2 Money doctors between the wars

The competition between central banks, private financial advisers, and multilateral agencies, 1919–39

Stephen A. Schuler

World War I provoked a crisis in the history of international finance. The previous half-century had witnessed rapid industrialization in the world's leading nations, the rise of managerial capitalism, and the development of financial intermediaries capable of channeling domestic savings and lending abroad in a large scale. Contemporary, especially those who had not examined adjustment mechanisms closely, attributed the smooth working of international exchanges to spreading acceptance of the classical gold standard (see, for example, Kenen 1940).

The war undermined both the political institutions and the conceptual framework that had allowed the credibility of the system (Blaug 1992). Liberal governments of the early 20th century still had underdeveloped tax bureaucracies, and the belligerent countries resorted to deficit finance to meet unanticipated expenses. The resulting inflation distorted relative prices. It also disrupted existing patterns of commerce and intercourse. State controls replaced free trade. Outside the United States, the gold standard, as it had traditionally operated, broke down. Britain, France, and America maintained (firewalls by pegging their exchange while hoarding lasting. Once these temporary arrangements ended, all European currencies depreciated against the dollar to a greater or lesser degree. The disrupted exchanges served as one harbinger of the shifts in financial power, changes in industrial competitiveness, and structural adjustments in trade patterns that had taken place during the war.

The postwar years provided increased scope for “money doctors” of several sorts to help reconstitute the multiannual financial system. Throughout this period, the London “City” as the unchallenged leader among financial centers, had managed long-term capital flows, accommodated trade, and provided shipping and insurance services worldwide. Joint-stock and merchant bankers in the City developed considerable expertise in defining financial credits and in serving as lenders of last resort. London bankers continued to boast overlooked expertise in trade finance even after 1918. Wall Street never developed a comparable acceptance market in the interwar years. Nevertheless, the deterioration in the balance of
Globalization reached a peak in the generation before 1914. By most measures, it would not approach those levels of integration again until the 1990s (O’Rourke and Williamson 1999). The interdependence of economies increased. That enhanced the ability of money-center bankers or consortiums to impose Western norms of private property, the rule of law, and the obligations of contract. This implied the transmission of cultural values as well as the institutional rules that emanated from them. In their own interest, the bankers encouraged the responsibilities of rulers to subjects in polities overseas or on the European periphery that had heretofore operated along strictly Hobbesian lines. Political scientists describe this development, perhaps too clinically, as the “convergence of expectations” in the international regime (Lipson 1985: 3-33).

The convergence, naturally, remained imperfect. Governments in lending countries rarely deployed military force to enforce market discipline on misbehaving states. Countries that invoked financial conventions in one decade regained access to capital markets in the next. Still, money doctors had an incomparably easier time performing their duties in the generation before World War I than after it. First of all, financial relations among the major countries remained relatively stable. As will be discussed below, that stability derived in part from common discipline and active management of the system this is from the intrinsic merits of gold convertibility itself. But stability as the center allowed money doctors to focus their attention on the periphery. With occasional exceptions, they could work to restore the finances of Portugal, Spain, and Greece, the Ottoman Empire and Latin America, even Austria and Russia, without endangering their own economies. Moreover, at Floudres and associates have shown, new gold supplies after 1866 set off a gentle inflation that muddled real debt burdens everywhere. Even almost effective taxation, debtor governments did not need to rely so heavily on seignorage. They perceived increased advantage in accepting the market discipline involved in adhering to the gold standard (Floudres et al. 1956).

If the assumptions and techniques of money doctors did not change radically as a result of the war, the political context in which they operated was transformed. Not only had the gold standard discipline and the web of understandings that sustained it fallen into disuse, but globalization went into reverse. Worldwide tensions to the free flow of capital, goods, and labor persisted stubbornly during the 1920s and remained further in the adverse economic climate of the Depression decade (Jones 2003). What’s more, the financial center failed to hold. Every country except the United States (and arguably the United Kingdom) had emerged as a deficit land in 1919, in need of external help to ensure its fiscal equilibrium. Traditional remedies proved inadequate and sometimes counterproductive. For example, the sheer magnitude of social disruption and decline of wealth in most combatant nations outlined the venerable deflationary nostrum of compressing the money supply back to prewar levels as a corrective for fiscal profligacy. When France adopted such a “waiving” scheme through the 1920 Dawes–Marrat Convention, the Banque de France yielded to temptation and eventually cooled the books.¹
At the 1919 Peace Conference the leading Morgan partner, Thomas W. Lamont, advised the American delegation in Paris on reparations, while Assistant Secretary Russell Leffingwell performed economic analysis for the Treasury Department. Five years later, both men had switched to analogous duties in the private sector. Lamont represented the bankers at the 1924 London Conference to redress Germany’s reparations debt; Leffingwell elaborated the economic projections at home, this time as a partner at Morgan Corrêa.

Leffingwell’s wartime assistant, S. Parker Gilbert, effectively ran the U.S. Treasury at Mellon’s undersecretary in the early 1920s, and then was tapped by Leffingwell to become Agent-General for German Reparations before elevation to a Morgan partnership himself. Another Lamont protégé, Jeremiah Smith, moved up as commissioner-general for the League reconstruction of Hungary.

Governor Benjamin Strong of the New York Federal Reserve Bank (FRBNY) developed a personal friendship as well as a strategic alliance with Montagu Norman, governor of the Bank of England. Earlier, Strong had learned his trade at Bankers Trust, a frequent participant in Morgan syndications; and Henry P. Davison, the author partner at Morgan’s in the older generation, had become the joint partner of Strong, Lamont, and Mouat when all four adored the same social circle in the New Jersey suburbs of Englewood. Norman, meanwhile, enjoyed the closest of personal relations with J.P. Morgan, Jr. and his New York partners, as well as with Edward Greenhill, the leading light at Morgan, Greenhill. A Thoroughbred stress, the latter served thirty-five years as a director of the Bank of England, including two terms on its inner Committee of Treasury. Lamont collaborated with one key partner of Lazard’s London branch, Robert Brand, in abortive negotiations for post-Versailles reconstruction loans, and he worked with the latter’s cousin Robert Kindersley on German currency reform five years later. Still another Lazard partner, Frank Ahlesch of the New York branch, conceived the anti-speculative action that Morgan’s executed in 1924 to save the franc, notwithstanding the tendency of old-school bankers to consider such actions abhorrent.

Owen D. Young, the conceptual point man for the Americans on the Dawes and Young committees of 1921 and 1922, were another New York banker, Morgan’s. Charles C. Dawes, the first American delegate to the 1924 Committee of Experts, not only remained personally close to Sir Josiah Stamp, his British counterpart, but their respective children united in marriage.

One could extend this prosopographical analysis indefinitely. Even some Germans gained limited entry to the dense web of interconnections as wartime animosities subsided. Carl Melchior, financial counselor to the German delegation at Versailles, struck up an intimate relationship with John Maynard Keynes and drew the latter into monetary advising in Berlin. Max Warsberg, Melchior’s partner, became a logical interlocutor on New York matters because his brother Paul, a co-founder of the Federal Reserve, maintained close links with Kohl, Lebès & Co. Academics, of course, moved in less exalted social circles, but even there personal connections reinforced a commonality of outlook. W.N. Cumberland and Arthur N. Young, successively foreign trade advisers at the U.S.
by the governor of the Bank of England, embraced the basic assumption that the British government should balance the budget, reinvestigate capital markets, and ensure sterling's convertibility at the prewar par as soon as that became feasible. Only the timing of the requisite policy measures remained open for serious debate. Ralph Hawtrey, the civil servant who drafted the bulk of the Cambell Report, may already have doubted whether precious-metal reserves would prove adequate to resist the gold-bullion standard, significantly. Hawtrey strongly emerged as one of the earliest advocates of the gold-exchange variant (Kinschberger 1984: 532-3). Officially, however, the Cambell Report embraced David Montagu's price-specie-flow model, under which gold-movements and internal price changes would automatically balance external accounts.

Economic historians have long acknowledged that the late-19th century gold-bullion standard involved substantial hands-on management. It did not function so differently from postwar gold-exchange arrangements as textbook models would lead us to suppose. Paper currency and bank deposits accumulated for 90 per cent of world monetary circulation by 1913, gold for merely 10 per cent. Monetary authorities in nations on the periphery already held surpluses and dollars as de facto substitutes for gold reserves, albeit not to the extent practiced later. Moreover, countries in deficit infrequently faced wages and prices down through higher discount rates in order to adjust the trade account. Nor did they issue gold to creditors, except as a last resort. Instead, capital movements accommodated deficits or surpluses for long periods without requiring readjustments on current account. The regime worked sufficiently most of the time, because bankers in the financial centers adhered to a common doctrinal ethos and shared a commitment to sound money. The London City bustled against the norms on the rules of the game by training elites from abroad as well as by extending counter-cyclical credits and facilitating trade. The criteria of the gold standard point out that regime credibility required political as well as economic harmony. The much-touted advance of democracy meant that labor unions and trade associations could make it hard for postwar governments to sacrifice domestic interests for a «harmonious» balance of payments goals (Eichengreen 1980: 4-12). And yet postwar experience drove home the parallel lesson that fiduciary inflation and external adjustments through currency devaluation set in motion a «cumulative, often irreversible, downward spiral.» The surplus for government policy choices had narrowed in both directions.

Even the strongest proponents of the gold standard did not claim that it would bring about automatic price stability. Precious metals varied in price like all other commodities. Kemmerer remained the Davies Committee that the purchasing power of gold in terms of a basket of commodities had risen by 50 per cent from 1793 to 1886 and then fallen back to the original level by 1914. The purchasing power of gold had tumbled another 50 per cent from 1913 to 1920, the trend reversed owing to postwar deflation, and the value of gold rose by 66 per cent from 1920 to 1924. Nevertheless, conventional thinking held that the restoration of confidence through a «common monetary standard would itself facilitate trade» revised

---

The prerequisites for monetary reconstruction

It is hardly surprising that continuity in personnel resulted in substantial consensus on the prerequisites for monetary reconstruction after 1918. The Cambell Committee on Currency and Foreign Exchanges after the War, chaired

---

State Department, had done graduate work with Edwin W. Kemmerer at Princeton. The two brought Kemmerer into the Washington act as a consultant on Latin American monetary problems and later as staff advisor to the Davies Committee. Concerned to hold all the 'legal' cards in the preparation of financial advice to Latin American nations, Kemmerer observed, that legalistic cut of mind penetrated to deeply into institutions and culture alike. The career of John Foster Dulles, a senior partner of Sullivan & Cromwell in the interwar years, illustrates that dedication at the Paris Peace Conference, Dulles essentially drafted the reparations terms of the Versailles Treaty. In the 1920s he drafted many of the Central European, Latin American, and Asian treaties, on the other hand, he counseled Washington regarding the vexed question of priority between private and government loans. Through his intimate friendship with Jean Moussot, among other connections, Dulles became deeply involved in debt renegotiations throughout the following decade. Only when the Depression overwhelmed traditional banking structures did a true outsider penetrate the closed circle of the financial cognoscenti, and then using mobilized credit for Germany and a dozen other countries in return for arms. The normally sober Finance Committee: "Technically this conception of writing the acquisition of national wealth, which seemed to promise a "formless" simplicity of great ideas." The Kogler conference collapsed when auditing fraud came to light. In retrospect, excesses of a few years which as individual man can draw and restore to the needs of a gradual shift in the precarious plates of international finance. Increasingly, it became clear that the problem of common monetary standards needed to rise, if at all, only at the level of governments. 

---

Monetary matters between the wars

---

55
came with political strings attached. The Americans insisted not only on Open Door principles in third countries, but also that American credits should be employed for the purchase of American goods. If the British needed liquidity beyond that, they should draw down their overseas holdings. In effect, Wall Street demanded a financial condominium that would encompass British preserves in Latin America and the Far East. As Lamont expressed the idea in his inimitable silly manner, "America has ample credit resources, Great Britain has wonderful credit machinery all over the world. Why not make a combination of the two?"

Both Whitehall and the City bankers poured cold water on the idea of an export subsidy given the terms on offer. The U.S. Congress subsequently provided a motive concomitant. It caused the requirements for foreign-trade financing in a limited way by statute. The 1919 Edge Act permitted Federal Reserve member banks to set up foreign-trade investment corporations exempt from usury trust construction, and Paul Warburg achieved a success in shipping raw materials to Germany through his International Acceptance Bank. American producers of wheat, cotton, copper, oil, and fertilizer set Europe's commodity needs through a variety of expedients (including speculation in depreciable currencies) during 1919-21. Yet although the cumulative trade surplus approached £6 billion in those years - and helped mitigate a fall in domestic demand - Washington steered clear of formal institutional efforts to stabilize currencies overseas.

In any event, the window for ambitious ventures quickly closed. The British wager that they could hold their own against the imroads of U.S. finance overseas proved correct, at least in the short run. In Latin America, for example, British institutions successfully resisted a competitive thrust from the burgeoning branch system of the National City Bank (Parvis 1969: 101-37). A number of British, Dutch, and German bankers organized the Amsterdam Memorial in 1920 in order to foster a public consensus for war-debt forgiveness. Paul Warburg and like-minded bankers proclaimed it "a mortification and a crime" that the United States would not put its shoulder to the wheel.

Such rhetoric played poorly on Main Street, however, as business failures multiplied during the U.S. business depression of 1920. It took no special insight to realize that the Amsterdam Memorial spokesmen had an agenda of their own. German-Americans sought to undermine the reparations settlement, and neutrals who stagnated "political delay" as counterproductive hoped to recoup their commercial losses and revitalize trade with the Reich. Sooner or later, the American cotton export industry produced a resuscitation of popular isolationism. Attempts at monetary reconstructions overseas would have to proceed piecemeal, or not at all. The delay, in any case, yielded compensating advantages. With the benefit of hindsight, most analysts consider the post-War advent of stabilization desirable as well as inevitable. Richard Meyer paints out this formal devolution before European nations had repaired wartime damage might have led to a choice of exchange rates inappropriate for normal conditions. On the other hand, forced deflation to restore the present parity would have produced insufferable shortages of domestic goods (Meyer 1970: 7, 157).
The limitations of multilateralism

In the absence of a trans-Atlantic drive en machina, the League of Nations arranged a conference of nineteen nations at Brussels in September 1920 to articulate the principles that should govern monetary reconstruction. One should not exaggerate the political importance of that conference. The largest creditors and the greatest defaulters, namely the United States and Russia, would for different reasons have no truck with any provisions of the League. The Germans were fully on the defensive, and the French were the overbearing and the dominating statesmen in shaping the agenda. Robert Boyce has likened the proceedings to "wisms against its." All the same, the League bureaucracy regarded the results that the Brussels Conference unamissously adopted as "the Law and the Prophets" for money everywhere.

Although the term "multilateralism" was not yet come into vogue, the Brussels system encapsulated the common wisdom of the day (League of Nations 1925: 39-13). A nation seeking to stabilize must balance its ordinary budgets through taxation, and incur extraordinary expenses through loans raised out of savings. Central banks of issue must be insulated from Treasury influence, with international supervision if external financing was required. The Dutch banker C.E. Van Mounen elaborated an international credit scheme providing that deficit governments earn the costs or other land, cash, or to meet the services on foreign stabilization loans (Silverman 1962: 233-8). The League of Nations Financial Committee opened an office in London to solicit for Members credits on a whole-time basis. Yet, surprisingly no potential lenders showed up. After eighteen months the League terminated the effort in embarrassment.

The League Financial Committee then shifted to targeted attempts to help defunct internal by one or in those geographical areas where the E ust would run, namely Central and Eastern Europe. The Financial Committee eventually played a constructive role sponsoring rehabilitation of Austria and Hungary, particularly after the Bank of England found it expedient to operate under League cover. Working through Sir Otto Niemeyer in London and with his financial officers in Vienna and keeping French influence out, once Austria pledged customs revenues and accepted foreign control of its central bank, Montagu Norman threw himself into the effort. The Bank of England discounted Austrian Treasury bills in March 1923. Soon after, he floated a long-term loan for Austria in tandem with the House of Morgan. 22

The next year, under Salter, a sterilized accommodation between Hungary and its large creditor, the Bank of England again took the lead in floating a loan for Hungary. The Austrian stipulations served as a model: Hungary undertook financial reform, raised matching funds internally accrued an American commissioner general, and created an autonomous central bank with Niemeyer's close associate, H.A. Stefanovits, acting as advisor (Savary 1976: 271-3). Subsequently, the League provided its imprimatur for small-scale syndicated loans to revive Greek and Bulgarian refugees and to conclude currency reform in Estonia and Danzig.

Despite the presence of a League administrative apparatus, in several cases for a decade or more, League reconstruction generally failed. Attempts to prevent renewed capital flight proved unavailing. Hungary, Greece, and Bulgaria defaulted outright in the early 1930s. Austria avoided technical default only because the creditor banks advanced fresh advances under treaty.

The League, who represented the Financial Committee in Budapest over fourteen years, waxed philosophical about the outcome. "In particular," he observed, the words pledge, security, capital, and 'value' may create the wrong impression...in the mind of the borrower. A member's reflection makes it clear that the implementation of such pledges cannot be achieved in the same conditions...as in a domestic loan, unless the pledged qm or revenues are situated outside the national territory of the borrower.

The specific terms of the loan contract made little difference: "As long as both sides have a will to collaborate, no one looks at a contract, and as soon as either side states claiming rights under a contract, collaboration is at an end." 23 In modern parlance, the Genoa authorities failed to renew the Coalition that asserted "ownership" of their structural adjustment programs. Given the clearly articulated agricultural, banking, and social crises that overworry Eastern Europe, however, a more realistic outcome scarcely seems imaginable.

The Young Committee on German Reparations set forth another cooperative model in 1929 by proposing a Bank for International Settlements (BIS). The BIS would act in the loan issuance as a trustee for German outpayments and provide a forum where central bankers could exchange views. Montagu Norman hoped that the BIS might develop institutional functions, and Emile Pinotet of Belgium and Hjalmar Schacht of Germany each roughed out analogous ideas. W. Randolph Burgess, in an loan to the New York Fed to the Young Committee, then submitted an ingenious plan to create special drawing rights deriving from reparation payments at the BIS. That facility could be used to increase global liquidity when gold production lagged behind the needs of trade.

The League Gold Delegation had just begun to study the possibility that the world stood at the brink of crippling deflation. Experts disagreed whether a substitute supply of new gold or failing industrial production could have the greatest effect on prices, and the three successive reports of the Gold Delegation failed to clarify the matter. The Burgess plan suggested how a combination of creative thinking and enlightened cooperation might produce solutions for otherwise intractable monetary problems. There seemed no obvious reason why the "gold letters" of which Keynes later spoke so disdainfully need lend inductively to deflation. 24 Burgess's seniors on the Young Committee waxed enthusiastic. Still,
Money worries between the wars

Sorng evoked a central bank conference to institutionalize such a system and argued instead for tackling stabilization country by country sequentially—what John H. Williams (1947) would later denominate the “key currency” approach. Bank of England records suggest that Norman really aimed to link as many nations as possible to sterling, even before the pound had returned to gold. When the Davos Committee drew up a Reichsmark stabilization plan in 1924, Norman fought a recognized battle to avoid having the new currency on the dollar. “I am sure...that sterling is depreciated in terms of gold,” he bemoaned the head of the Netherlands Bank,

but it remains the main basis on which European exchanges are operated, and I am very strongly of the opinion that, as Europe obtains no financial assistance or cooperation from America, Europe should no further attach itself to the bank which for the present America controls.”

Nonetheless, Norman saw the return of sterling to the pre-war par in 1925 as his finest accomplishment. He labored indefatigably to arrange a Federal Reserve Bank credit and a Morgan loan to ensure a smooth return. The London authorities had multiple reasons for worrying about wartime inflation before relative prices became fully aligned, but international considerations placed high on the list. Not merely Germany, but also South Africa, Australia, the Netherlands, and Switzerland plowed an immense return to gold. Winston Churchill explicated the policy considerations underlying the Treasury view in May 1925:

If the English pound is not to be the standard which everyone knows and can trust—the business not only of the British Empire, but of Europe as well, might have to be conducted in dollars... That would be a great misfortune.

Following sterling’s return to gold, Strong and Norman continued their collaborations to stabilize the continental countries between 1925 and 1928. At the same time, Norman undertook to foster central banks in the British Dominions.

Although Europe stabilized its in 1926 without obtaining either outside Treasury or central bank loans, Strong provided moral support and quietly detested Robert Wauzer to render technical assistance. For reasons of amfedipio, the French hesitated to acknowledge publicly just how much help they needed. The cooperative ventures to stabilize Belgium, Italy, Poland, and Romania, by contrast with the French operation, have come in for trenchant criticism. The magazine evaluates focus less on the monetary aspects of stabilization than on the political conditions in which they took place. Most of these operations, after all, followed some variant of the financial model adumbrated in 1920 at Brussels. They involved balancing the budgets, consolidating the floating debt, shortening the recovery of the target country’s capital base, and selecting a realistic exchange rate. In return, the foreign central banks provided their instruments by subscribing to a credit and by tapping the capital markets for a

Central bank cooperation and conflict

While the Geneva and Basel institutions registered vast success as money doctors, the central banks compiled a stronger record at least before the winds of Depression blew their achievements away. Indeed, the period 1934–31 figures as the great age of central bank cooperation. Benjamin Strong, governor of the New York Fed, began to cultivate his opposite numbers in London and Paris as early as 1916. In the 1920s, he devoted much of his energy to collaborating with Montagu Norman of the Bank of England in heading the key countries toward a stable-currency regime. A generation later, Allen Sprott, also a president of the system, with most of the power in Washington, had most of the knowledge in New York. Strong likewise labored chronically under the conspicuous criticism of small-town bankers who denounced the Federal Reserve Board in his day. Herbert Hoover, as secretary of commerce, decided Strong as a “mental influence” in Europe who had inspired easy-money policies in 1924 and 1927 primarily to assist his “enemies.” In fact, Strong instead, domestic and foreign imperatives worked together in both episodic lower discount rates stimulated business and relieved hard-pressed Western farmers at the same time that they opened U.S. markets to foreign borrowing and laid the foundation for monetary rehabilitation abroad. Strong readily conceded that a central bank must privilege domestic monetary management in the event of conflict. In that spirit, the New York Fed advocated restrictive measures in 1929–30 to curb stock-market speculations, even though higher rates would place additional pressure on sterling.

The biographers of Lord Norman, governor of the Bank of England, have fabulously documented his critical alliance with strong, yet they underestimate his tenure. Norman burned with nationalistic fervor to restore the place of sterling in 1922 Census Conference with a political purpose in mind. Under his proposed mainstay reserves entirely in gold. The others would hold half of their reserves cooperative credit policies. Strong felt claming qualms about the suggested more alarming, if major countries underpaid to manage the system by black cheking in some of the impoverished nation’s of the world... whose govern-
follow-on long-term loan. Richard Meyer contends that, although visible official intervention may prove indispensable from time to time, neither Belgium, Italy, France, nor Germany absolutely needed the credits and loans accorded to them for development purposes. In practice, the target countries played the role of participant banks off against each other to obtain the lowest possible conditions and the maximum of centralisers (Meyer 1970: 16–160). In other words, the money doctors proved too easy to resist in political success. Hence bargaining terms moved in favor of individual nation-states at the expense of the global financial architecture.

Belgium, for one, took advantage of its diminutive size to stabilize below purchasing-power parity; when France followed suit, that aggravated the outcome.

By contrast, Italy was allowed, for reasons of prestige, to stabilize at a high rate that proved unsustainable in full employment. In addition, Montago Norman, carried away perhaps by the Morgan interests, was afraid of losing his influence in the central bank independence in Rome. The Polish and Romanian stabilizations, even worse, exposed the political tensions among the central banks. Allowing political sympathies to warp his judgment, Norman collaborated with the Reichsbank of Hjalmar Schacht in an effort to impose the odium of League control on Poland. The Poles, preferring to find the Americans "disinterested," wanted off that threat, first by inviting Professor Edmund Kemmerer to investigate, and then by placing themselves under the protection of the FRBNY and a second-tier American bank syndicate, with a more altruistic control. Not surprisingly, after providing a temporary stimulus, the growth of new loans turned off (Praec 1986: 40–129).

A controversy over Italian stabilization complicated the alienation between the London and Paris central banks. Norman, inveighing precociously, sought to force Belgium and Luxembourg to accept League dictates. Governor Moreau complained in "irresponsibility" all over Europe and employed the Financial Committee as the instrument of that "domination." The franc had meanwhile Banque de France was to draw downSterling balances in London. The French, when Norman, pretending that nothing had changed, still sought to black the Little Entente.

Benjamin Strong deemed the whole matter a tempest in a teapot. The sums to encourage France as a capital lender. In the end, the French went on conflict with others. The Bank of England could never again rely on French powers of cooperation between key money centers that large implications. By 1927 it had dissolved on its basis; even those who had not staked present experience closely - that the gold-exchange standard did not adjust to shocks automatically. Rhetoric aside, the central banks preserved in effect over a managed-currency standard. France's policy of gold accumulation contained the general perceived threat to sterling's stability and thereby to systemic equilibrium. Yet the German compensations exposed the manifest political limits to central banks acting as money doctors more generally.

Wall Street to the rescue?

While central banks set the tone, the lending investment banks of the 1920s provided the bulk of the capital for foreign loans. The most important ones, J.P. Morgan & Co. and Leafield, maintained representation in all three major New York money centers and offered one-stop shopping for countries in need of financial assistance. Morgan's still figured importantly as the dominant banking house of the era. Specializing in "relationship banking," it had strengthened its position by representing the British and French governments during the war and by overseeing purchases as well as the final mopping of foreign loans. Although the Wilson administration began with a deep popular sympathy of Morgan influence, it came increasingly to rely on the talents and contacts of the firm. Thomas W. Lamont assumed a commanding position in the economic group that assisted President Wilson at the Paris Peace Conference (Glasser 1999: 371–405).

Nevertheless, the partners at 23 Wall Street became somewhat troublesome during the 1920s by the quasi-public duties that the institutional structure of capitalism had thrust upon them as private citizens. "The Morgan firm is an amalgam," Dwight Morrow once admitted, "it is accountable to nobody but its own sense of responsibility." Privy as rationalization, J.P. Morgan preferred to think of himself as a type of high-level bond salesman, "simply an expert... upon the marketability of securities." Even in private correspondence, the partners preferred to speak of the investment market's requirements, and of themselves as their mere interpreters.

At the same time, American financiers underwent massive structural change in the postwar decade. The transfiguration of Wall Street ultimately circumscribed Morgan leadership. Having witnessed the government's success in mass marketing Liberty Bonds in 1917–18, bankers no longer placed their flotations among a small coterie of the wealthy. Instead, they tapped the burgeoning savings of the lower classes. Upcoming firms hungry for business, chief among them Dillon, Reed & Co., Harris, Forbes & Co., and Hailey, Stuart & Co., repeatedly undercut Morgan's position by offering easier conditions on foreign loans packaged for retail distribution. The security affiliates of national banks, with deeper pockets than private banks, took a growing share of the debenture business as well as leading in stock placements. Although Morgan's and its East Coast "establishment" allies continued to set the terms for high-visibility loans to West European governments, their ability to impose conditioned on smaller flotations elsewhere declined (Carasso 1970: 241–99). Claiburns stood ready to meet the public appetite for securities without formally categorizing risk against
As one of the new breed unashamedly told a Congressional committee, "The banker is like the grocer. He supplies what the customer wants."

In 1921 the Harding administration sought to impose public oversight on foreign loans. Secretary of Commerce Hoover repeatedly pressed to enlarge that scrutiny. But State and Treasury Department officials feared that, if they saddled judgment on any loans as a business proposition, they would incur a potential legal liability for those floations to which they posed no objection. They accordingly isolated themselves to passing on the appropriateness of loans (for example to nations that had failed to fund their war debts). When the speculative boom of the middle 1920s threatened to get out of hand, bureaucrats became uneasy about the volume of German and Latin American loans for unproductive purposes. Still, aside from cautioning the borrowers indirectly, they dared not interfere.

When Congressional committee members called them to account in the 1930s, the Morgan partners justly boasted that only two of their own issues had ever gone into default. The exceptions were the Doera and Young loans, which they had floated at the behest of the U.S. government. Certainly the House of Morgan concentrated on relationship banking and gave a wide berth to risky syndications for most developing countries. As State Department observers, Lamont traveled to the Far East in 1923 to secure Japanese adherence to the International China Concessions, yet the firm confined its own Asian leading in the following years to Japan. Maintaining a preserver ethos that hid fear to disapper among the newer Wall Street conglomemates, J.P. Morgan prided himself on applying strict moral as well as financial criteria to the activities of the firm. Two years after the war, he resisted pressure to consider a lucrative contract advising the Deutsche Reichsbahn. "From what I see of the Germans," he counseled his partners in the house office, "they are second-rate people, and I would rather have their business done for them by somebody else." All the same, on occasion Morgan's fear no less than his prudent lenders when it encountered the problem of political risk. Marc Floridan suggests that, even in the 19th century, relationship banking did not foster a very effective form of conditioned political risk. The weaknesses of such arrangements became particularly more open in the world after the war, as the Mexican example demonstrates.

In 1911 Lamont had the misfortune to become chairman of the International Committee of Bankers on Mexico. Over the next two decades he spent more time defending the interests of external creditors dispensed in the Mexican Revolution than on any other matter. He visited Mexico City in October 1921 with the hope of making President Obregón a refinancing offer he could not refuse, but departed with empty hands. Having observed the success of the Bolsheviks in repudiating foreign obligations, the Mexican negotiators perceived no need to pretend they might make macroeconomic adjustments. "I did not think any government of modern times would so frankly proclaim its complete dishonesty or its abandonment of all decent finance or norms,"amed Jack Morgan fires his note at the Paris Ritz. He congratulated Lamont of demonstrating at least how to "get out before they stole your pocketbook or watch."

Ever the preternatural optimist, Lamont resumed talk with the Mexican finance minister in 1922 and reached an apparent understanding on annuities secured by oil export taxes and railway revenues. The Churubusco regime sought U.S. recognition and hoped to restore its credit rating in order to qualify for a new loan — all without yielding the essence of its revolutionary claim to subsist rights.

To no one's great surprise, the 1922 agreement did not stick. When the Mexicans failed to 'scoop up new money, Finance Minister Alberto Parti withheld Mexican remittances on the grounds (still unusual in the postwar decade, but increasingly common from the Great Depression onward) that "human rights" trumped "legal" considerations. One partial default followed another. In 1930 Ambassador Morrison, placing national-security concerns above bondholder interests, fought to scuttle a revised agreement worked out by his former partners on the ground that it provided no comprehensive settlement of Mexican obligations, both foreign and domestic. The 1930, 1931, 1932, and 1942 refundings proved no more durable than their predecessors, particularly after Washington began to advertise as a "Good Neighbor Policy" for Latin America. Neither portfolio investors nor the intermen recovered more than a minuscule fraction of their original investments or accrued interest. Twenty years along in the process, Lamont reminded a new Mexican finance minister of his boyhood experience seeing a woman skinning cats alive. When he remonstrated, the woman replied: "Oh, they get used to it." As many doctors found as often in the interwar era, political risk loomed larger than financial risk.

Academics and freelancers

Counseling economists constituted the fourth category of "noisy doctors" between the wars. The Progressive era in America popularized the ideas of democratic public service. Reformers held that the rigorous application of scientific principles could produce advances in public administration as striking as those in the hard sciences. The same generation saw the rise of economics as a credentialed, professional discipline at American universities. Economists made equal theoretical advances elsewhere, of course. And the British were the first to institutionalize independent economic advice to government with the formation of the Economic Advisory Council in 1923 (Hosomi and Whish 1977). But the unique status of the "expert," became a particular ingredient in American popular culture, where economists, like other social scientists, obtained recognition in the media and special administration as "yesmen" in their field.

Europe boosted some well-known independent economists too, but it was not always transparent who employed or what motivated them. Charles Rist carried out a number of missions to Eastern Europe — to Rumania in 1927-8 and to Austria in 1931 — nominally wearing his expert hat, but in practice representing the French government, which sought to extend influence in the region on the cheap. Russell Leiflingwell of Morgan's decided "publicist-economists," like Keynes, Gustav Cassel, and Veblen-Stuart, who made their living mostly through journalism or speculation and who thought, "in their wisdom," that they
could control the price level better than the Bank of England or the Federal Reserve. These advocates' advocacy of a managed currency made them archetypal hard-money advocates...

Money doctors between the wars 67

Keynes nurtured a close relationship with the Hamburg financier Carl Melchior throughout the post-Versailles hiatus, and like-minded German industrialists subsidized the influential Manchester Guardian Commercial Supplement in which the Cambridge economist purported to present a neutral analysis of European stabilization issues. Keynes found himself drawn into the vortex of laissez faire when Melchior's shipping friend Wilhelm Cuno of Hapag became chancellor of the Reich. In November 1922 the Reich government cast about for a mechanism to head off a declaration of default by the Reparations Commission. It decided to invite seven "independent financial experts," including Keynes and Cassel, to make recommendations for stabilizing the Mark. Arriving in the German capital early, Keynes advanced his own ideas in finished form while his fellow experts were still engaged in "preliminary malleability." He persuaded the majority to support a two-year reparations moratorium as a precondition to thorough-going monetary reform, just as the host government desired.

In June 1923 Keynes again rode to the rescue. This time he visited Berlin surreptitiously and worked with Cuno, Melchior, and Foreign Ministry officials preparing a crucial German reparations note. Then he scurried back to London to praise his own handbook in The Times and Guardian. The alternative to the Cuno offer, he warned, would be a reign of tribute and rape extracted by France, "as the Goths did in the fifth century." It is hard to imagine that Keynes failed to catch on to indications that the Reich government had mastered the hyperinflation as a matter of national policy. After all, Cuno did not mince his words about sterilization in private conversation with his Hamburg friends. Shortly afterward he confessed: "If the reproach was made that we didn't get our tax system in order, well naturally our wish had been to solve the repairation problem first and the tax problem only afterward." What satisfaction did Keynes derive from his German ventures? He kept his pulse on exchange rates and used this knowledge to advise a British textile firm as well as to negotiate for King's College and on his own account, but those were secondary gains. Mostly one can speculate, he acted for the narcisistic gratification of pulling the strings behind the scenes and advancing a political cause in which he believed.

Rather more prosaically, a number of academic economists in the United States turned their expertise to the modernization and reform of monetary conditions annual. Professor Edwin W. Kemmerer of Princeton figured as the most prominent of his cohort. Other foreign advisors, including W.W. Cumberland, John Burke Young, Arthur N. Young, Arthur Millspaugh, and Frank Potter, were either Ph.D. students or close colleagues of Kemmerer (Curti and Birr 1954). Kemmerer obtained his first experience as a money doctor in the Philippines, where he served as currency adviser to the U.S. mission in 1903, shortly after receiving his Ph.D. (Gillauer-Schumate 1948: 359–75). Between 1917 and 1934 Kemmerer led financial missions to seven Andean countries as well as to South Africa, Poland, China, and Turkey— in short, to an assortment of nations that lay in the U.S. sphere of influence or disdained potentially humiliating advice from the League. Although Kemmerer, along with Joseph Davis of Harvard, won public plaudits advising the Davies Committee on German currency reform, he specialized in the transfer of American expertise to developing countries. Indeed, Emily and Norman Rosenberg portray the Kemmerer missions as rubber-glove colonialism, suitably repackaged for liberal sensibilities (Rosenberg 1999: 59–83). While not wholly of the mark, that interpretation does less than justice to third-world business notables who embraced modernization as a way to leverage economic growth on their own initiative. In any event, Kemmerer preached the same type of orthodox reform program advocated by the Brussels Conference and applied by the League Financial Committee. He cast that program, however, as part and parcel of a more ambitious modernization project. He advocated balanced budgets, scientific collection of taxes, the elimination of corruption and subsidies, the equilibration of exports and imports, and, most important of all, the creation of an independent central bank as a stepping-stone in adoption of a currency linked to gold.

Kemmerer habitually arrived on site with a team including accountants, customs specialists, and men skilled in public administration and finance. He marketed a style of modernization that appealed to local elites who favored an open, export-oriented economy, and in that way pioneered the "ownership" adjustment programs that would become best practice at the IMF half a century later. At the same time, Kemmerer missions provided a stamp of approval to reassure potential U.S. investors. Although the relationship remained secret, Kemmerer accepted an annual retainer from Dillon, Read & Co. from 1924 onward (conflict-of-interest standards were less rigorous then than they have since become). Notwithstanding the efforts of the Kemmerer teams to maintain academic independence, State Department officials feared by the later 1920s that the publicity attending his missions often facilitated irresponsible borrowing for unproductive purposes (Rosenberg 1999: 155–65). As it turned out, without deep structural and social change in borrowing countries, the Kemmerer reforms tended not to stick. Like IMF programs in a later era, they signaled the creditworthiness of borrowers, but they provided no guarantee of sustainability if commodity prices turned down or political preferences changed (Drahé 1994: 128).

Conclusion: disintegration of the reconstructed order

The Great Depression swept away the financial edifice laboriously reconstructed in the 1920s. The gold-exchange standard collapsed, increasingly economies began to question the expediency of restoring it. In the United States, France,
and even in England, the respective Treasuries acquired increased leverage at the expense of central banks. In the United States, the Glass–Steagall Act of 1933 worked in tandem with the explosion of capital markets to undermine the functions and prerogatives of private investment banks. There was “no business doing” either in New York or London, lamented J.P. Morgan disconsolately as late as 1938.14 The Latin American nations that Kemmerer had advised used the excuse of falling commodity prices to suspend his reforms, even though some of those same nations experienced an unprecedented industrial boom (Diaz Almagro 1983: 3–40). Certain independent financial advisors, for example Arthur Young in China, continued to find employment, but New Deal silver policy undercut whatever wisdom. Young could dispense on the spot (Young 1935). In short, the Depression decade offered little scope for the miniaturizations of money doctors, even in the major countries.

Bretton proved a notable exception to the rule. The British Treasury rejected the novel reflationary idea of Keynes, yet it relied heavily on other economic expertise in crafting its recovery strategy of balanced budgets and easy money. The Bank of England attracted its purview not only to advise Commonwealth central banks but also to foster financial rehabilitation at firm level through its Securities Management Trust.49 Elsewhere, populist governments of every stripe created suspicions of the ideology and cultural assumptions embraced by money doctors even when they had to call upon their carefully circumscribed expertise. Franklin D. Roosevelt crafted his bombshell message denouncing the “old failure of so-called international bankers” and torpedoing stabilization at the 1933 World Economic Conference without advice from anyone except his point person neighbor, the gentleman apple grower Henry Morgenthau. Declaring that the bankers had “foolish” him over abandoning gold, he turned the next four to five per cent level of agricultural unemployment, George Warren, far counsel on devaluation. The country was in “agricultural revolution,” he maintained; it could stand losing its bonds in the countries and farmers. Where Undersecretary of the Treasury Acheson snorted that “no reputable economist agreed with the milk farmer who was proposing this,” Roosevelt delightedly appropriated the slogan: “the program of a milk farmer.”40

Economic policymaking in Germany and France also reflected philosophical levels at times. Reichsbank President Hjalmar Schacht insisted that Hitler had one idea about finance and a very good one indeed: “It was, leave it to Schacht.”41 In fact, although Hitler lacked the time to read Keynes and Cassel, he repudiated liberal economics and talked of overcoming “a monetary system already attacked by Moses and Christ.” He aimed somewhat vaguely at a full-employment socialist economy deriving its innermost essence from a new “material understanding” and “ethical orientation,” in the management of money and credit in other spheres. He would employ Schacht as long as he proved useful to maintain the plausibility of the Deutsche Mark abroad; after that “the bonds would have done their duty.”42 The French Popular Front also created a rebellious universe for removed from Brussels Conference ground rules. The valuable methodological orator Vincent Auriol, finance minister in 1936, envisaged a simple solution to an imbalance in French external accounts: “Les banques, je les ferme; les banquiers, je les enferme.”43 For good measure, Auriol ordered a telephone tap to monitor conversations at the Banque de France.44 The civil servant at the Finance Ministry who executed Auriol’s orders concurred privately that “the financial aspects of the government’s plan are completely subordinated to their social ideas.”45 The measures taken did not increase government creditworthiness, and three devaluations followed within the next two years, leading to rumors of foreign machinations among those already conspiracy-minded. The precepts of the 1920 Brussels Conference had little appeal in a world suffering from mass unemployment, the simplicity of world trade, capital controls, competitive currency devaluations, and premonitions of a new way to come.

Significantly, the default experience of the major creditors in the 1930s, as contemporary analysts recognized, depended mostly on the geographical distribution of their assets. Systemic default in Central and Eastern Europe, China, and Latin America took place in part for political reasons. Countries in the British Commonwealth suffered from the same economic lib as comparatively situated nations elsewhere. All the same, they avoided default. In 1935 London Stock Exchange loans issued seven years earlier for Empire governments stood on average at 119 per cent of par, loans for corporations at 118 per cent of par, and even loans for commodity producers at 84 per cent of initial value.46 Obviously the Dominions that dominated an export surplus with Great Britain helped preserve export markets by maintaining a reputation as good borrowers. But it is too simple to say that those borrowers credibly weighed the pecuniary advantages against the costs of delinquency. The imperial visionaries who crafted the Ottawa Agreements of 1932 saw preferential tariff arrangements as a first step toward the broader coordination of trade, migration, and capital movement. The bankers and industrialists who managed the system mutually shared schooling, training, and moral assumptions (Drummond 1972: 17–120). The multiple linkages of interest and sentiment that bound the Commonwealth together evidently militated against interruptions of debt service on grounds of political expediency. Common values proved a more durable tie than the technical stipulations of the money doctors.

In summary, few interwar money doctors, individual or institutional, registered a lasting success. But it does not follow that their failures derived from unanticipated theory or inadequate technique. Money doctors always figures as a complex enterprise. It requires political as well as economic judgment. IMF money doctors of the current day have access to better statistics and more elaborate econometric models than did their interwar predecessors. Yet they too must wield their way among conflicting political pressures. Money doctrine, like skilful landscape architecture, requires vision and plumbing, but also ongoing attention to detail and a modicum of luck. A perfect storm can devastate the most artfully designed constructions. To put this another way, the outcome of any macroeconomic stabilization program depends on the specific structure of the economy and the prospects for political accommodation within the target society.
It has become fashionable nowadays for economists to blame the breakdown of the world economy in 1929-33 on the purported rigidities of the gold-standard system. The perspective of contemporaries rested on closer acquaintance with the political consequences that underlay the monetary regime. "The gold standard is sound policy," Leopold wrote in his contacts on the Court of the Bank of England in 1929, "but it is not an insurance policy against all the ills the body politic is heir to."23 The Great Depression brought about a change in political sensibilities that 21st-century economists take virtually for granted. The old model, Eichengreen and Jiménez remind us, hypothesized that "extremely expansive monetary and fiscal policies were widespread problems. Inflation created chronically overvalued currencies and, with incomplete liberalization of capital markets, limited the ability of central banks and governments to borrow.24 Enter the money doctors.

In the second-generation model in which current practitioners adhere, central banks and governments are assumed to "maximize a welfare function" in which "domestic variables like output, employment, and the stability of the banking system" outweigh the commitment to any exchange-rate peg. As Eichengreen and Jiménez explain the situation in the value-neutral dictum characteristic of the profession today, "the government may be prepared to pay the cost of opting out of its exchange-rate commitment when a high level of joblessness increases the urgency it attaches to the pursuit of reflationary measures." What's more, heightened devaluation expectations under those circumstances can add a devaluation premium to interest rates. An external shock has feedback effects on both unemployment and currency stability: The quantitative data indicate that this is precisely what happened in England in 1933.25 The promises of bankers from the 1920s about "honest money" have only limited applicability in such a brave new world. That is why the proponents of the IMF began talking from the outset about altering the burdens of structural adjustment fairly between debtor and creditor nations (Janes 1996: 27-34, 329-446). Who adjusts, how, and how much becomes a function of political bargaining.

Notes

3. Kindleberger (1978); Cassis (1975); Keynes (1984-95, vols. 2 and 3).
7. Lachapelle (1952); Netter (1954); Arthur Raffel, who played a central role in the transformation of the system, was also one of the most influential figures in the French-Russo sphere. Compare the discussion in Guespar and Raffel (1931) and Prieur's assessment in Chapter 1 of this volume. (Raffel is published in French.)
10. See Momm (1978); Suhr (1987); Duchêne (1984); Rostow (1953); Schuschnig (1955); Schorsky (1976); Bock (1980); Case and Case (1982); L. Chandler (1984); Jones (1984); Lamont (1984); Chinn (1985, 1993); Bok (1989); Ferrini Brasco (1996); Schorsky (1984); 124-6. The author thanks J.P. Morgan for providing evidence from the Frank Abakos Papers, Sterling Library, Yale University, showing Alschuler's patronage of the 1923 plan to support the franc.
14. Bloomfield (1950); Triffin (1961); Lindblad (1984); Bordo and Eichengreen (1986).
19. Wurzburg to Baud, 22 May 1920, Box 22, Robert Brand Papers, Bodleian Library, Oxford.
24. See the post-1945 doctrine of local "ownership" of structural adjustment programs, see Chapter 3.
27. L. Chandler (1960); Clarke (1967).
31. L. Chandler (1958: 427-79); Clarke (1967: 448-49), and, especially, on Norman's trip to New York, Charles Harris Diary, 4-6 Feb. 1929, Box 16, Harris Papers, Library of Congress.
32. Clay (1955); Bok (1967).
34. Strong to Norman, 14 July 1922, Benjamin Strong Papers, FRINY.
43. For an explicit acknowledgement of this fact, see Strong to Morrow, 19 Oct. 1927, Benjamin Strong Papers, FRINY.
47. Gurri (1992: 34).

Money doctors between the wars
References


Money decimals between the tests

Ferroux, G. (1909) La crise internationale, Paris: Collectif CEDAM.