Central Bank Diplomacy: Montagu Norman and Central Europe's Monetary Reconstruction after World War I[1]

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In the history of interwar international monetary and financial affairs one could hardly find any other single figure than Montagu Norman whose ideas and ambitions proved so influential in the process of Europe's monetary stabilisation.

Norman became the Governor of the Bank of England in 1920 and remained in that position for twenty-four years, an unprecedentedly long period of time in the Bank's history. In 1921 he was exactly fifty years old, and he carried on almost unabatingly intense and comprehensive activity in monetary and financial diplomacy throughout the first post-war decade, as if intending to belie one of his biographers who stressed his propensity for deep depressions.[2] His endeavours are all the more respectable as the long decade from 1920 to 1931 was an era of small victories and great defeats for Britain as an economic great power, justifying melancholy rather than a mental state free from despair and gloom.

One way of assessing the significance of Norman's role in Central Europe's post-war stabilisation and of identifying the motives for his deep engagement in the region's financial and monetary affairs throughout the decade leads through a close

[1] The present paper is a chapter from a longer unpublished work on Hungary's monetary diplomacy in the 1920s. The task undertaken here is to identify and explain the motives and objectives of the Bank of England in its policies in Central Europe around the mid-1920s. Financial support for the research for this paper is gratefully acknowledged from the foundations of the Swedish Handelsbank and the Association of Swedish Savings Banks, and from the Swedish Research Council of the Humanities and Social Sciences. The author's thanks are due also to the Archives of the Bank of England, the Swedish Riksbank, De Nederlandsche Bank, the National Bank of Hungary and the Federal Reserve Bank of New York, and to the Manuscripts Departments of Princeton University and of Yale University Library, for allowing him to consult the sources held in their collections. Two longer-term fellowships in 1989 and 1991/92 at the Swedish Collegium for Advanced Study in the Social Sciences have been of great help in bringing the MS to its final form.

[2] Cf. Andrew Boyle, *Montagu Norman. A Biography* (New York: Weybright and Talley, 1967). Thereafter Boyle, *Montagu Norman*. Sir Henry Clay's important work is to be mentioned here, too: *Lord Norman* (London: Macmillan/New York: St Martin's Press, 1957). Thereafter Clay, *Lord Norman*. Unlike Boyle's, Sir Henry's work leaves Norman's childhood and psyche alone and concentrates instead on his activities as a central banker. Sir Henry's efforts resulted in a book which, together with Lester W. Chandler's work on Norman's opposite number across the Atlantic, Benjamin Strong (*Benjamin Strong, Central Banker*, Washington, DC: The Brookings Institution, 1958), constitute part of the pioneering and, even today, fundamental literature on interwar international monetary relations.

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study of his understanding of the monetary problems of Europe, his ideas concerning the art of central banking, and his views as to the place of London and of the pound sterling in the changing galaxy of international financial and monetary relations after the Great War.[3]

As we shall see in what follows, there was considerably more room for innovation and for the application of novel methods and institutions in Norman's policies than for a vice-like adherence to pre-war practices. The contemporary meaning of the slogan 'return to [pre-war] normalcy' was of much greater complexity than is often suggested in the historiography of the period. If there had been one tradition in relation to which Norman was strongly conservative, indeed, it was London's leadership of the world's financial and monetary affairs. In fact, the cultivation of this tradition was the rationale for the innovations he sought to have accepted and introduced internationally.

As Norman saw it, there had been three major destructive forces or tendencies in the post-war world the taming of which he considered as top priority on his own agenda. Norman was concerned, in general, about *the subordination of economic rationality to goals and aspirations fed by 'irrational' political, national and other non-economic motives*. More concretely, the source of Norman's apprehensions was *the crisis experienced in Europe's financial, monetary and trade relations* attributable, in his view, to: the new state structure in Central and South-eastern Europe deriving from the peace treaties and embodying purely political (power) aspirations and a complete disregard of rational (economic) considerations; the senseless greed of the victorious side of the war manifest in the insatiable reparations demands; the hindrances standing in the way of a settlement of inter-allied debts; and, in general, the nationalism of small and big countries antagonising the nations of Europe and the world rather than promoting their co-operation. Thirdly, but not at all least, Norman was greatly troubled by *the shift in international (and intercontinental) economic and financial power relations to the benefit of New York and at the expense of London* (a concern which was only aggravated by the challenge posed by Paris to London's European leadership in the last third of the 1920s).

[3] In writing this paper I relied primarily on my own research carried out in various archives in Europe and the USA. An independent study of the primary sources seemed to be justified as I wished to raise questions on which the historiography of the field had little to offer. This, however, does not make it less necessary to acknowledge my considerable debt to the vast amount of scholarship that has been invested in the study of the field. I wish to list here only the most important items in the literature: W. A. Brown, *The International Gold Standard Reinterpreted*, 2 vols (New York: National Bureau of Economic Research, 1940); S. V. O. Clarke, *Central Bank Cooperation: 1924–31* (New York: Federal Reserve Bank of New York, 1967); F. C. Costigliola, *The Politics of Financial Stabilization: American Reconstruction Policy in Europe 1924–1930*, PhD thesis (Cornell University, 1973); *idem*, 'Anglo-American Financial Rivalry in the 1920s', *Journal of Economic History*, Vol. 37, no. 4 (1977), 911–34; D. E. Moggridge, *British Monetary Policy, 1924–1931: The Norman Conquest of $4.86* (Cambridge: Cambridge University Press, 1972); R. S. Sayers, *The Bank of England 1891–1944*, 3 vols (London: Cambridge University Press, 1976); David Williams, 'The Evolution of the Sterling System', in C. R. Whitlesey and J. S. G. Wilson, eds. *Essays in Money and Banking in Honour of R. S. Sayers* (Oxford: Clarendon Press, 1968).

I

Anti-Politics: The International of Autonomous Central Banks

When retiring from his post at the Bank (in the spring of 1944), Norman received the following lines from an old friend of his, Russell C. Leffingwell (of the House of Morgan, New York):

> When history comes to be written from a point of vantage somewhat remote from currency controversies, it will I think be judged that your leadership in monetary reconstruction gave the world the best chance it had after the First World War for peace and law and order. ... I think you did a great job and ... it might have had ultimate and durable success if the politicians had done a better job.[4]

It is hard to miss the apologetic overtone in Leffingwell's retrospective evaluation: as if the politicians had been responsible for the collapse of the financial–economic reconstruction effort of the 1920s. This impression is further strengthened by Norman's answer to Leffingwell: 'What makes me despondent is the failure of the politicians to do their part and to give a sense of political security.'[5]

Of course, in hindsight, hardly anyone would question the suggestion that the politicians of the interwar era proved bankrupt. But to put the blame on them even for the defeat of Norman's anti-political utopia is a completely different matter and would, indeed, be highly questionable.

It was not as late as 1944, nor was it Norman alone who reached the conclusion that politics was harmful rather than helpful in treating the (economic) ills of the world. In the eyes of contemporary theorists as well as practitioners of economic life, the experience of the First World War, the peace treaties, the protracted diplomacy of reparations and inter-allied debts, and the widespread use of inflation as a means of financing budgetary deficits were all proofs of the politicians' inability to provide the right answer to the decisive economic and social questions of the age. In this regard, complete agreement prevailed between Paul Warburg and Marcus Wallenberg, Benjamin Strong and Montagu Norman, or John Maynard Keynes and Gustav Cassel. In October 1921, Leffingwell described the state of affairs obtaining in the US like this: 'We are gradually coming to have a fairly enlightened opinion upon financial and economic problems in the business and banking world, but it finds no very strong reflection in public opinion or among the politicians.'[6] It is in this era when the first formulation of Keynes's 'law of economic policy' was made – the law according to which politicians are of necessity the prisoners of obsolete economic theories (in other words, new economic or political theories can only affect public policies after a substantial delay) and which has been made really famous and known throughout the economic profession in the formula it was given

[4] Leffingwell to Norman, copy, 19 April 1944, 1030, Box 6, Folder 133, Leffingwell Papers, Yale University Library, New Haven, Conn.

[5] Norman to Leffingwell, Isle of Man, 6 June 1944 *ibid.*

[6] Leffingwell to Basil Blackett (Controller of Finance, Treasury, London), New York, 6 Oct. 1921, Box 1, Folder 9, *ibid.*

in the *General Theory*.[7] Introducing one of the special issues of the Manchester Guardian devoted to the problems of post-war reconstruction in Europe, Keynes wrote:

Even if economists and technicians knew the secret remedy, they could not apply it until they had persuaded the politicians; and the politicians, who have ears but no eyes, will not attend to the persuasion until it reverberates back to them as an echo from the great public. Instructed opinion is already far in advance of public policy.[8]

It was his doubts as to the politician's capability of rational behaviour that kept Keynes among the protagonists of the restoration of the gold standard in the spring of 1922. Remarkably, the arguments he had for a gold standard were much akin to those Norman put forward in his answer to Churchill's provocative 'Exercise' of early 1925. Keynes wrote as follows:

If gold standards could be reintroduced throughout Europe . . . one of the most vital parts of pre-war organisation would be restored. *And one of the most subtle temptations to improvident national finance would be removed; for if a national currency had been stabilised on a gold basis it would be far harder (because so much more disgraceful) for a Finance Minister so to act as to destroy this gold basis*.[9]

Compelled by Churchill's 'Exercise' to defend the policy of a return to the gold basis Norman wrote: 'The Gold Standard is the best "Governor" that can be devised for a world that is still human, rather than divine.'[10]

At the first private international meeting of economists and bankers after the war, hosted by the president of De Nederlandsche Bank, Gerard Vissering, New York banker Paul Warburg expressed a view held in common by all those present when he stated that *the future of Europe was hostage in the hands of the politicians* of the Reparations Committee. Warburg suggested 'the bankers of Europe ought to come together and judge the present situation like doctors over a case'.[11]

7 'The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest.' J. M. Keynes, *The General Theory of Employment, Interest, and Money* (New York & London: Harcourt Brace Jovanovich, 1964), 383–4.

8 *Idem*, 'An Introduction', *The Manchester Guardian Commercial Supplement: Reconstruction in Europe*, 18 May 1922, Section II, p. 66.

9 *Idem*, 'The Stabilisation of the European Exchanges, A Plan for Genoa', *ibid*., 20 April 1922, Section I, p. 4 (my emphasis).

10 'Commentary by the Governor', 2 Feb. 1925, T 172/1499B, Treasury Files, Public Record Office, London.

11 The minutes of these informal meetings (leading up to the Brussels International Monetary Conference) are held in the Archives of De Nederlandsche Bank (thereafter NBAV) Doss. 94, Doos nr. 39. Among the participants of the 13 Oct. and 2–3 Nov. 1919 meetings were Fred I. Kent (New York), Paul M. Warburg (New York), Raphael Géorges Lévy (Paris), John M. Keynes (London), Gerard Vissering, J. van Vollenhoven, P. J. C. Tetrode, G. H. M. Delprat, Ter Meulen (Amsterdam), Emil Glückstadt (Copenhagen), Rodolphe de Haller (Bern), G. Pictet (Geneva), Patrick Volckmar (Christiania) and Marcus Wallenberg (Stockholm).

The freeing of currency and finance or, more generally, of economy from under the sway of politics that had extended its mandates arbitrarily – this constituted the central motive in Norman's thinking and practical policies already at the beginning of his career as Governor of the Bank of England. Understandably enough, the focus of his attention was central banking, and he regarded it as his foremost international duty to try and purge the domain of currency and credit from all interference from government policy, thus restoring the autonomy of central banks. In Norman's global strategy, this autonomy (which in his view needed protection even against private interests) had a twofold function: first, the independence and autonomy of central banks vis-à-vis all agents of politics was a necessary precondition for their being able to perform their traditional duties of preserving the stability of the national currency and to regulate the domestic credit market; and secondly, the very same autonomy provided as well the basis for international co-operation among central banks from which Norman (and some of his friends) expected the solution of such problems of post-war reconstruction, as the politicians and their organisations had proved less than a match to due to their structurally or institutionally determined incapability.

Norman arrived at an agreement with his most important ally, Benjamin Strong (Governor of the Federal Reserve Bank of New York), on the main criteria of 'sound central banking' as early as February–March 1921.[12] This *credo*, assuming great practical significance quite soon after its establishment, may be epitomised in two important principles: (*1*) the principle of autonomy of central banks over the domain of currency, monetary and credit policies (including the demands that all fiscal operations affecting the currency and money market should be concentrated in the central banks and that these should also be independent of the profit-orientated private sphere); and (*2*) the principle of international co-operation among central banks (including the norm that central banks should mutually concentrate their foreign operations with their respective counterparts).

Norman was especially eager to win for his project the support of the central banks of Europe's neutral countries. He was to establish good relations early on with his Dutch colleague, Gerard Vissering. As a result of the confidential negotiations conducted in Amsterdam in the autumn of 1921, Norman arrived at an agreement with Vissering and with Pierre Jay, Chairman and Federal Reserve Agent at the Federal Reserve Bank of New York, on continued efforts to promote

(1) An understanding as to the general financial policy of Central Banks;
(2) Co-operation on international and economic lines among Central Banks; and
(3) An eventual consortium of Central Banks (under the lead of the Federal Reserve Bank) for the rehabilitation of Austria and Eastern Europe on purely economic lines.[13]

[12] Norman's note, entitled 'Central Banks' and dated 16 Feb., was enclosed to his letter to Strong dated 17 Feb. 1921, 1116.2 (3) Benjamin Strong Papers, Federal Reserve Bank of New York. Strong's additions to the text, amounting (from a European point of view) only to insignificant modifications, were communicated to Norman in a letter of 21 Mar. 1921. For the text of the amended version, see Clay, *Lord Norman*, 282–4.

[13] Norman to Vissering, 12 Oct. 1921, Internationale Besprekingen 2, Doss. 16, NBAV.

This informal agreement, spelling out only the general framework designed to bring together the banks of issues of the world, clearly indicates Norman's desire to make the Americans engage themselves in the solving of Europe's problems. Indeed, one of the most important targets to be achieved by resorting to the policy of co-operation was to overcome the isolationist stance of the US political authorities. The fact that Benjamin Strong appeared to exhibit a far more generous and understanding attitude towards Europe than his federal government was an essential consideration underlying Norman's strategy. For post-war Europe, weighed down by enormous debts to the USA and struggling with a lack of capital, the International of Central Banks conceived as a formation working along 'purely economic principles' could deliver the much needed help only if it proved capable of promoting the movement of surplus funds across the Atlantic and of securing the co-operation of the dollar that was playing an increasingly prominent role in the international monetary system.

The most eloquent definition of the essential features of Norman's anti-politics came from Pierre Quesnay, advisor to the Governor of the Banque de France, who, upon his return from a visit to London in early autumn 1926, gave this account to Émile Moreau:

> The economic and financial organization of the world appears to the Governor of the Bank of England to be the major task of the twentieth century.
>
> In his view politicians and political institutions are in no fit state to direct with the necessary competence and continuity this task of organization which he would like to see undertaken by central banks, independent at once of government and of private finance. Hence his campaign in favour of completely autonomous central banks, dominating their own financial markets and deriving their power from common agreement among themselves.
>
> They would succeed in taking out of the political realm those problems which are essential for the development and prosperity of the nations: financial security, distribution of credit, movement of prices. They would thus prevent internal political struggles from harming the wealth and the economic advancement of nations.[14]

The restoration and cultivation of a central banker's self-consciousness, of the power and authority of central banks, figured high among Norman's objectives, and he tended to understand this task as a function of establishing and internationally spreading an ethos of central banking. The almost complete seclusion from publicity, the distance kept consistently vis-à-vis other organisations and institutions of political and economic life, the general secretiveness exhibited by the Bank of England, all served the efforts to construct and reproduce a code of central bank behaviour. 'I don't see why. *Can't be too dignified,*' was Norman's reaction when he read a letter of the young (British) advisor to the National Bank of Hungary in which the latter informed him that the Bank in Budapest did not regard it as incompatible with the dignity of a central bank to spread their reports well beyond the borders of the fraternity of the banks of issue.[15]

[14] Émile Moreau, *Souvenirs d'un Gouverneur de la Banque de France* (Paris: Librairire de Médicis, 1954), 137. Quoted by Boyle, *Montagu Norman*, 205.

[15] My emphasis. Norman's reaction leading to a note in the margin of Siepmann's letter was evoked by the following section: 'I think it will be well to have a fairly long distribution list and not to

From early 1921 onwards, Norman was working with an impressive resolution on getting a growing number of central banks to accept and subscribe to the fundamental principles of autonomy and international co-operation. The consistent distinction between the political and economic criteria was a recurring and strongly emphasised feature in his correspondence. He never missed an opportunity to stress the vital importance for central banks to place their activities upon purely economic and financial bases. In his zest for educating foreign institutions to adopt what he wished to see as the universal ethos of central banking, he was willing to go quite far in keeping his own Bank's policies in harmony with the principles of this anti-politics. He must have considered proper (exemplary) conduct the best pedagogy, and this had not failed to affect the relationship between the Bank of England and the British governmental authorities. In a letter addressed to the Foreign Office in January 1929, he summarised his standpoint in this respect as follows:

> As to the general question, we [the Bank of England] have made it a practice to avoid calling at our Embassies or Legations when any one of us happens to be in any particular Capital, and this applies to America as well as Europe. We have done so for the reason that our attitude is essentially non-political and is concerned solely with Central Banking, that we have no information to give to Ministers and that we do not expect to receive political information from any one of them in those Capitals where we may have dealings with Central Banks.
>
> Our position in this respect is, of course, different from that of, say, the Bank of France, who, along with their Government, play a definite and united part on political lines in practically all their international transactions, directed in every case towards a national policy.[16]

In 1922, Norman devoted most of his efforts to the establishment of an International of Central Banks. He wished to promote the cause of European reconstruction and, thereafter, the maintenance of a regimen of stable rates of exchange through close co-operation among central banks based on the criteria of economic rationality, motivated by the common interests of the banks of issue and organised within the frameworks of a formal association. The resolutions adopted by the Genoa conference, the proposals for the 'International Gold Standard Convention' implying a universal gold-exchange standard – with London and New York as its gold centres – and the initiative to summon an international meeting of central banks, mirrored Norman's ambitions rather than genuine international consensus.[17] The Convention, it was hoped, would have enabled London to preserve the leading

be too dignified about vouchsafing information to people who are not central banks. I hope you agree that this is good policy.' H. A. Siepmann to the Governor [Norman], Budapest, 18 Sept. 1925, OV 33/39, Bank of England, Central Archives (thereafter *BECA*).

16 Quoted by Clay, *Lord Norman*, 289.

17 As to the currency resolutions of Genoa, R. G. Hawtrey, at the time expert at the Treasury, emphasised in 1925 that 'from the beginning to the end the plan embodied in the resolutions was an English one'. 'The Genoa Currency Resolutions', 4 Feb. 1925, T 172/14499B. F. H. Nixon, director of the Economic and Financial Section of the League of Nations, was also of the opinion that 'the whole of the financial work was in the hands of the British delegation'. 'Financial Commission of Genoa. Memorandum by Mr. F. H. Nixon, May 1922', Marcus Wallenberg Papers, Skandinaviska Enskilda Bankens arkiv, Stockholm. Sen. Wallenberg, a Stockholm banker, was a member of the League's Financial Committee.

international position of the pound sterling first, by obliging New York (the other gold centre) to co-ordinate its policies with London, and secondly, by obliging the other participating central banks to deposit and concentrate their monetary gold reserves with London and New York, thus minimising the shares in their reserves of effective gold held in their own vaults. It would have been the task of the central bank conference, to be summoned by the Bank of England, to give a final shape to the convention and to decide the mode of institutionalising co-operation between central banks. Norman embarked on feverish diplomatic activities, targeting first of all New York and the central banks of the European neutral nations (especially De Nederlansche Bank and Sweden's Riksbank).

The conference never came off. It was torpedoed by the opposition of New York where, just as in Tokyo or in Stockholm, the idea of institutionalised co-operation started and regulated by binding international agreements was regarded as completely unacceptable. However, the draft resolutions formulated in London in preparation for the conference should still be considered as an important document pertaining to Norman's international objectives. It gave a concise definition of the code of conduct of central banks, which was indeed regarded as the norm of practical action, at least in the case of the Bank of England under the leadership of Norman:

1. Autonomy and freedom from political control are desirable for all Central and Reserve Banks.
2. Subject to conformity with the above clause a policy of continuous co-operation is desirable among Central Banks and Reserve Banks, wherever situated.
3. Without hampering their freedom, co-operation should include confidential interchange of information and opinions among such Banks with regard to such matters as rates of discount, the stability of exchanges and the movement of gold.
4. Each such Bank should recognise the importance of international as well as national interests in the re-establishment of the world's economic and trade stability.
5. Each such Bank should endeavour to conduct its foreign banking operations exclusively with the respective Central or Reserve Banks of other countries.
6. Each such Bank should endeavour to extend adequate and proper banking facilities, without undue regard to profit, to other Central and Reserve Banks: such facilities to include the custody of gold, monies and securities and the discounting of approved bills of exchange.
7. Each such Bank should take steps as may be possible to ensure at all times the absolute right of withdrawal of all gold, monies and securities on behalf of other Central and Reserve Banks.
8. Each such Bank should endeavour to assist in the establishment of a free market in forward exchange in its own country when no adequately organised market exists.[18]

In the German and Austrian stabilisations, just as in Hungary's *Sanierung*, Norman and his Bank played a significant role both in securing the necessary international political and financial conditions and in designing the programmes of stabilisation.

In the autumn and early winter of 1921, when Stinnes, Rathenau and Reichsbank President Havenstein, one after the other paid their visits to London's leading

[18] 'Agenda. Resolutions proposed for adoption by the Central and Reserve Banks represented at Meetings to be held at the Bank of England, Part I. Resolutions concerning Co-operation', Draft, 13 June 1922, Riksbankens Arkiv, Stockholm (hereafter RBA). Also in Doss. 2, II, NBAV.

political and financial figures, Norman took an active part in the efforts to solve the German stabilisation problem. He consistently refused to talk to anyone other than Havenstein. And he saw to it, already at this early stage, that Havenstein should not be mistaken as to London's demands concerning the type of relationship that should prevail between the Reichsbank and the German Government:

One of the results I wish to see emerge as an outcome of the negotiations now in progress is a strengthening of your (Reichsbank's) position vis-à-vis your own Government. In my opinion a Central Bank which is so much dominated by its own Government as to have no independence or initiation and even no right of protest is not in a fair position and therefore cannot play its part either within its own country or, still more, alongside other Central Banks. That is for instance the present position of the Bank of France, and we all lose by it. In varying ways the position of the Netherlands Bank and of the Bank of England and even of the Federal Reserve Bank is different and more independent, and, now that we have more or less emerged from the domination of our respective Governments which during the War was unavoidable, all Europe will gain from it.[19]

Early in 1924, when Norman was organising the first co-operative central bank credit to fund the advance necessitated by the establishment of the German Gold Discount Bank, Victor Moll, chief of the Swedish Riksbank, tried to stay out of the co-operating group of central banks. It was not only Moll whom Norman found hard to interest in his project. But the absence of the Riksbank from the group would have meant the loss of a *neutral* participant of great *political* significance. Norman's irritation was only enhanced by Moll's rather clumsy explanation for his unwillingness: 'The liberty of acting of the Riksbank', Moll wrote to Norman, 'is strictly limited, by the Bank Law, to the real problems of a Central Bank. It is therefor[e] highly doubtful if, at all, the Riksbank will be able to participate.'[20] No wonder Norman's answer to Moll's apology was to become one of the pearls of his numerous educating letters addressed to various colleagues revealing and stressing the anti-politics of the policy of central bank co-operation:

'I can conceive no more 'real problem' than the purpose of my enclosure [referring to an agreement between Norman and Hjalmar Schacht as to the subscription of the stock of the new bank]. The problem of Central Europe is as vital to Sweden as to any other country: the danger of a collapse in Central Europe is still present and there is no one of us in Europe who would not wish to prevent such a disaster. <u>The politicians do not appear to be able to settle this problem at the present time and I submit that it is, therefore, the duty of Central Banks to join now together and maintain as far as possible the economic position of Central Europe until such time as agreement and reconstruction is possible.</u>[21]

II

Norman and the League of Nations

'Bringing order into the Austrian House' was the first major project undertaken by the Finance Committee of the League of Nations in their efforts to promote the

[19] Norman to Havenstein, 5 Dec. 1921, copy, 1116.2 (3), Strong Papers.
[20] Moll to Norman, 6 Feb. 1924, copy, RBA.
[21] Norman to Moll, 29 Mar. 1924, RBA. My emphasis.

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stabilisation of Central Europe. The first plans for an Austrian stabilisation programme were inspired by ideas originating from Paris and met with Norman's profound disapproval. 'Even a sound economic plan for Austria if financed and controlled by the Entente would inevitably be more political in the long run than economic,' he objected and urged the Finance Committee to try to mobilise support from the neutral countries.[22] He had no doubt that the aim of subjecting Austrian finance to Entente control was to place 'the ultimate power ... in Paris'.[23] Also he knew such a mechanism of control would achieve nothing but political exploitation of a monetary and financial crisis.[24] In spite of this, Norman was willing to consider seriously the use of the League in promoting the cause of European stabilisation.[25]

Indeed, there seemed to exist a genuinely mutual interest in establishing close co-operation between Threadneedle Street and Geneva. In the case of Austrian reconstruction, already during the first informal discussion of the plan, Arthur Salter[26] and his colleagues were firmly of the opinion that the cause of Austria was quite hopeless without Norman's collaboration and support.[27] A tranche issued in London was the *sine qua non* for the successful execution of any stabilisation project dependent on the flotation of a substantial international long-term loan. Acceptance by (that is, a successful issue in) the City of London was a vital letter of recommendation needed to open up other international markets for the loan. And under the arrangements prevailing in most of the 1920s, the bankers in the City did not even consider an application unless the plan had been submitted to and received the consent of the Bank of England. The legitimacy of Norman's informal but none the less effective control derived from the common interest of the City: the defence of the international position of the pound sterling and the ambition to return to the \$4.86 parity rate.[28]

22 Norman to Strong, 9 June 1921, copy, BECA.

23 *Ibid.*, 14 Nov. 1921, copy, BECA.

24 The inability of French politicians to consider the issue of financial–economic reconstruction separate from the interests of French security was regarded by Norman as the heaviest burden on post-war Europe. On their first personal meeting, Norman told Émile Moreau, the Governor of the Banque de France: 'I want very much to help the Bank of France. But I detest your Government and your Treasury. For them I shall do nothing.' Moreau, *Souvenirs*, 49, quoted by Boyle, *Montagu Norman*, 198.

25 'If and when the time comes, the League of Nations Scheme will have to be dressed up in somewhat different garments to make it non-political and so palatable to Vissering, to yourself and to this Country,' he wrote in the letter to Strong of 14 Nov. 1921. And indeed, later on he would undertake to play a major role in bringing the Austrian action of the League to success, as a later version of the programme satisfied him as to the non-political character of the whole project. His good contacts with the New York House of Morgan were crucial in placing the American tranche of the loan. After the successful flotation of the Austrian Loan, Sir Arthur Salter (later Lord Salter), Director of the Economic and Financial Section of the League, wrote: 'Norman's assistance (though his reaction is to my taste a little too dramatic at times when difficulties arise) was invaluable.' Salter to Sir Basil Blackett, Geneva, 6 July 1923, copy, S. 115, A. Salter Papers, League of Nations Archives, United Nations Library.

26 Salter, General Secretary of the Reparations Commission in 1920–2, was twice Director of the Economic and Financial Section of the League of Nations' Finance Committee – from 1919 to 1920 and 1922 to 1931.

27 Lord Salter, *Memoirs of a Public Servant* (London: Faber & Faber, 1961), 177–8.

28 Concerning the regulation of capital exports from Britain and the control exercised by the Bank of England see John M. Atkin, 'Official Regulation of British Overseas Investment, 1914–1931',

Norman for his part was interested mainly in the advantage offered by the organisational frameworks of the League. In identifying these advantages we may safely rely on a description from the Director of the Economic and Financial Section from August 1922. In January 1922, the Government of Czechoslovakia initiated negotiations for a contract on an international loan to be issued in London, Amsterdam and New York. The Baring Brothers of London had no objection to the security offered (the income from customs duties), but, in view of the political instability prevailing in Eastern and Central Europe, they demanded that their representatives be allowed to operate from Prague to control the administration of the incomes mortgaged in order to secure the interests of the creditors. The Prague Government found this proposal humiliating. Eventually

A way out was found by the Czech Delegate proposing that the League of Nations should be charged with arbitration in case of any difference between the Czech Government and the lenders about security, and that the League should be requested in case of such difficulty to take such action as might be necessary to secure the interest of the bond holders.

This has been accepted by the bankers on the one hand and by the Council of the League of Nations on the other, and it opens a way by which arrangements can be made for the reconstruction of central and eastern Europe without compelling these new or impoverished countries to submit to a control by foreign governments or foreign financial groups. Evidently the reason why this kind of arrangement is satisfactory to the Czech Government is that Czechoslovakia is a member of the League of Nations and she is not, therefore, sacrificing her independence or diminishing her sovereignty in accepting arbitration by an association of which she is a member.[29]

This solution gave the Czechs access to the much desired money and provided the safety net deemed necessary by the creditors and bankers. The new function entrusted to the League of Nations bureaucracy (the Finance Committee and the apparatus of the Economic and Financial Section) provided it with additional prestige and power and provided the cause of Europe's economic and financial stabilisation with a most effective method of eliminating one of the major political–legal impediments to reconstruction:

That difficulty is this: that the reconstruction of Europe turns entirely upon the reconstruction of the Finance of the different Governments (because so long as their finances are not sound you get inflation and the steady depreciation of the exchanges) but the Governments in question are not willing to submit to a foreign control. On the other hand, the bankers in England or America, who might consider making loans to these new or impoverished countries, are not going to take the risks involved without having some kind of control on the spot.

Economic History Review, Vol. 23, no. 2 (1970), 326–30; *idem*, *British Overseas Investment, 1918–1931* (New York: Arno Press, 1977); see also Moggridge, *Policy* 206–11.

[29] 'Czecho-Slovak Loan. Memo by Mr. Nixon [Aug. 1922], enclosure in the letter of Frank H. Nixon (Director of the Economic and Financial Section 1920–2) dated 5 Aug. 1922. The addressee cannot be identified precisely, but the copy reveals that his title was 'Governor', his nationality American, and that he must have been the leader of some association lobbying for the League of Nations idea in the US. 'We in Europe who are strong supporters of the League', Nixon concluded his letter, 'count with great confidence upon your vigorous and well-informed activity on behalf of the League in the United States.' Letter and enclosures in S. 123, No. 5, Salter Papers.

It was this loan–diplomacy know-how that was relied on and further developed by the Economic and Financial Section when taking care of Austrian stabilisation. In the latter case, the role of the Finance Committee was extended to cover important new elements in the early period between the spring of 1921 and August 1922. At the request of the Supreme Council of the Allied Powers, a Finance Committee delegation went to Vienna in early 1921. Having thoroughly *studied the economic and financial position of Austria*, the delegation outlined a comprehensive financial *reform programme*. (This included: currency stabilisation by way of a strong independent bank of issue; fiscal equilibrium; a foreign loan; and the appointment, made jointly by the Austrian Government and the Finance Committee, of a committee to control the administration of incomes mortgaged for the service of the loan. The Finance Committee also played a considerable part in persuading relevant governments to consent to the release, for a period of twenty years, of certain incomes of the Austrian state from under the reparation liens – a necessary precondition of any serious loan negotiations.[30]

The framework provided by the League and the goods it could deliver – such as the international control and the stabilisation programmes designed by independent experts – proved to be useful not only in gaining the goodwill and confidence of foreign investors but also in making feasible, in terms of domestic politics, the application of such unpopular, restrictive measures as were deemed inevitable from the point of view of *Sanierung*. The Vienna delegation of the Finance Committee, for example, extracted a formal written undertaking from all the Austrian political parties to support the execution of the programme designed by the delegation. All these functions could, in Norman's eyes, most usefully complement what the secret diplomacy of central banks was to achieve. Norman regarded the League machinery as a means to be combined with the 'consortium' of central banks working towards the objectives of the latter.[31]

An additional fact, which made the League machinery perhaps even more appealing to Norman, was that quite a few of the key figures comprising the active membership of the Finance Committee and the apparatus of the Section were themselves Britons. To give only the most important examples we may name in this connection Arthur Salter, Henry Strakosch,[32] Otto Niemeyer,[33] Frank

[30] A concise presentation was produced by one of the section's senior members, the Dutch J. van Walré de Bordes, concerning the League's activities, up till Aug. 1922, in connection with the Austrian stabilisation: 'The Work of the League for the Financial Reconstruction of Austria', 3 Aug. 1922, attached as one of the enclosures in Nixon's letter of 5 Aug.

[31] 'In due course, when sufficient progress has been make, the question should come up of dealing with Austria on the lines of the League of Nations Scheme (with which object our proposed consortium of Central Banks may be suitable.' Norman to Vissering, 16 Nov. 1921, Doss. 16, Internationale Besprekingen 1, NBAV.

[32] Sir Henry Strakosch, London banker with interests in South African gold mining, member of the Finance Committee of the League of Nations 1920–37.

[33] Sir Otto Ernst Niemeyer, senior civil servant in the Treasury (1906–27), Controller of Finance (1922–7), member of the Finance Committee of the League of Nations (1922–37) and managing director of the Bank of England (1927–52).

H. Nixon and Alexander Loveday.[34] Although not all of them were members of Norman's club, the Athenaeum, they did speak an idiom very close to Norman's own. Their understanding of the ills tormenting post-war Europe was much akin to Norman's while Norman himself was disposed to define tasks for his Bank which might have been more appropriate to a programmatic declaration of the League. He wrote to Havenstein, explaining his support for the League of Nations' stabilisation programme for the City of Danzig:

> The sole object of the Bank of England is, and must always be, the re-establishment of peace and stability in Europe, and they feel that they can help most usefully in the attainment of this end by developing co-operation between themselves and the central banks of the various countries concerned. With that aim in view I shall think it right therefore to assist the League in their endeavours by expressing my readiness to grant credit to the new Bank if satisfactorily established.[35]

As time went by, the significance of the League in Norman's stabilisation strategy only increased. A possible explanation is that the first successful actions which involved the League set a pattern that came to be regarded not merely as one of many possible ways but as the only way to proceed. The other, and more important, explanation is, however, to be found in Norman's failure in grounding the co-operation among central banks on a *formal* association. His considerable efforts spent in trying to bring together the meeting of central banks initiated by the Genoa conference were wasted. Benjamin Strong exhibited just as little inclination to be a party to a formal international association based on the acceptance of binding rules and norms as the central bankers of neutral Europe (not to speak of Paris, where hardly anyone cared to refute Norman's opinion that the Banque de France had been the worst sinner in pursuing central banking informed by political–nationalistic considerations). The practice of co-operation thus became confined to *ad hoc*, individually organised, actions securing short-term credits for stabilising central banks.

By 1923 the ties between Norman and the Finance Committee of the League had become organic components of the European stabilisation process. Whenever an opportunity arose, the Bank did everything in its power to get the countries of Central and Eastern Europe to choose the League's path to monetary stabilisation and fiscal *Sanierung*. The League, on the other hand, integrated Norman's objectives into its stabilisation programmes by providing for the establishment of autonomous banks of issue which were ready to adopt the policy of international co-operation or, as in the case of Hungarian stabilisation, by supporting the adoption of a sterling standard.

[34] Alexander Loveday, economist and statistician, worked for the League of Nations between 1919 and 1946.

[35] Norman to Havenstein, copy, 3 Oct. 1923, OV 34/72, BECA.

III

'All for the good of Sterling!' *London, Central Europe and New York*

In a private letter of early 1926, Norman wrote:

> In Berlin, you must realize, what is not German is (excepting the diplomatics) American. The only powerful agency there is the Dawes machine which dominates German life; and the Dawes machine, while nominally and in form international, is in practice dominated by Americans. This suits me well as all these Americans have long been friends but its effects may be far-reaching .... England is part of Europe: Europe quarrelled: Europe has thus reached poverty and so far has kept dis-union alive within her: American is detached and has thus become rich: so Europe is the 'promised land' to America: to be possessed without even competition![36]

Probably no previous political administration in London had been so intensely bound up with European affairs as the one that had to face the consequences of the political and economic crisis on the Continent after the war and the peace treaties. True enough, the war had strengthened London's colonial position and it had neutralised (it was believed) for a long time to come Britain's most dangerous European rival, Germany. But after the war Britain was much more interested in Europe than it had been before. (This new interest constituted much of the basis for the collisions with the great power ambitions and policies of European security issuing from Paris.) One of the motives for this increased interest in Europe was Britain's weakening economic performance. The foremost concern of the City and the Bank of England was, of course, to restore and consolidate the global financial leadership of the London Market and the pound sterling.

London's pre-war financial primacy as well as the challenge it was exposed to after the war can (partly) be explained, and is certainly well illustrated, by Britain's share in long-term international investments. Some of the findings of the critical revision carried out by D. C. M. Platt[37] may be applicable even to the statistics of the interwar period: it would hardly be surprising if even in that period much of Britain's capital exports had consisted in 're-exports', that is, funds invested abroad which were actually foreign savings channelled *through* the British banking system. From an exchange point of view, however, the original source of the funds invested did not matter much. The impact of the confidence of foreign depositors in the London banks, as well as of the vast incomes accruing from the foreign investments, were equally beneficial for the international position of the pound sterling.

The pound sterling as an international currency was also benefitting from Britain's impressive share in world trade: the United Kingdom answered for more than 13 per cent of world exports and for more than 15 per cent of world imports in 1913. Given Britain's advantages – the share in the world trade, the position as the largest shipping and colonial power in the world, the general dependence on the

36 Quoted by Boyle, *Montagu Norman*, 197.

37 D. C. M. Platt, *Foreign Finance in Continental Europe and the United States, 1815–1870* (London: Allen & Unwin, 1984).

Table 1 *International investments (US $000,000s)*

	1914		1928	
	Amount	%	Amount	%
United Kingdom	18,300	41.6	18,100	36.3
France	8,700	19.8	3,500	7.0
Germany	5,600	12.7	1,100	2.2
United States	3,500	8.0	17,200	34.5
Other countries	7,900	17.9	10,000	20.0
Total	44,000	100.0	49,900	100.0

Source: W. S. and E. S. Woytinsky, *World Commerce and Governments. Trends and Outlook* (New York: The Twentieth Century Fund, 1955).

international economy and the highly developed, internationally orientated, economic (banking) institutional infrastructure – it would have been a miracle if London had not emerged as the world's leading exchange for commodities and financial transactions. London had come to administer not only Britain's foreign trade and payments but also a great deal of the trade and payments between other countries worldwide. London had worked as the world's clearing centre and the Bill on London had become a widely used means of international payment. As a consequence, the British banking system earned annual interests, dividends, fees and commissions amounting in sum to more than twice the value of the country's annual excess of imports over exports. Another, no less important, consequence had been the outstanding role assumed by the pound sterling among the world's reserve currencies. In 1913, 16 per cent of the official (monetary and fiscal) reserves of the world were held in bills of exchange or in other liquid international assets (*devisen*), while the rest (84 per cent) was held in precious metals, overwhelmingly gold. In Europe, the role of gold as an international reserve was less pronounced than elsewhere. Table 2 shows the composition of the world's *devisen* reserves in terms of the major currencies. There can be no doubt as to London's global leadership before the war. But it is also worth noticing that, in 1913, the non-metallic reserves of Europe were still held in Paris or Berlin value rather than in pounds sterling.

Unfortunately, we lack comparable data for the post-war years. Our guess is that, during the war, it was mainly the currencies of the European neutral countries (Switzerland, Holland and Sweden) which came to increase their shares in the composition of Europe's reserves. After the war the pound sterling (re-)established itself in Europe but, as the end of the 1920s approached, it was increasingly forced to share the cake with the US dollar. Such tendencies seem to be suggested by the fragmentary data pertaining to the liabilities of the Hungarian Devisenzentrale, to the composition of the *devisen* and currency reserves of the Hungarian Treasury, to the composition of the Hungarian National Bank's reserves and outgoing payments, and to the currency and creditor composition of the short-term foreign

Table 2 *The composition of the world's official (fiscal and monetary) foreign exchange reserves, 1913*

	(%) Worldwide	European	Extra-European
	Foreign Exchange Holdings		
Sterling	38.2	11.7	76.0
French franc	24.5	39.4	3.1
German mark	13.3	17.5	7.3
Other	5.6	6.6	4.2
Not specified	18.4	24.8	9.4
Total	100.0	100.0	100.0

Source: On the basis of Peter Lindert's data, 'Key Currencies and Gold 1900–1913', *Princeton Studies in International Finance*, No. 24 (August 1969), 18–19.

debts of Hungarian banks during the 1920s.[38] As the necessary precondition for becoming a reserve currency was stability, we can be quite sure, however, that the true favourite to advance into the vacuum left by the French franc and the German mark was the US dollar, the only currency with a stable relation to, and free convertibility into, gold.

The changes undermining the global leadership of the pound sterling had started already in the pre-1914 world. By 1913, in terms of both volume and per capita GNP, the US possessed the world's most powerful economy. For a long time, the advance of the US to the position of leading economic power had been taking place without the simultaneous development of any remarkable dependency on the foreign markets. In 1913, the US export:GNP ratio was only 1.1 per cent, while the same ratio in the case of Britain reflected a considerable vulnerability (15 per cent). Yet London had shown no signs of worry over US expansion before the war. The world market as a whole experienced rapid growth during the three decades preceding the war, and therefore it had been able to absorb increased American exports without forcing Britain to make any radical adjustments in order to preserve, or even to increase, her share. Wartime and postwar developments, however, proved much more problematic from London's point of view. While a great deal of economic capacity was occupied by Europe's 'quarrel', Britain lost some of its most important markets (especially in Latin America) to the US. At the same time, the US trade surplus with Europe (and with Britain) grew many times over. Europe financed the increasing excess of imports partly by growing indebtedness to the US and partly by letting the US take over a substantial part of its foreign investment. The state debt of the United Kingdom to the USA was as high as £900 millions in 1923, about six times Britain's annual surplus in current

[38] Cf. György Péteri, 'Reserve and Vehicle Currencies in the Financial Structures of Hungary, 1924–1931', *The Journal of European Economic History* (1992), forthcoming.

international payments in that period. Payment by commodity exports was impeded by the high level of British costs and by protectionist US customs policies.

The inaccessibility of the American market and the large deficits in Europe's foreign trade sustained very high European rates on New York, leading to a rapid and massive accumulation of monetary gold in North America. By the beginning of the 1920s, almost 40 per cent of the world's monetary gold reserves had found its way into the vaults of the North American banking system.[39] By the end of the 1914–18 war, the US dollar was the world's only currency enjoying free convertibility to, and a relatively stable value in, gold. The pound sterling, on the other hand, emerged from the war as a paper currency with a strongly fluctuating dollar rate well below the pre-war (parity) level.

On the basis of the above it seems reasonable to assume that the problem of European reconstruction presented itself to Norman in two distinct aspects or at two different levels.

1. First of all, it presented itself as *the general question of the revitalisation of European economy and trade*. Europe's crisis meant a market contraction for British industry, the general depression of world trade and, consequently, the loss of a considerable part of the invisible incomes generated in British banking, shipping and insurance business. All this, per se, had a disastrous effect upon the position of sterling which was only aggravated by the chaotic state of affairs prevailing in the European currency system due to the inflationary process and the reparation transfers.

Norman, in common with some other leaders of Britain's foreign economic policy, identified the root of the problem in Europe's and especially Central Europe's politically fuelled divisions. The task was, as they saw it, to restore economic unity, and they understood that they could not satisfy themselves with less than the revitalisation of the whole European economy:

> These months past have seen the Centre of Europe worsen right along [Norman complained in the autumn of 1923] & although the outsides have somewhat seemed to increase their equilibrium, Europe as a whole has gone backward: this I think is in general a true picture. Trade has not improved because it can only really improve as a whole (& world trade is poor just as Europe's trade is): added to which Nationalism – sometimes called Patriotism – has been active. Look at the spirit of Italy against Greece; at the hatred of her neighbours toward Hungary; of France against Germany & so on to Bulgaria & Turkey.[40]

The revitalisation of the European economy was a precondition of Britain's economic health, but it presupposed the restoration of the intra-continental division of labour, the reactivation of foreign trade relations among the European nations and, especially, the re-integration of an economically re-unified Central and Eastern Europe into the international economy. The short-lived (British) project of an 'International Corporation for Trade in Eastern Europe and Russia' was to serve the

[39] Société des Nations, *Memorandum sur les Monnaies et les Banques Centrales 1913–1925*, Vol. I (Geneva, 1926), 65.

[40] Norman to Strong, 8 Oct. 1923, copy, BECA.

latter objective; and so was the unusual step the Bank of England took of acquiring proprietary control over the Anglo-Austrian Bank of Austria.

The background of this takeover was as follows. When war broke out the Anglo-Austrian Bank's liabilities vis-à-vis London institutions were concentrated at the Bank of England. After the war, the only method of settling the bank's debts in London appeared to be the capitalisation of those debts, whereby the bank's control necessarily landed in Threadneedle Street. That is to say, it was to a great extent rather an ownership imposed on the Bank of England by circumstances than an acquisition of the Old Lady's own choosing. Therefore, it seems inappropriate to describe these developments as the 'Expansion of the Bank of England into Central Europe'.[41] Also, as we have already shown, Norman's own strong views as to the proper role and mandates of a central bank would hardly have allowed him to take such an action strictly reserved, in his opinion, for the profit-orientated private sphere. The very first commandment of his 'code of conduct' from 1921 was to the effect that 'A Central Bank should not compete with other Banks for general business'.[42] Instead of 'expanding into Central Europe', Norman regarded the funding of the Anglo-Austrian Bank's debts in the aforesaid manner as an opportunity to promote the re-integration of Austria into the European economy: 'It ought to be a help towards the opening up of Austria.'[43] When the plan for the funding was considered by the highest policy-making body of the Bank, the Committee of Treasury, 'the Committee agreed that the Bank should give financial support to the new bank *in order to assist business in Eastern Europe* and to support the agreed investment arising out of cold storage bills'.[44]

In the period under scrutiny, Norman's major ambition was 'containment' rather than 'expansion'. Indeed, he was preoccupied by the apprehension that the policies of the Entente (i.e. the policies of France) might thrust Central Europe into economic and political chaos, thus reducing to nil the resistance of the Old World to the revolutionary challenge from the East: 'I don't believe it would take a great deal of financial or political stupidity at the present moment to bring chaos into Austria similar to what we see in Russia; to break up Germany, and beginning in Portugal to spread revolution right through the Peninsula.'[45] Such concerns motivated London's (and the Bank's) active engagement in the process of Central Europe's financial and economic reconstruction aimed at a general revitalisation of the European economy. Indeed, Norman's ambition was not simply to emancipate

41 Cf. A. Teichova, 'Versailles and the Expansion of the Bank of England into Central Europe', in Horn & Kocka, eds. *Recht und Entwicklung der Grossunternehmen im 19. und 20. Jahrhundert* (Göttingen, 1979).

42 Norman's note entitled 'Central Banks', dated 16 Feb. 1922, enclosed in Norman to Strong, 17 Feb. 1921, 1116.2 (3), Strong Papers.

43 Norman to Strong, 7 Nov. 1921, copy, BECA.

44 Committee of Treasury Minutes, Book 47, 19 Oct. 1921, BECA (my emphasis).

45 Norman to Strong, 1 Dec. 1921, copy, BECA. Norman found it rather unfortunate that the Entente survived the war, as it served, in his view, exclusively French interests: 'I think we should have done more good had we formally divorced ourselves a year or more ago; for nothing has been done of late by the allies to which we either did not object or only unwillingly agreed.' *Ibid.*, 8 Oct. 1923, copy, BECA.

economic life from political domination. He also wanted to achieve political ends (social and international peace) by economic means. In Central Europe his undertaking was to overcome the political divisions resulting from the peace treaties and to replace them with a new union based on economic stability and close co-operation between the countries concerned. A month before the flotation of Austria's long-term League of Nations loan, Norman wrote regarding his expectations:

If we can thus set up Austria, we must tackle Hungary next, so as to establish one by one the new parts of Old Austria & then perhaps the Balkan Countries. Only by thus making the various parts economically sound & independent shall we reach what I believe to be the ultimate solution for Eastern Europe viz an Economic Federation to include half a dozen countries on or near the Danube free of customs barriers & c.[46]

2. The monetary and financial aspects of Central Europe's reconstruction, however, had even *a direct relevance for the international position of London and sterling.* If the reconstruction and the expected upswing in the economy of Europe were indeed to be reflected in the active items of Britain's balance of payments, in the improvement of British industry and trade and in increased business activity in the City, then London had to see to it that stabilization should not proceed by way of a further marginalised pound going hand-in-hand with the increased presence of the dollar in Europe's monetary and financial structures. Of the latter as a possible outcome both the British Government (the Treasury) and the Bank were quite aware, and it was the desire to avoid this scenario which directed much of their practical actions.

Treasury expert Robert Hawtrey, for example, when analysing the monetary problems of Europe in early 1920, came to the conclusion that it would be best to stabilise the strongly inflated currencies in relation to some stable currency, at the actually obtaining rate, thus postponing the return to a gold standard to a later time (a suggestion that came to be reflected in the recommendations of the Brussels Monetary Conference). But Hawtrey also added that the establishment in Europe of such exchange standards might easily frustrate London's aspirations:

To take advantage of the Exchange Standard there must be a trustworthy foreign currency to base it on. The natural currency to choose is the U.S. dollar, which is at its gold par. But it is to our interest to induce European countries to choose sterling. We do not want to smooth the way for New York to become the financial centre of the World.[47]

Hawtrey was well aware that the future of sterling was to a great extent a matter of relative tempos, that it depended on whether or not London would succeed in restoring and stabilising sterling's pre-war gold-parity rate (US $4.86) and in freeing

[46] *Ibid.*, 9 Apr. 1923, copy, BECA. Similar views were held by Otto Niemeyer. And he was quite plain as to Britain's political interests. In his letter to the Foreign Office, explaining why it would be most advantageous for Britain to direct the issue of Hungary's stabilisation to the League's Finance Committee, he wrote: 'If we could tie up another loose end in this way we should, I believe, extend and increase our consolidation in South-East-Europe.' Niemeyer to M. W. Lampson (Foreign Office), 16 Mar. 1923, copy, OV 33/70, BECA.

[47] Hawtrey, 'The Memorial for an International Conference on the Financial Situation', 26 Jan. 1920, T 172/1157.

the London gold market *prior to* the stabilisation of the Continent. If London lagged behind the Continent in the process of stabilisation, it was feared the probability would increase of Continental Europe's opting for a gold or dollar (as opposed to sterling) standard, leading to a massive transfer of deposits and monetary reserves (motivated by the high risks pertinent to rate fluctuations) from London to New York. Such transfers would then defer sterling's recovery indefinitely and might even make permanent the loss of primacy among the major reserve currencies of the world. 'If sterling could could be at its gold par by the time the European currencies are settled,' Hawtrey wrote in his note quoted above, 'this [i.e. the choice of sterling as opposed to the dollar as the standard] would be almost a matter of course. A paper pound, subject to unforeseeable vagaries, may not prove acceptable ...'.

All this was just as obvious to Montagu Norman as to Hawtrey. But Norman also saw the complication arising out of the fact that European reconstruction was not possible without substantial American support, considering the measure of indebtedness, economic exhaustion and lack of capital. Thus, the answer to the challenge posed by the dollar could not be allowed to endanger the mobilisation of the dollar in the pursuance of European objectives. This explains why Norman, for a relatively long time after the war, appeared to be ignorant of, or at least indifferent to, the competitive aspects of reconstruction (except, of course, for the 'politically' inspired reparations and reconstruction policies of Paris, to which he was a consistent and fierce opponent). Until about 1923 he must have been hoping that he would be able to secure a leading role for sterling in Europe's monetary system without Europe (and England) having to forego the resources of America. But as to the willingness of New York and Washington to co-operate, he was disappointed on several occasions. A simultaneous and comprehensive settlement of the issues of reparations and inter-allied debts was consistently regarded by US political leaders as completely out of the question. The plans for Eastern and Central European economic revitalisation *by government help* contained very little to recommend them in the eyes of US leaders. Nor could Norman find a satisfactory amount of interest on the part of American bankers and investors towards Europe. In June 1923, for example, the New York flotation of a tranche of the Austrian long-term loan was only possible because of Norman's personal friendship with J. P. Morgan. But, too, the convalescence of the pound sterling and of the British economy took much longer than Norman had hoped. After some promising developments in the first half of 1923, neither the desired increase in the American price level nor the ease that was expected in the New York money market came about. As the year drew to a close and 1924 began, the New York rate of the pound sterling fell back to the very same level from where it had taken off a year before.

It was probably a combination of these experiences that made Norman – although he still counted on Strong's willingness to co-operate[48] – less shy than he

[48] 'When you [are] back into harness just you look around & see if you cant join hands with us (Bank I mean) in some of our ventures!! What about Germany? or Greece? or Hungary? all *central-bank* business pure & simple which is already started: or Albania & Danzig which are to follow? I am sure *you* would like to take a hand but I fear you cant. America as a country is less and less disposed to take a hand

had been before in pursuing the interests of sterling from late 1923 onwards. On certain occasions he would even risk collision with New York.

In 1924–5, until the restoration of the free gold market and the stabilisation of sterling at the pre-war gold parity, Norman had as a rule tried to make the support given by London to the stabilisation of Central European currencies conditional upon the adoption of sterling as the basis or standard of stabilisation. The first occurrence of this policy is to be found in a Bank document of December 1923. Memorandum 'C' stipulated that the sterling standard be introduced in connection with the establishment of the German Gold Discount Bank.[49] As the programme of stabilisation included a co-operative central bank credit to the Reichsbank, several of Norman's foreign colleagues received a copy of the memorandum. In the letter accompanying the memorandum, Norman wrote to the governor of the South African Reserve Bank, W. H. Clegg:

> In our mind we accept this scheme in principle. In attempts to recover the liquid assets which have gone overseas from Germany; to provide a more or less stable Note (based on Sterling) which may be safely held by Germans; to provide a private concern separate from the Government and out of reach of the Reparation Commission part of whose assets may be used for working capital for trade. <u>All for the good of Sterling!</u>[50]

But hardly had the copies of Scheme 'C' been posted from Threadneedle Street when Norman received another stabilisation plan, this, too, designed for the Germans, by Gerard Vissering. Norman found one essential difference between his and Vissering's plan: the latter suggested placing the Germany currency on a gold basis.[51] Norman swiftly replied to Vissering asking him to reconsider his position and to lend his support to a sterling basis. His arguments seem to substantiate what has been written above on the turn of Norman's policies towards a more open and direct pursuance of the interests of sterling:

> While I agree that the shares [i.e. the stock of the Gold Discount Bank] may be calculated on gold basis, I submit that the Notes should adopt Sterling (as the only practicable alternative) rather than gold and be repayable outside of Germany: they would thus be less likely to be hoarded and the 'Gold Bank' would be free from dependence on America. I am aware, of course, that Sterling is now depreciated in terms of gold: but it remains the main basis on which European Exchanges are operated and I am most strongly of opinion that as Europe obtains no financial assistance or co-operation from America, Europe should no further attach herself to the basis which for the present America controls.[52]

Had he faced only Vissering's opposition in the matter of dollar versus sterling, Norman would probably have managed to get sterling accepted as the basis for the

& so I guess will continue till after the Presidential Election. It is Jack Morgan *personally* whom we have to thank for the fact that Austria got money in New York.' Norman to Strong, 8 Oct. 1923, copy, BECA.

49 Copies of the memorandum are to be found in Doss. 2, II, NBAV, and enclosed in Norman to Strong, 7 Jan. 1924, copy, BECA.

50 Norman to Clegg, 10 Jan. 1924, copy OV 34/117, BECA (my emphasis).

51 'Summary of Vissering's paper on "Monetary Reconstruction in Germany", 4th December 1923', with Norman's commentaries stressing among others: 'The essential difference between this and "C" is gold versus sterling". OV 34/117, BECA.

52 Norman to Vissering, 14 Jan. 1924, Doss. 2, II, NBAV.

stabilisation of the German currency. However, in the body responsible for the comprehensive programme of stabilisation (the Dawes Committee), the USA was represented, too. To begin with, Norman played high and showed no willingness to compromise at all. He was aware (and he also made others aware) that the success of one of the most vital phases in the plan (the international issue of a big loan) was crucially dependent on London's participation. When Sir Robert Kindersley, the British member of the Dawes Committee and one of the directors of the Bank of England, asked him telegraphically whether he could agree to funding the new Discount Bank in gold, while the notes and credit would be placed on a sterling basis, Norman responded with a resolute 'No',[53] in spite of the fact that this would have been the very same compromise which only a month earlier he himself put forward to Vissering.

The negotiations for the establishment of the Gold Discount Bank started on the basis of Norman's scheme 'C', on 11 March 1924.[54] Hardly a few days had elapsed when objections started to come in from New York. The most active person propelling the American opposition against Norman was Paul M. Warburg, a banker with a European background, who devoted much of his energies to acquiring an international financial position for New York commensurate with the actual strength of the US economy. Warburg sent a telegram to Vissering protesting against what he called the 'exclusion of New York' and arguing for the adoption of a gold (i.e. dollar) basis instead of the fluctuating sterling.[55] His letter to Owen D. Young,[56] the American member of the Dawes Committee, confirms that London's apprehensions as to the prospects of restoring and preserving the global leadership of sterling in the face of the American challenge were well founded:

It is difficult for me to attempt to express my thoughts concerning the problem in hand, or, rather, not in hand. The opportunity that the present emergency in Europe offers is unique, and I don't believe it will ever be again within as easy a grasp of the United States as it is today. It is the question of whether the Dollar shall permanently retain a predominant position, or whether we are willing to surrender financial mastery to the Pound Sterling for good and all! England realizes that, and that is why the Bank of England is willing to go a considerable length in granting facilities. Baron Bruno Schroeder from London, who is here just now, confirmed that in his talk with me yesterday. He said that 'if the Pound Sterling was good enough for England it was good enough for Germany, and that the Germans could not afford the luxury of having Dollar exchange'. That statement is, of course, fallacious, because it is more of a luxury to have a fluctuating pivot than to have a stable one. Germany, in accepting the Sterling as her financial pivot, would place herself under a handicap, while if she could base her financial system on the Dollar, it would be easier for her in the future to engage in world business, and to compete with England more effectively.[57]

53 Kindersley to Norman, telegram, Paris, 19 Feb. 1924, and Norman to Kindersley, telegram, copy, 20 Feb. 1924, 34/120, BECA.

54 Max M. Warburg to Paul M. Warburg, Hamburg, 10 Mar. 1924, telegram copy, 20.0/2, Strong Papers.

55 Paul Warburg to Vissering, telegram, New York, 15 Mar. 1924, Doss. 2, II, NBAV; Paul Warburg to Max Warburg, telegram, copy, 10 Mar. 1924, 120.0/2, Strong Papers.

56 Young was presiding over the currency sub-committee where J. Stamp was the British member.

57 Paul Warburg to O. D. Young, copy, 21 Mar. 1924, 120.0/2, Strong Papers.

The US banking community followed Warburg's action with great sympathy. The Advisory Council of the Federal Reserve Board, including among its members representatives of the major commercial banks,[58] issued a communiqué to evaluate the Dawes Report. Regarding the issue of currency stabilisation they maintained the following:

Unless America finds ways and means to permit her excessive banking strength to benefit other countries particularly those striving to bring their house in order, the dollar cannot maintain its position as a world standard of exchange, and foreign countries and even American banking and commerce will once more in a larger degree become dependent upon and tributary to the Pound Sterling to the greater exclusion of the dollar.[59]

The Advisory Council also stressed the need for certain reforms, if the dollar's international role was to be strengthened, in the norms and rules regulating the activity of American banks and of the Federal Reserve System. Among such desirable changes it strongly recommended that the discounting in New York of foreign bills of exchange, or the acceptance of these bills as security for advances, should be made possible.

Strong and the Washington leaders of the Federal Reserve (among them A. C. Miller) found themselves in agreement with Warburg's objectives,[60] but they were much less enthusiastic over the idea of direct or indirect participation by the Federal Reserve in the credit to be granted to Schacht's Bank. In a letter to Warburg, Strong excused himself – 'The situation has not justified my taking active part'[61] – but a month later, writing to Pierre Jay from Europe, he revealed that it had never been his intention to undertake an active role.

For us to take bills as base described involves one considerable departure from our present practice in that the acceptor will be neither all American concern nor a foreign one domiciled in America. That does not disturb me greatly, but it would be distinctly bad to have the impression get about that we were a party to a credit transaction or had taken the first step in getting behind <u>any</u> plan for currency or monetary or credit reorganization in Germany or anywhere else in Europe. That first step, when taken, must <u>follow</u> real construction progress over here, which is not yet in evidence with a telescope. Some German of more ambition than honesty could well picture an American 'eligible' credit as a real participation in a transaction by the F.R. System, and that should not be allowed to happen. If you <u>do</u> decide to make such bills eligible, see that it is understood that we would <u>not</u> take them were our own wishes to be disregarded.[62]

All this, however, was not merely a reflection of the view of the Governor of the Federal Reserve Bank of New York that European (German) economic–political developments did not justify lending active support to Europe's stabilisation. Strong was rather sceptical even of the need to help the dollar vis-à-vis the pound sterling.

58 For quite a long time, before and during the war, Paul Warburg acted as the Council's chairman.

59 The communiqué was sent by Owen Young to Kindersley, and to other members of the Committee, in a telegram dated 15 May 1924. Enclosed in Kindersley to Norman, 15 May 1924, OV 34/120, BECA.

60 A. C. Miller to Paul Warburg, copy, 27 Mar. 1924, 120.0 (2), Strong Papers.

61 Strong to Paul Warburg, copy, 11 Mar. 1924, Strong Papers.

62 Strong to Jay, Paris, 4 Apr. 1924, copy, 1000.5, Strong Papers.

Eventually, the Report of the Dawes Committee suggested stabilisation on a gold basis. This had been regarded all the time as self-evident by Schacht and other leading representatives of German economic life[63] even though, at the beginning of the year, Norman still firmly believed that Schacht would opt for sterling.[64] Strong refused to be alarmed by London's (Norman's) efforts to force Central Europe into a sterling block which he regarded simply as a transitory phenomenon, convinced as he was that, within a short period of time, Britain, too, would return to the gold basis to which there was no workable alternative. Strong, very wisely and at an early point in time, understood that the German stabilisation would not only *not* lead to the ousting of the dollar (gold) from Europe's currency system but would actually constitute one of the major factors pressing London towards an early return to the gold standard. Writing to Pierre Jay from Paris in the last week of April 1924, he explained:

I am always considering our old bugbear 'gold' and the gold standard – and how these new developments fit into our picture. . . . First, of course, all depends upon the fate of the Dawes' plan. If it is successfully launched I would look for two years or so during which Germany would balance her budget and stabilize her currency, – it is not impossible that she might take a little of our gold. That would leave the pound and franc afloat. The British would view (and do) the former with consternation. The French will be more complaisant. So what is the problem as to dollars and pounds? It seems to me to have become simplified in so far as the urgency will grow in London to get back to Orthodox ways as soon as possible; and that feeling has gained a new impulse because of the Dawes plan.[65]

Considerations of solidarity and the appreciation of London's positive role in Europe's stabilisation provided Strong with further arguments for avoiding a direct collision with Norman. Norman had Strong's understanding and sympathy when it came to his hesitation to go for an early restoration of the gold basis. And as long as such questions as that of the inter-allied debts were unsettled, Strong did not fail to emphasise the responsibility of the US, namely that (as he himself wrote) 'the fate of sterling in a measure rests with us'. Unlike other New York bankers, Strong was of the opinion that Germany's (Europe's) reconstruction had to rely to a great extent on credits from London, and therefore he opposed any suggestion or policy implying discrimination against London.[66]

Strong's expectations proved to be well founded: the German stabilisation was carried through on a gold basis without either the Federal Reserve System having been compelled to get directly involved in the discussions in favour of the dollar, or

[63] Schacht wrote to Paul Warburg: 'It is our desire not to base ourselves entirely on the Pound Sterling ... it appears to me that this matter is clearly elucidated in the Dawes Report, according to which only "gold" comes into question as the basis for the future German Reichsbank. There is also not the least doubt, as far as I am concerned, that we cannot have any real economic basis in Europe until the currencies, at least of the leading and most important countries, are again placed on a gold basis.' Berlin, 31 May 1924. An English trans. of the letter was enclosed in Warburg to Strong, 12 June 1924, 120.0 [2], Strong Papers.

[64] Norman to Vissering, 14 Jan. 1924, Doss. 2, II, NBAV.

[65] Strong to Jay, Paris, 23–8 Apr. 1924, copy, 1000.5, Strong Papers.

[66] Strong to James A. Logan (non-official American delegate to the Paris Reparations Committee), 11 July 1924, copy, 1011.1 (1), Strong Papers.

Germany having been forced to miss London's financial support. Moreover, as the Federal Reserve Bank of New York declared itself willing to accept German bills of exchange as security, even Warburg achieved much of what he set out after, acquiring for New York (and, of course, for his own bank, the International Acceptance) a substantial portion of the credit to be lent to the Gold Discount Bank.[67]

Norman seems to have been forced to capitulate in the case of German stabilisation. When assessing the weight and significance of his defeat, however, we should not neglect the fact that his policy of building a 'sterling bloc' had been motivated by the lack of interest exhibited by New York towards Europe at the turn of 1923–4. The short period between early spring and the summer of 1924 brought a number of improvements in this respect. The contribution made by New York to Germany's stabilisation credit eased the burdens weighing down sterling and thus brought the time closer when even London could return to the gold basis. After all, Norman had never contemplated establishing as a longer-term or permanent solution a European sterling bloc organised around the paper pound. Indeed, the circumstances in which the Austrian stabilisation was carried through (New York's meagre participation in the stabilisation loan) were the major motives that lay behind Norman's 'heterodoxy'. Despite the burden of financing the Austrian stabilisation falling mostly on Europe (and first of all on London), the Austrian National Bank chose first the Swiss franc and then the US dollar as the basis upon which to stabilise the schilling.[68] This had caused a flight of Austrian assets (among them, the yield on the loan granted in Europe, first of all by London) to the dollar (to New York) in order to neutralise the exchange risk. Norman was entirely right to worry about a recurrence of the pattern as long as Europe's stabilisation, while relying much more extensively on the resources of London than of New York, continued to be effected in terms of gold (which, at the time, was another name for the dollar). In this respect Norman was simply presenting the world with an alternative: if Europe opts for the gold basis, then the gold market – in other words, New York – should finance the bulk of the stabilisation credits. If, however, New York refuses to lend adequate financial support, and Europe expects London to come to its help with credits, then Europe ought to accept sterling as the standard of its currencies, at least as long as sterling itself is off the gold basis.

In the light of the above, German stabilisation cannot be regarded as a clear-cut defeat for Norman. After all, his overriding objectives were to minimise the burden shouldered by London and by the pound sterling, to promote Europe's monetary stability, rather than to extend the sterling bloc for its own sake. It cannot have been of great significance to him whether these major objectives were achieved through stabilisation effected on a sterling basis or by New York's increased engagement. (Obviously, a combination of sterling-based stabilisation and substantially improved funding by New York would have been the most beneficial for London.)

[67] Norman to Vissering, 15 Apr. 1924, Doss. 2, II, NBAV.

[68] Cf. League of Nations, *The Financial Reconstruction of Austria. General Survey and Principal Documents* (Geneva, 1926), 90–1.

The cautious formulae applied by Norman (as well as his allusion to the significance of the time factor) in his letter to Strong of June 1924 seem to confirm our view:

I know your views on the stabilisation of German Currency. I am not sure that I entirely agree with them because I am not sure that, *at any rate up to the present time*, the European currencies were not better stabilised on Sterling than on Gold: a case in point has been Austria. *But as conditions are changing, I think it is very likely that Germany will not be a case in point.* Anyhow, the Dawes Plan apparently stipulates for a Gold valued currency and your view is therefore to prevail.[69]

Having brought Austrian stabilisation to a conclusion, Norman found a means – the Finance Committee of the League of Nations – of paving the way for other *Sanierungen* by eliminating a number of hindrances resulting from political animosities and lack of confidence. The League's part was crucial in acquiring legitimacy for the stabilisation programmes and in providing control of the execution of these programmes. In the course of German stabilisation diplomacy, on the other hand, Norman defined the main contours of the policy aimed at securing a minimum level of harmony between the needs of European reconstruction and the short-term requirements of protecting sterling's international position. These two components, in combination with the idea of an International of Central Banks emancipated from the guardianship of politics, constituted the strategic core in the foreign policies of Threadneedle Street that shaped their relations with the National Bank of Hungary or, indeed, with any other stabilising central bank dependent on London's political and financial support.

69 Norman to Strong, 16 June 1924, copy, BECA (my emphasis).