collective international interests be reconciled with calculations of national advantage? What institutional and legal forms were needed for a properly working international financial system to operate?

In these debates, the politics of central banking played a crucial part. Central bankers in the course of the 1920s attained a degree of national and international prominence that they had never previously held. After the early 1920s, when stabilisation of European and Latin American currencies became a central theme, and until the Great Depression, which made co-operation much more difficult, a number of men in central banks stood at the heart of the new politics of world economics: Montagu Norman as Governor of the Bank of England, Émile Moreau as Governor of the Banque de France, Benjamin Strong, the Governor of the Federal Reserve Bank of New York, and Hjalmar Schacht, President of the German Reichsbank.

They have not been kindly judged by history. The accusations are numerous. It is claimed that Norman in 1925 took sterling back to the gold standard at an unrealistically over-valued parity, did not understand the criticisms advanced by John Maynard Keynes, stood in the way of a ‘modern’ economic policy, and was responsible for Britain’s sluggish interwar economic performance. German historians have shown how Schacht with his attacks on public finance in republican Germany prepared the political way for dictatorship, and soon after leaving his position in the Reichsbank made an alliance with Adolf Hitler. In economic matters, he allowed an immense wave of short-term capital imports in the late 1920s, which made Germany especially vulnerable to international depression. The withdrawal of these short-term loans in 1931 was the major cause of the severity of the German slump. Even Strong, a convinced internationalist and a powerful personality, is sometimes said to have been a significant influence for the worse during the depression by the fact of his absence: he died in October 1928, and no one could adequately fill his shoes.
Of course, these conventional criticisms frequently overstate the case: it is difficult to believe that the poor performance of the British economy resulted from the life of one man, or that the American crash followed from the death of another. But modern economic historians have established a 'consensus' that the system that the central bankers built, the revived gold standard, played the major role in causing the serious economic weakness of the later 1920s. One important task for the historian is to show how a system that was supposed to create stability ended in such abysmal failure.

The issue of the relationship of central bankers to politics was from the start as controversial as the question of their economic performance. In political terms, criticisms of interwar central bankers have pointed out the frequently anti-democratic language and actions that characterised the practice of central banking, which saw its mission as restraining and limiting the actions of spendthrift politicians. Defenders of the central bankers have replied by pointing out that at least in some societies, internally divided and ferociously nationalistic to the outside, some constraining of democracy offered the only route to building international peace and stability.

The essays in this issue offer surprisingly sympathetic accounts of the motives of some of the major players in the world of the revived gold standard, even though the outcome of these actions represented a major catastrophe: a collapse of European economics and politics. In the light of the final result, most readers will at first ask how it is possible to have any sympathy whatsoever for the central bankers of the 1920s.

In different ways, the authors of the essays presented below point out the extent to which the problems faced by the central bankers were of an entirely new order. Norman talked about the institutional development of central banks as if he were participating in a gigantic experiment. The new threats to stability, and in particular the large capital flows (frequently speculative movements) of the 1920s, required international co-operation in order to prevent destabilising consequences. Such co-operation required the subordination of purely national concerns.

According to Norman, effective international co-operation in monetary matters depended on providing a counter-weight to the claims and demands on the states of the post-war world. At the height of the success of international stabilisation, and when the prospects for peace and recovery appeared bright, he wrote:

Central banking is young and has no tradition: it may last and may develop, or its usefulness, to fill a short post-war need and no more, may soon come to an end. On the one hand its sphere may be limited by the qualification that no Central Bank can be greater than its own


State – the creature greater than the creator. On the other hand, a Central Bank should acquire by external help (as in some ex-enemy countries) or by internal recognition (as in France) a certain freedom or independence, within, and perhaps without, its own State. By such means alone can real co-operation be made possible. I cannot define the position thus acquired but it should surely permit a Bank to ‘nag’ its own Government even in public and to decide on questions on other than political grounds.  

Without strong institutions the new environment would breed both domestic and international chaos:

1. Constant inflationary pressure was a legacy of war finance, and of a subsequent inability of democratic politics to produce a financial stabilisation. New political expectations and demands produced higher public spending, but most governments found it impossible to maintain wartime taxation, or impose new peacetime taxes, on a population which also wished for a return to normalcy. The result was a proclivity for deficits, financed through monetary issue, which led in the first half of the 1920s to inflations and hyper-inflations. Central bankers in this environment believed that they needed an institutionally anchored independence if they were to counter pressures from the world of politics.

   This view of inflationary pressure having deep-seated social roots was quite widely shared. Sir Arthur Salter, the Director of the League of Nations Economic and Financial Section, expressed it eloquently in evidence to the US Senate’s Commission of Gold and Silver Enquiry: ‘There is still sometimes too great a disposition to regard inflation as merely a financial vice, a sort of post war Finance Minister’s drug habit. It is too little recognized that it was in many cases the only practicable method of avoiding social collapse in the conditions prevailing immediately after the War. Inflation is, in my view, the practically inevitable complement of war and post war [domestic] loans after these passed a certain proportion of the national income or taxable capacity of a country.’

   In the longer run, however, inflation reduced the likelihood of long-term foreign inflows (as opposed to short-term speculative movements). It destroyed the price mechanism and made impossible the attainment of economic stability and balanced growth. It endangered the social and political order that had originally produced the inflationary dynamic.

   In order to stabilise, politically and socially, countries needed independent central banks, which would not be submissive to domestic political pressure and would be able to reassure the foreign financial community as to their autonomy. The independent central banker emerged as the lynch-pin of the attempt to build a stable international financial system.

2. In a similar way, private banks’ credit policies had become politicised, and central bankers faced constant and insistent demands for financing from the commercial banking system. As in the case of budget stabilisation, here also stability could only be achieved by restraining domestic credit inflation: this, too, was

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supposed to be the task of the new autonomous central banks. They were to be insulated not only from political pressure, but also from the domestic financial community.

3. What would happen if the central bank doctrine succeeded, and produced new confidence? In Central Europe and Latin America, one of the attractions of the central bank programme was that it would attract significant inflows of foreign resources. Indeed this consideration formed the principal reason why states were prepared to tolerate the severe limitations on their sovereignty imposed under the central bank doctrine. But the resulting capital flows severely constrained central bankers’ abilities to control the course of developments.

The success of central bankers in re-establishing what they termed confidence meant that they faced again, as a result of very large capital movements, those problems of international credit inflation that they had sought to eliminate in domestic politics. The restored gold-standard system first generated enormous streams of capital movements; then made the recipients vulnerable to a deflationary shock. One of the reasons for the eventual failure of the central banking view was its success in promoting confidence in a world in which the destabilising forces — social and national conflicts — remained as potent and as explosive as they had been in the immediate aftermath of the World War.

Péteri demonstrates how the central bank doctrine evolved in the early 1920s. According to Montagu Norman, central banks needed autonomy from the government, and from the financial sector, in order to operate domestically. That autonomy was also the basis for their ability to (co-)operate on an international level. Mouré tells the story of the successful co-operation in the mid-1920s between the Bank of England and the Federal Reserve Bank of New York, and later with Banque de France until the apogee of internationalism in central banking in 1927. He then traces the beginning of the strain that reduced the scope for co-operation in the depression. Clavin tells the story of the fading years of central bank co-operation: that period when the initiative had passed out of the hands of the Normans and Schachts, and into the much more politicised concepts of governments which needed to fulfil both domestic promises of national recovery and international demands for empire. The world after 1931, and especially after 1933, was no longer the place for a theory so anti-political as that of the international co-operation that Norman and Strong had co-operated in launching in the 1920s.

All the essays show how a theory of management evolved that attempted to separate ‘economics’ from ‘politics’, and then to deal non-politically, technocratically, with the narrowly economic element. Stabilisation of budgets and of monetary issue formed the basis of the recommendations of the international central banking community.

The authors leave little doubt about the good motives of the central bankers. But they do not dispute the failures. Good motives alone are not enough. Economic decisions involved choices about the relative welfare of competing social groups; and economics also played a part in the new imperial orientation of some of the
great powers in interwar Europe. Economics, it might be concluded, could not be as simply and neatly separated from politics as Norman and his colleagues had hoped and believed. And politics increasingly came to mean the elevation of national and power interests above economic co-operation.