PRINCETON STUDIES IN INTERNATIONAL FINANCE NO. 33

The Reconstruction of the International Monetary System: The Attempts of 1922 and 1933

Stephen V. O. Clarke

INTERNATIONAL FINANCE SECTION
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The author, Stephen V. O. Clarke, is Chief of the Foreign Research Division of the Federal Reserve Bank of New York. He is the author of a monograph on *Central Bank Cooperation: 1924–31*, published in 1967, and of various other studies on United States and foreign monetary problems. The present study was prepared for the Paris meeting of the French Economic History Association in October 1973.

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PETER B. KENEN
Director

Princeton University

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CONTENTS

LIST OF CHARTS

I. INTRODUCTION

The current worldwide effort to rebuild the international monetary system is the latest in a series that extends back at least to the early 1920's. Indeed, in the past half-century there has seldom been a year when the authorities somewhere were not concerned in greater or lesser degree with the strengthening, if not the reconstruction, of that system. Many of these efforts have been bilateral or have involved only a relatively few countries, for example, the stabilizations of various European currencies in the mid-twenties, the establishment of the British-French-United States stabilization arrangement in 1936, and the negotiation of the reciprocal credit facilities among central banks in the sixties. Others have involved multilateral negotiations among a somewhat larger group of industrial countries, for example, those that led to the establishment of the General Arrangements to Borrow in 1962. On yet other occasions negotiations have been undertaken on a virtually worldwide basis: at Genoa in 1922, London in 1933, Bretton Woods in 1944, and in connection with the establishment of the Special Drawing Rights facility in the late sixties.

An examination of all these efforts would doubtless be profitable, but the character of the current negotiations, together with limitations of time and space, suggests that the worldwide group is the most rewarding to study. Within that group a further narrowing of the field is suggested because the United States was clearly dominant at Bretton Woods and because the SDR negotiations were concerned primarily with international liquidity. In contrast, the current negotiations involve a number of strong countries, none of which is dominant, as well as the whole gamut of international monetary issues. In this respect, the current efforts are broadly similar to the negotiations of 1922 and 1933.

In writing this paper I have benefited from the suggestions of numerous colleagues and friends, especially Charles Kindleberger, Herman Krooss, James Moore, Richard Sayers, and Gregory Schmid. Although they have saved me from various errors of fact and interpretation, the responsibility for any faults that remain is of course my own. Needless to say the views expressed in this paper are solely those of the author and not of the Federal Reserve Bank of New York. I also wish to express my appreciation for the painstaking research assistance of Gwendolyn P. Webb.

Although both the Genoa and London conferences must be classed as failures, the records of the negotiations and the memoirs of participants provide a fascinating account of the interaction between economic developments and international monetary thought. At Genoa the traditional gold-standard view, as formulated by British thinkers, was accepted almost without question. Eleven years later this view was championed primarily by the French and other Continental Europeans but was rejected in practice by the United States, Britain, and the countries that were to comprise the sterling area. With this shift in monetary views came two other crucial changes. At Genoa the aim was a unified monetary system based on parities fixed in terms of gold—a system in which domestic economies would have to adjust in order to maintain international equilibrium. By 1933 only the inflation-scarred Continental Europeans were clinging to the traditional order of priorities, while Britain and the United States gave domestic recovery precedence over external stability. The further outcome of London was to accelerate international monetary disintegration, with the sterling area, the European gold bloc, and the United States each dealing as best it could with its special regional problems.

The records also emphasize the inextricable entanglement of international monetary reconstruction with other economic and political issues. In both 1922 and 1933, proposals for monetary reconstruction had especially profound and—more important—conflicting implications, not only for the trade policies and domestic economic prospects of the participating countries but also for their security. Proposals that were regarded by some countries as serving their policy aims were regarded by others as injurious. The clash of interests was evident in 1922 when a combination of security considerations and domestic financial needs stopped France from modifying its reparation claims in order to establish a basis for the exchange stabilization that all agreed was desirable. The clash was evident again in 1933 when fears of a setback to domestic recovery led the United States to torpedo temporary stabilization arrangements that it had previously favored.

Indeed, the overwhelming impression given by the records of the two conferences is that monetary reconstruction is dominated, if not overwhelmed, by higher-priority national policies. An international monetary system, if such an entity can be said to exist at all, consists of arrangements for the provision of liquidity, for the convertibility of currencies into each other and into reserve assets, and for the adjustment of imbalances through exchange-rate changes and other measures. To be meaningful such arrangements must surely be expected to endure—they are long-term in nature. On the other hand, the pressures that are brought to bear on the decision-makers at international conferences are overwhelmingly short-term in nature. Technical advisers may take a long-term view, but political leaders can ignore the short-term pressures only at their peril. The timing of negotiations is therefore crucial. Proposals that are rejected as excessively risky or costly in a depression may well be acceptable in prosperity or when previous difficulties have convinced political leaders that there is no satisfactory alternative. As events actually developed in 1922 and 1933, short-term political pressures killed numerous promising proposals for which the time became ripe only later.

II. THE NEGOTIATIONS OF 1922

In 1922 the background for international monetary reconstruction was hardly promising. Only three and a half years after the end of World War I, Europe's needs for food, raw materials, and capital goods for reconstruction were still well in excess of output. Throughout most of Western Europe, industrial and agricultural production was well below the 1913 level.[1] The significant prewar trade with Russia had dried up in the wake of the 1917 revolution.[2] The United States had sharply reduced, then stopped, official lending to the European Allies soon after the Armistice, had rejected both the Versailles Treaty and membership in the League of Nations, and, while insisting on the settlement of war debts, complicated their repayment by sharply increasing tariffs.[3] For their part, the European victors insisted that Germany should pay reparations that would, in effect, finance both reconstruction and war-debts payments to the United States, among other things.[4] On this basis, France proceeded to restore its devastated territories, financing the work through internal borrowing that it expected to repay out of reparations.[5] At the same time, the victors attempted to squeeze reparations from Germany, whose government was weak, whose population resented the burdens imposed by the treaty, and whose economy was in the throes of an inflation that was destroying the currency. During the two years ending January 1922, the mark depreciated almost 70 per cent to a value equivalent to 2 per cent of its 1913 gold parity. Other major European currencies were also unpegged from gold and, as Chart 1 shows, generally fluctuated in sympathy with the mark, although they depreciated less than the German currency. Of the major countries, only the United States still adhered to the gold standard.

The early 1920's witnessed a succession of international conferences

[1] Svennilson, 1954, pp. 18, 233, 246, 304.

[2] League of Nations, 1925, pp. 42, 115, 132, 346.

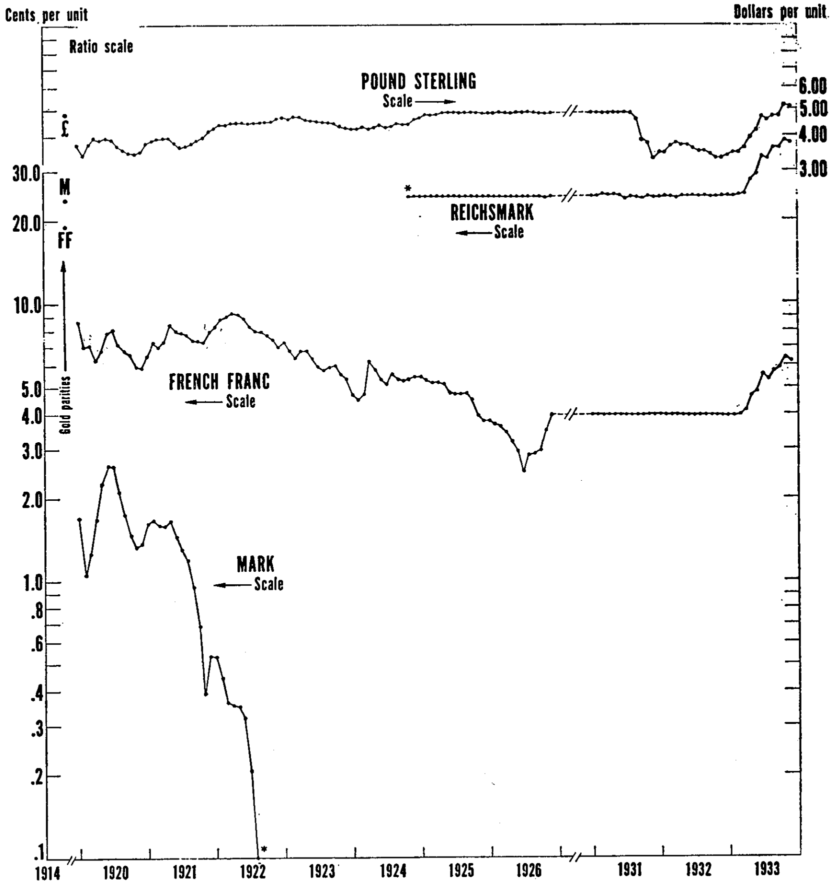
[3] Studenski and Krooss, 1963, pp. 339–342.

[4] Bergmann, 1927, Chap. 2; Balfour Note of Aug. 1, 1922, reprinted in *Foreign Relations of the United States 1922*, Vol. 1, Washington, D.C., 1938 (cited hereafter as *Foreign Relations 1922*), pp. 406–409; and Felix, 1971, pp. 38–40, 154–155.

[5] Wolfe, 1951, pp. 29–30.

Chart I

FOREIGN EXCHANGE RATES IN NEW YORK JUNE, 1914 AND SELECTED YEARS 1920-1933



Note: Monthly averages of daily market buying rates in New York at noon for cable transfers.

* The monthly average of daily rates for the mark dropped below 0.1 cents in August 1922. In the fall of 1923, the rate was stabilized at 1 trillion marks = 23.8 cents. In October 1924, the old currency was replaced by the reichsmark whose parity in terms of gold was established at the equivalent of 23.82 cents.

Source: Board of Governors of the Federal Reserve System, Banking and Monetary Statistics (Washington D.C., November 1943).

convened to grapple with Europe's difficulties. Of these, the one held at Genoa between April 10 and May 19, 1922, was perhaps the most notable. Some thirty-four countries—mostly European—attended. Germany and Russia were invited on a basis of equality with the other major powers for the first time since the war. In addition, the United States was invited, and at an early stage there were some hopes that it would attend.[6] For Britain and France, the main sponsoring powers, international monetary reconstruction was only one among the conference's several aims, probably not even among the most important. More fundamental was the need to restore the prosperity of Central and Eastern Europe and so provide the basis for a re-expansion of international trade.[7] This need was felt most keenly by Britain, whose economy, after the hectic postwar boom of 1920, had collapsed into depression during 1921. During the latter year, British industrial production was only 81 per cent of the 1913 level, the volume of its exports only half the prewar amount, while unemployment totaled 13 per cent of the labor force.[8] Trade with the shattered economies of Central and Eastern Europe was especially depressed.[9] Britain's urgent need to restore this trade provided the major impetus for the conference.

Britain's broad strategy in pressing for the conference is clear. Diplomatic and trade relations with the Soviet government—theretofore regarded as a pariah—would be established.[10] The basis for German economic reconstruction would be provided by revised reparation arrangements—possibly a reduction of periodic payments or even a temporary moratorium accompanied by an international loan—that would facilitate the stabilization of the mark. It was hoped that the United States would cooperate by scaling down its war-debt claims and by supporting a loan for Germany.[11] With intergovernmental debts settled and the prospect for a revival of trade brightened, the basis

[6] *Foreign Relations 1922*, pp. 384–388. See also D'Abernon, 1929, p. 268, and letter of Feb. 18, 1922, from Benjamin Strong, Governor of the Federal Reserve Bank of New York, to Montagu Norman, Governor of the Bank of England. (The Strong/Norman correspondence is in Strong, 1922.)

[7] "Résolution adoptée par la Conférence de Cannes, 6 janvier 1922," in *Documents Diplomatiques*, 1922, pp. 15–16.

[8] *The British Economy: Key Statistics 1900–1966*, pp. 5, 8, 14.

[9] Board of Trade, 1937, pp. 354–357, and League of Nations, 1925, pp. 345–347.

[10] Owen, 1955, pp. 610–621.

[11] "Plan for a Financial Settlement," Memorandum on German Reparations enclosed in letter of Jan. 25, 1922, from Basil Blackett to Benjamin Strong, and Norman's letter to Strong, Mar. 22, 1922, p. 3 (Strong, 1922).

would be laid for a stabilization of Europe's currencies and a return to the gold standard.[12]

The chances that this scenario would work out were never bright and, as events developed, nearly all the hopes for the conference were dashed. In extending their invitation to Russia, the sponsoring powers had stipulated that diplomatic recognition would be granted only if the Soviet regime, among other things, accepted responsibility for the foreign debt of the overthrown imperial government.[13] This condition was especially important to France, whose investors held some $2 billion equivalent of imperial obligations.[14] Confronted with these claims, however, the Soviet delegation to the conference had the bad taste to make huge counterclaims on account of damages arising from Allied assistance to White Russian counterrevolutionaries.[15] On this score the negotiations broke down amid mutual recriminations.

The prospect for a scaling down of reparations and war debts also suffered heavy blows. In France the government of the conciliatory Aristide Briand fell in January 1922.[16] Raymond Poincaré, the new premier, was skeptical about the usefulness of the conference and agreed to his government's participation only on the condition that the agenda exclude any discussion of changes in France's rights under the Versailles Treaty and especially in its reparation claims under the schedule accepted by Germany in May 1921.[17] In the United States the funding commission, established in February 1922 to negotiate the repayment of war debts, was specifically denied authority to make any reduction in the amount outstanding.[18] Beyond this, the United States refused to be represented officially at the conference, ostensibly because it dealt with European political questions in which America

[12] Norman letter to Strong, Mar. 21, 1922.

[13] "Résolution adoptée par la Conférence de Cannes, 6 janvier 1922," in *Documents Diplomatiques*, 1922, pp. 15–16.

[14] Dulles, 1929, pp. 72–73.

[15] "The Genoa Conference: A Month of Crisis," *Current History*, 16 (June 1922), pp. 479–480, and Mills, 1922, p. 182. See also *Papers Relating to International Economic Conference*, 1924, p. 44.

[16] *The Economist*, 94 (Jan. 14, 1922), p. 39.

[17] "Premières instructions au Président de la Délégation française à la Conférence de Gênes, 6 avril," in *Documents Diplomatiques*, 1922, p. 48.

[18] Public Law No. 139, 67th Cong., Feb. 9, 1922.

did not care to become involved.[19] In fact, the United States wished to avoid any imbroglio either with the Soviet regime, to which it had not extended diplomatic recognition, or with the allies over the question of scaling down reparations and war debts.[20]

Perhaps the most sensational blow—one that almost broke up the conference—was the signing on April 16, 1922, of the Treaty of Rapallo between Germany and Russia. Efforts by the signatories to pass off the treaty as an instrument that would merely restore ordinary diplomatic and trade relations failed to assuage the surprise and outrage of Britain and France. In renouncing various financial claims against each other, Germany and Russia undermined such hopes as the Allies still retained for repayment of the Czarist foreign debt. More serious, the signing of the treaty was accompanied by an intensification of secret military cooperation between the two countries that, so far as it related to Germany, clearly violated the aims of the Versailles Treaty. Rumors about this cooperation, which began to circulate soon after the treaty was announced, conjured visions—eventually realized—of an alliance between the two outcasts that threatened the security of Western Europe generally and France in particular.[21] Thereafter, France's fears for its security overwhelmed its desire for monetary stability.[22]

Hope for a Reparation Settlement

As the date for the Genoa conference approached, however, most of these developments were still in the future. In London, New York, and even in Paris there was still hope for new reparation arrangements that would provide a basis for European currency stabilization. These persisting hopes centered on a decision of the Reparation Commission in early April to appoint a committee of bankers to explore the terms

19 Secretary of State to the Italian Ambassador, Mar. 8, 1922, in *Foreign Relations 1922*, pp. 392–394.

20 Letter from Strong to Norman, Feb. 18, 1922 (Strong, 1922).

21 Eyck, 1962, pp. 221–224; Hallgarten, 1949; Wheeler-Bennett, 1936, p. 293; Owen, 1955, pp. 615–616; Hajo Holborn, "Diplomats and Diplomacy in the Early Weimar Republic," in Craig and Gilbert, 1963, p. 169; *Current History*, 16 (June 1922), pp. 452–453, 480–486.

22 Harold Nicolson (1937, p. 241) writes: "It is impossible to resist the impression that M. Poincaré, from the day he succeeded to office, was determined to occupy the Ruhr and to obtain French security by force."

and conditions for an international loan for Germany.[23] This decision followed repeated appeals from Germany that it was unable to fulfill the May 1921 reparation schedule and the granting by the Commission of a partial reparation moratorium in January 1922.[24] In these circumstances the loan proposal had a broad appeal. By facilitating the stabilization of the mark, the loan would help end inflation in Germany and start that country on the road to economic recovery. Germany's long-term ability to meet reasonable reparation claims would thus be strengthened. In addition, the loan proposal had the short-term attraction that a substantial part of the proceeds was expected to be transferred to France, where it would contribute to the financing of reconstruction. France therefore approved the proposal subject to the somewhat ambiguous proviso that, in making its report, the bankers' committee should particularly take into account Germany's obligation under the May 1921 reparation schedule.

For Britain and for the unofficial American delegates to the Reparation Commission who favored the loan, the crucial question was whether the lure of an immediate cash payment might induce France to ease its reparation policy. Cabling the State Department, R. W. Boyden, one of the United States delegates, explained that the Reparation Commission's action in appointing the bankers' committee was:

> really serious constructive effort to get reparations and all German obligations on business basis. Effect hampered slightly for present by restricting Commission on demand French Delegate to existing requirements Treaty and Schedule of Payments, but this restriction will disappear if Committee finds, which seems unavoidable, that even small loans impossible while requirements upon Germany remain unchanged. We therefore regard project as opportunity for world financial opinion express itself effectively with great possibility beneficent result. Should hope final result to be recognition of fact that Germany cannot pay what she is capable of paying until total obligation brought within limit her capacity. I am sure this purpose in minds all delegates except French,

[23] The resolution of the Reparation Commission is reproduced in a letter of April 6, 1922, to Strong from James A. Logan, Jr., Assistant Unofficial U.S. Delegate to the Reparation Commission (Strong, 1922).

[24] "Décision de la commission des réparations accordant un délai provisoire au gouvernement allemand pour le payement des échéances du 15 janvier et du 15 février 1922, en vertu de l'état des payements," in *Documents Relatif aux Réparations*, 1922, pp. 185–186, and Bergmann, 1927, p. 114.

and even he also certain French Government officials give hints of possibility change French policy if supported by assurance or hope of substantial payments cash thru medium such loan.[25]

Thus, while the conference was proceeding in Genoa, members of the Reparation Commission conducted parallel discussions, approaching interested governments about the loan and searching for candidates to serve on the bankers' committee. Soundings in Paris in mid-April seemed hopeful. French Treasury officials did not discourage the impression that their government might consider a reduction in reparations in order to meet the conditions for an international loan to Germany that would provide substantial and urgently needed financial resources for France.[26] By late April a distinguished committee had been picked, including Sir Robert Kindersley, a director of the Bank of England, Charles Sergent, president of a Paris commercial bank and formerly a deputy governor of the Bank of France, and J. P. Morgan from the New York financial community.[27] Viewing the prospects for floating such a loan in New York, Benjamin Strong, Governor of the Federal Reserve Bank of New York, commented:

> If undertaken fairly promptly, I think a large amount could be raised, but I do not think it could be raised unless the country was satisfied, on the one hand, that reparation exactions did not exceed capacity to pay, and, on the other hand, that the German Government was running its affairs on a really business basis, which I am very sure they are not doing; the only doubt in my mind being whether it is wilful and deliberate, or ignorant and stupid. . . .
>
> As to the German loan itself[:] it should be offered in England and France, and possibly some other countries, as well as here. That gives a certain assurance that the "buck" is not being passed to us. It is, in my opinion, absolutely essential that a considerable amount of the proceeds (how much must be determined at the time) should be allowed for actual work of reconstruction of the German economic structure, rather than paid over in toto to the reparation beneficiaries.[28]

As the Genoa conference drew to a close, the first meeting of the bankers' committee was scheduled for May 24 and, at least to the

[25] Quoted in a letter from Logan to Strong, Apr. 6, 1922 (Strong, 1922).

[26] Logan letter to Strong, Apr. 15, 1922, p. 2.

[27] Logan letter to Strong, Apr. 14, 1922, and Strong letter to Logan, Apr. 24, 1922.

[28] Strong letters to Logan, Apr. 24 and May 15, 1922.

financiers concerned, the prospects seemed favorable that a substantial loan could be floated and a beginning made toward European stabilization.[29]

The International Monetary Proposals of 1922

These loan negotiations were going forward at about the same time that the international monetary proposals, for which the Genoa conference is usually remembered, were being considered. The proposals originated in Britain, which then occupied the center of the international monetary arena virtually unchallenged. The recognized and predominant international financial center of the era before 1914, Britain was still a major power; the extent to which its basic position had been weakened during World War I was not yet apparent. Germany and France were deeply preoccupied with domestic financial difficulties. The withdrawal of the United States into isolation under the Harding administration meant that, at this stage, America influenced international monetary reconstruction primarily through central and private banking channels. In these circumstances, the leading role was taken, almost as of right, by the British.

Drawing on prewar experience, the British authorities had formulated their views of the desirable international monetary system long before the conference assembled at Genoa. As early as January 1918, the Government had appointed a Committee on Currency and Foreign Exchanges after the War, chaired by the then Governor of the Bank of England, Lord Cunliffe. In an interim report[30] published in August of the same year, the committee presented a classical description of what its authors took to be the working of the pre-1914 gold standard. The report is relevant for this study because its international monetary model was in many respects the one that was accepted by virtually everyone at Genoa and even eleven years later by the Continental European countries that participated in the London conference. It was, of course, a system in which the parities of currencies were assumed to be permanently fixed in terms of gold and in which gold movements associated with payment imbalances brought equilibrating adjustments in domestic interest rates, wages, prices, and

[29] Logan letters to Strong, May 5, 1922, pp. 2–3; May 26, 1922, pp. 1, 4; and June 2, 1922, pp. 2–3. See also *The Economist* 94 (May 13, 1922), p. 890.

[30] Reprinted in Kirkaldy, 1921, pp. 438–455.

spending. The conception was of a unified world in which the component national economies adjusted in order to maintain international monetary stability. Not only was this view accepted without dissent by the committee, but its members conducted their discussions *on the assumption* that sterling would eventually be stabilized at its prewar parity equivalent to $4.86.[31]

The means by which the Cunliffe committee proposed to restore the gold standard are also relevant. Basically, the key to success was felt to be the drastic reduction of government influence on the operation of market forces. In the 1918 setting this meant the ending of policies that harnessed finance to the winning of the war, particularly (1) the cessation of government borrowing, especially from the banking system, (2) "the repayment of a large portion of the enormous amount" of bank-held government debt, and (3) the re-establishment of the Bank of England's freedom to use its discount rate to deal with movements in its gold reserves. In addition, the committee suggested a variety of gold economy measures: the ending of the circulation of gold coin; the centralization of gold with the Bank of England; the acquisition of gold coin and bullion for export by the public only from the Bank of England. By providing that gold be used primarily for international settlements, the committee hoped to increase the scope within which the authorities could administer the gold standard.

These recommendations formed the basis for the international monetary views supported by the British at Genoa and were to a large extent reflected in the proposals eventually adopted by the conference. In the monetary sphere, the British came to Genoa well prepared. Well in advance of the conference, a draft of the proposals had been composed by British monetary specialists—among whom Ralph G. Hawtrey, then of the Treasury, was prominent.[32] This draft was circulated to interested authorities abroad toward the end of February 1922.[33] Toward the end of March, experts from Belgium, France, Italy, and Japan, as well as from Britain, met in London to discuss and slightly modify the British proposals.[34] Thereafter, the Allied experts' draft was again slightly amended and adopted by the Financial Commission

[31] Moggridge, 1972, p. 18.

[32] Clay, 1957, pp. 137–138.

[33] Norman letter to Strong, Feb. 23, 1922.

[34] Norman letter to Strong, Mar. 29, 1922. The experts' draft is published as part of Document No. 5 in *Documents Diplomatiques*, 1922.