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## *Financial Crises and Lenders of Last Resort: Policy in the Crises of 1920 and 1929\**

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Professor Kindleberger's recent discussion of the possible rules for a lender of last resort in the international economy in *Manias, Panics and Crashes*<sup>1</sup> is in many respects a distillation of an established tradition in the literature. The *locus classicus* for modern discussion, which itself turned an inter-war conventional view<sup>2</sup> into a traditional view, was W A Brown's monumental *The International Gold Standard Reinterpreted 1914-1934*.<sup>3</sup> In his two volumes, Brown suggested that the pre-war international monetary system worked relatively smoothly because it was dominated by one centre, which was the main clearing house for credit and commo-

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\* I should like to thank Susan Howson, participants at the May 1979 Bad Homburg Colloquium on Financial Crises and the Lender of Last Resort sponsored by the Maison de Science de l'Homme and the Werner-Reimers-Stiftung and the May 1979 meeting of the U. K. Social Science Research Council's Monetary History Group for comments on earlier drafts. The Social Sciences and Humanities Research Council of Canada provided financial support to enable me to participate in both meetings.

<sup>1</sup> New York: Basic Books, 1978.

<sup>2</sup> For an early example of the conventional view, see J. M. KEYNES, *A Treatise on Money* (1930) reprinted as volumes V and VI of *The Collected Writings of John Maynard Keynes*, London: Macmillan, 1972, esp. vol. V, ch. 21v.

<sup>3</sup> New York: National Bureau of Economic Research, 1940.

dity transactions as well as the major source for international lending at both long and short term. He then went on to suggest that one of the major reasons for the fragility and ultimate breakdown of the inter-war gold standard system was the fragmentation of central functions between London and New York, and to a lesser extent Paris, without any compensating co-ordination of policy.

In the course of the 1960's in his writings on the international monetary system, Professor Kindleberger came close to something approaching the Brown position when discussing the role of the United States in the Bretton Woods system.<sup>4</sup> In the years following, he made his affinity with Brown's position quite clear, most notably perhaps in *The World in Depression* where he argued: <sup>5</sup>

The explanation of this book is that the 1929 depression was so wide, so deep and so long because the international economic system was rendered unstable by British inability and United States unwillingness to assume responsibility for stabilising it in three particulars: (a) maintaining a relatively open market for distress goods; (b) providing counter-cyclical long-term lending and (c) discounting in crisis... The world economic system was unstable unless some country stabilised it, as Britain had done in the nineteenth century and up to 1913. In 1929, the British couldn't and the United States wouldn't.

Although this view went somewhat beyond Brown,<sup>6</sup> Kindleberger has now taken it even further. He has taken over from the domestic central banking literature the notion of the lender

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<sup>4</sup> C. P. KINDLEBERGER, *Power and Money: The Economic of International Politics and the Politics of International Economics*, London: Macmillan, 1970, chs. 13 and 14.

<sup>5</sup> London: Allen Lane, 1973, pp. 291-2.

<sup>6</sup> And even at least some of the pre-1914 evidence, in particular that of PETER LINDERT, 'Key Currencies and Gold 1900-1913', *Princeton Studies in International Finance*. No. 24. August 1969. Other recent studies stimulated by Brown or Kindleberger include Susan Strange, *Sterling and British Policy: A Political Study of an International Currency in Decline*, London: Oxford University Press, 1971 and B. M. ROWLAND (ed.), *Balance of Power or Hegemony: The Inter-war Monetary System*, New York: New York University Press, 1976.

of last resort and added it to his conception of the usefulness, in an imperfect world, of hegemonic international monetary arrangements. In this, he is echoing one of the intellectual bases for the Keynes-Henderson plan of 1932.<sup>7</sup> As well, he has argued that in three international crises, those associated with the years 1873, 1920 and 1929, the absence of an international lender of last resort made the crises and their associated slumps more severe than they might otherwise have been.<sup>8</sup>

In what follows, I leave to one side the issue of importance or non-importance of hegemonic international monetary arrangements. This, as the reader shall see is a subsidiary issue in Kindleberger's recent thesis. As well, I have largely ignored 1873. This second omission is not a reflection of Kindleberger's uncertainty as to his case for this crisis.<sup>9</sup> Rather it reflects an historical problem. For 1873 sits oddly with its successor crises in that, as Frank Fetter has pointed out,<sup>10</sup> there was no recognition that any organisation or any country had any particular responsibility for the stability of the international financial system. By contrast, in the crises associated with 1920 and 1929, the recognition of the responsibility, not to mention the willingness to accept it, may not have been as widespread as some think desirable, but at least it existed in influential circles.<sup>11</sup> Moreover, in 1873 it is arguable that in many of the relevant countries there was no agreement on the usefulness or desirability of a national lender of last resort; so that it was hardly likely that an international lender of last

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<sup>7</sup> For a discussion of the origins of the plan, plus its fate, see S. K. HOWSON and D. WINCH, *The Economic Advisory Council 1930-1939: A Study of Economic Advice during Depression and Recovery*, Cambridge: Cambridge University Press, 1977, pp. 114-21. The original Henderson proposals appear on pp. 272-81.

<sup>8</sup> *Manias, Panics and Crashes*, pp. 188, 192, 194.

<sup>9</sup> *Ibid.*, pp. 213-14.

<sup>10</sup> F. W. FETTER, *Development of British Monetary Orthodoxy, 1797-1875*, Cambridge: Harvard University Press, 1965, pp. 255-6.

<sup>11</sup> In 1931, and before, the recognition of the need for some responsibility was primarily English, in both the Bank of England and elsewhere. Even there though, it was better articulated *after* the event.

resort would exist or operate effectively, other than in the historian's wilder imaginings, except as an outcome of market forces or a series of fortunate accidents. In 1920 and 1929 it is more plausible to imagine that matters might have turned out differently.

Even leaving 1873 to one side for the purposes of the present discussion, there is still another problem that raises its head at several points in the course of what follows: what exactly is an international lender of last resort to do in particular cases?

In the case of a domestic lender of last resort, although one might dress the function up with phrases such as 'maintaining the stability of the financial system', historical practice has usually boiled down to maintaining one-to-one convertibility between certain financial assets, most notably national currency and bank (or, more recently near-bank) deposits, with some proviso as to allowing unsound concerns to go under. Internationally 'however, there may, as in 1873, 1920 or 1974-9, be no analogue - no pattern of fixed exchange rates the maintenance of which' as Kindleberger seems to suggest, might be the object of a successful lender's policy. Internationally, the freedom of exchange rates to move will provide some insulation from international events for national economies, which could, in theory at least, make an international lender of last resort less necessary. Exchange rate fluctuations, it is true, *might* produce problems for other economic factors but they might also allow levels of output, employment and prices in individual national markets to remain more stable than they might otherwise be and so reduce the need for a lender of last resort. Indeed, it might be argued that exchange rate flexibility might be preferable to a lender of last resort on the international scene. Of course, as the events of recent years have suggested, even flexible exchange rates *may* need supportive official international lending on a large scale,<sup>12</sup> if the shocks to the

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<sup>12</sup> Of course, if nation states are less than the economist's 'optimal currency area', this consideration applies to other aspects of the discussion, but I leave this to one side in what follows.

system are large and the learning processes of market participants are relatively slow. Even in a fixed exchange rate régime international support could be conditional on exchange rate alterations. Moreover, in the aftermath of major wars the disequilibria may be so large as to require large amounts of reconstruction lending before either fixed or flexible exchange rate systems can work effectively - except as symptoms of despair. All I am trying to suggest is that simple-minded analogies between domestic and international lenders of last resorts may often be misleading.

Lest these remarks seem to be taking me too far from my theme, I would suggest that they are relevant to both inter-war crises discussed by Kindleberger. To tie them in, let me examine events and policies in each of the crises.

#### 1920

Although many of the external trappings of the pre-1914 gold standard survived the First World War and most important countries ended the war with exchange rates relatively close to their pre-war parities, the events of the war years had destroyed many of the elements underlying the pre-war pattern of exchange rates. The war brought marked disparities in inflationary experiences, which in many cases became even greater in the immediate post-war period. In addition, at the end of the war, government finances in the core countries of the international economy were in varying degrees of disarray. By themselves, these factors would have made an early return to exchange stability — not to mention the pre-war pattern of exchange rates desired by many policy makers and expected by many other economic factors — extremely difficult, especially in the post-war social turmoil and revolutionary threats to the existing order. As well, the war had altered many of the 'fundamentals' underlying the old régime. It disrupted pre-war patterns of trade, to the longer term disadvantage of such large pre-war traders as Britain and Germany. Along with the Russian revolution, it had markedly changed the

invisible income positions of many countries as a result of inflation, wartime liquidations, borrowing, seizures and shipping losses. Also, the peace settlement had left the defeated stripped of many remaining assets and liable for a stream of reparation payments whose magnitude was still unknown a year after the end of hostilities. Finally, the collapse of old empires and shifting frontiers — not to mention four years of destruction and neglected wear and tear — had left many countries financially and economically devastated. These problems were most acute in Central and Eastern Europe.

If anything was necessary in this situation, it was an international programme for post-war relief and reconstruction. Beyond some relief in the form of food supplies, much of which was only available on a cash or credit basis, the governments in a position to provide aid made no provision. Several ambitious schemes were in the air in the spring of 1919 and later, but came to nothing. What Allied (and neutral) governments were unwilling to agree to, the private sector could hardly replicate; so the issue went by default and governments and private individuals made the best arrangements they could in the circumstances. Given that the major international creditors immediately after the war were the United States and other non-European countries — Britain was in current account deficit in 1919<sup>13</sup> — Europe covered her immediate post-war deficit by running down existing balances, short and long-term borrowing, and sales of securities as well as moving to eliminate the deficit through exchange depreciation, in the process attracting short-term capital.<sup>14</sup>

Against this backcloth, after a brief post-war breathing space, a short, sharp post-war boom occurred lasting roughly a year. Its origin lay in post-war shortages and supply disruptions in the

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<sup>13</sup> E. V. MORGAN, *Studies in British Financial Policy, 1914-1925*, London: Macmillan, 1951, p. 341.

<sup>14</sup> R. Z. ALIBER, 'Speculation in the Foreign Exchanges: The European Experience', 1919-1926, *Yale Economic Essays*, II (1) 1962, pp. 187-8.

context of a restocking boom, which coincided with the end of wartime controls in most potential supplying countries. In Britain and the States, as elsewhere, the boom was initially fuelled by large government deficits financed by credit creation and easy credit conditions. (In countries outside the United States such as Britain, exchange depreciation also gave price levels an upward twist during the boom, especially given wage indexation, and some of the Anglo-American differences in price experience during the boom reflect this depreciation.)<sup>15</sup> As well, in Britain a sharp upward trend in labour costs came very early in the boom<sup>16</sup> while elsewhere (and later in Britain) money wages followed prices upwards.

As the boom gathered momentum, generating and fulfilling inflationary expectations, the stance of policy began to change, notably in Britain and the United States. In both countries, when the boom began in the spring of 1919 the central government's budget had been heavily in deficit. Sharply falling expenditures coupled with rising revenues brought both budgets into surplus in the last quarter of 1919.<sup>17</sup> These swings into surplus, which continued in 1920, exerted a marked deflationary pressure on aggregate demand. They reflected not only the process of demobilisation but also the beginnings of attempts by the governments concerned to return to budgetary 'normalcy' and to cope with the debts left over from the war. At the same time, the

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<sup>15</sup> *Ibid.*, 197.

<sup>16</sup> J. A. DOWIE, '1919-20 is in Need of Attention', *Economic History Review*, 2nd series, XXVIII (3) 1975.

<sup>17</sup> Nor were the magnitudes involved unimportant for the final result. In the United States, between the fiscal year ending 30 June 1919 and that ending 30 June 1920 federal expenditures fell from \$ 18.4 to \$ 6.4 billion, while revenue rose from \$ 5.1 billion to \$ 6.6 billion. In Britain, comparing calendar 1918 with calendar 1919, central government expenditures fell from £ 2.2 billion to £ 1.4 billion while revenues rose from £ 918 million to £ 1019 million. Sources: U. S. Department of Commerce, *Historical Statistics of the United States: Colonial Times to 1970*, Washington: Bureau of the Census, 1975, series Y335-6; C. H. FEINSTEIN, *National Income, Expenditure and Output of the United Kingdom, 1855-1965*, Cambridge: Cambridge University Press, 1972, table T12.

monetary authorities in the two countries were struggling to gain their independence (or regain it in the case of Britain) and their control over events, most often by argument but on occasion by stealth.<sup>18</sup> By the end of 1919 discount rates had started to move upwards in response to deteriorating central bank reserve positions, which, despite government desires for cheap finance, made some action imperative in both countries.<sup>19</sup> In the early stages the rise in rates was larger in Britain, as was the slowdown in the rate of growth of the monetary aggregates.<sup>20</sup> Thus by the end of 1919 policy had changed markedly from its earlier relative ease. Moreover, Britain and the United States were not the only countries cutting back in 1919.

The post-war boom, which had carried wholesale prices up by 46 per cent in England in thirteen months and 39 per cent in America in fifteen months, broke in the early part of 1920. In the United States if we are to believe the National Bureau, the break came in January and coincided with a sharp rise in Federal Reserve discount rates, which, coupled with a refusal by American banks to continue advances to exporters holding sales proceeds in foreign currencies, produced a sharp fall in European exchange rates.<sup>21</sup> In Britain the turning point came in March,<sup>22</sup> with other countries following. In both Britain and the U.S., the origins of the slump lay in the domestic economy: in Britain export markets did not become unfavourable until

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<sup>18</sup> S. HOWSON, 'The Origins of Dear Money, 1919-20', *Economic History Review*, 2nd series, XXVII (1) 1974, pp. 96, 98.

<sup>19</sup> *Ibid.*, pp. 98-100; E. R. WICKER, *Federal Reserve Monetary Policy, 1917-1933*, New York: Random House, 1967, p. 45.

<sup>20</sup> S. K. HOWSON, *Domestic Monetary Management in Britain, 1919-38*, Cambridge: Cambridge University Press, 1975, pp. 17-18; M. FRIEDMAN and A. J. SCHWARTZ, *A Monetary History of the United States 1867-1960*, Princeton: Princeton University Press, 1963, pp. 229-30.

<sup>21</sup> R. G. HAWTREY, *Monetary Reconstruction*, London: Longmans, 1923, p. 71.

<sup>22</sup> However, the outlook had been uncertain some months before the turn. See HOWSON, *Domestic Monetary Management*, p. 10.

later in the year.<sup>23</sup> In both countries, the upper turning point was followed by a further turn of the monetary screw which carried Bank rate and the New York Federal Reserve discount rate to 7 per cent on 15 April and 1 June respectively. Both rises reflected further reserve stringency.<sup>24</sup> In Britain, the possibility of another rise in rates was discussed during the summer of 1920 but was vetoed by the Chancellor.<sup>25</sup> On both sides of the Atlantic the high rates of the spring of 1920 were to remain in force for a year.

In late 1919 and 1920 some deflation was a deliberate policy goal of the authorities in both Britain and United States. In Britain some of the desire for deflation was a reflection of the policy goal of a return to gold at pre-war par, which became official policy in December 1919, for such a goal required a measure of relative British deflation. However, some of the impetus towards the deliberate use of monetary measures to break the boom came from the view that the consequences of a rate of inflation of 1919-20 proportions (which was higher than that of 1973-5) were in themselves undesirable for society.<sup>26</sup> As well, both the British and American authorities believed that once deflation had started it was desirable to maintain deflationary monetary pressure until the system came to rest at a new equilibrium with lower prices.<sup>27</sup>

The sharp decline in activity that began in 1920 was fairly general internationally, as was the fall in prices. True, some of

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<sup>23</sup> A.C. PIGOU, *Aspects of British Economic History 1918-1925*, London: Macmillan, 1947, pp. 185-6; H.B. LARY and associates, *The United States in the World Economy: The International Transactions of the United States during the Interwar Period*, Washington: Department of Commerce, 1943, p. 142.

<sup>24</sup> HOWSON, *Domestic Monetary Management*, p. 23; L. V. CHANDLER, *Benjamin Strong: Central Banker*, Washington: Brookings, 1958, pp. 183-5.

<sup>25</sup> R. S. SAYERS, *The Bank of England, 1891-1944*, 3 vols., Cambridge: Cambridge University Press, 1976, I, p. 123.

<sup>26</sup> HOWSON, 'The Origins of Dear Money', pp. 100-5. See also S. K. HOWSON, '“A Dear Money Man”?: Keynes on Monetary Policy, 1920', *Economic Journal*, LXXXIII (2) 1973, pp. 456-64.

<sup>27</sup> WICKER, *Federal Reserve*, ch. 3; CHANDLER, *Benjamin Strong*, pp. 69-74; HOWSON, *Domestic Monetary Management*, pp. 28-29.

the countries that were to fall into hyperinflation were to prove exceptions to the rule, as were countries such as Australia, the Netherlands and Sweden.<sup>28</sup> Although exchange rates were flexible, with little direct official intervention even to smooth trends, and did move in some countries to provide some insulation from international deflationary pressures,<sup>29</sup> the range of movement was often constrained by official policies which more often than not were directed at clearing away the financial debris of the war and preparing the ground for a return to fixed parities. In this regard the situation was similar to that of 1873, when, although Britain was the only country on a full gold standard, exchange rate fluctuations were very small. Deflationary pressures were therefore more easily transmitted through current account and capital movements than would otherwise have been the case, notably in the sharp fall in imports into the United States between 1920 and 1921 and the sharp rise in gold movements to the United States.

Despite all that happened during the recession that began early in 1920, it is not clear that a lender of last resort would have had an important role to play. For one thing, the upper turning point was not followed by or accompanied by a financial crisis, although the difficulties of the Japanese silk market have played a role in some accounts of the turning point. Moreover, it is doubtful whether any lender could have encouraged exchange stabilisations at or around 1920 levels — the lure of pre-war par was too strong, as it was to remain later<sup>30</sup> and even the Genoa resolutions on

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<sup>28</sup> A. MADDISON, 'Phases of Capitalist Development', *Banca Nazionale del Lavoro Quarterly Review*, no. 121 (1977), table A5.

<sup>29</sup> M. PALYI, *The Twilight of Gold, 1914-1936: Myths and Realities*, Chicago: Regency 1972, table II-4. An examination of monthly averages of exchange rates on New York for the period suggests that exchange rate movements provided a significant element of insulation in countries pegged to silver, such as China and Mexico, and in Argentina, Brazil, Chile, India, Italy, Norway, Portugal and Spain. Board of Governors of the Federal Reserve System, *Banking and Monetary Statistics, 1914-1941*, Washington, 1943, table 173.

<sup>30</sup> As it was to be in France in 1922, when the authorities flatly rejected an American

currency with their let outs for severely depreciated currencies were two years away. Nor can one really blame the absence of such a lender and the resulting exchange depreciation for the German hyperinflation, as Kindleberger seems to.<sup>31</sup> The mark exchange rate with the dollar was roughly the same in May 1921 as it had been in April 1920; German domestic prices remained relatively stable over the year and with the fall in import prices the general price level actually fell.<sup>32</sup> True, despite the Erzberger reforms the budgetary position was far from ideal and the balance of trade position remained weak, but a lender of last resort would hardly have improved matters. In fact, it might be argued that rather than a lender of last resort in 1920-21, what the world could have done with were an international relief and reconstruction programme in 1918-19, a more orderly process of decontrol and conversion after the war and a Federal Reserve system which understood its business better during 1919-21.

## 1929

The 1929 recession and its succession of financial crises took place in the context of a disintegrating regime of fixed exchange rates. The years prior to 1929 had seen a painful reconstruction of the international monetary system and the return of all major economies, except Japan, to fixed exchange rates. The reconstructed 'system' of the late 1920s was, however, hardly an 'equilibrium' system, even before the slump perturbed it. The exchange rates chosen in the 1920s' series of national stabilisation decisions had

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stabilisation proposal. See S. A. SCHUKER, *The End of French Predominance in Europe: The Financial Crisis of 1924 and the Adoption of the Dawes Plan*, Chapel Hill: University of North Carolina Press, 1976, p. 37.

<sup>31</sup> KINDLEBERGER, *Manias, Panics and Crashes*, p. 192.

<sup>32</sup> C. BRESCIANI-TURRONI, *The Economics of Inflation: A Study of Currency Depreciation in Post-War Germany*, London: Allen and Unwin, 1937, p. 30; League of Nations, *The Course and Control of Inflation: A Review of Experience in Europe after World War I*, New York, 1946, p. 104.

left a significant number of substantial over and undervaluations amongst the currencies of the industrial countries but no common perceptions as to how the adjustments necessary to remove the resulting stock or flow imbalances would occur. Subsequent events had done little to remove the initial imbalances in the system and in some cases, such as Germany, had added problems; so that some countries entered the recession with inappropriate exchange rates. At the same time, although global supplies of international liquidity were probably adequate, they were badly distributed: from 1928, when France began to accumulate gold on a large scale (as well as worry about the composition of her reserves) and the United States experienced a stock exchange boom, most countries in the system felt the pressure of undesired reserve losses.<sup>33</sup> As well, many countries other than France were already unhappy with the composition of their international reserves. The gold exchange standard re-born at Genoa, as a gold-economising device and a possible means of stabilising the purchasing power of gold and adopted by a number of countries, often as a part of a League of Nations stabilisation scheme, was now less popular. This decline in popularity was the product of several factors: the rise of France, contemptuous of British pretensions in the face of weakness and looking for her place in the sun; the belief that the gold exchange standard was a second class regime; and the post-1925 weakness of sterling, the major reserve currency. This unpopularity produced added strains in the system as France altered her pattern of asset accruals and other countries became less willing holders of sterling. Finally, French and American monetary policies during the upswing had ensured that even during the upswing such little adjustment as occurred did so against a slightly falling price level.

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<sup>33</sup> The continuous pressure on London in the 1920s had its parallels in the years surrounding 1873, when the gold accumulation policies of France, Germany and the United States were a source of difficulty. See R. G. HAWTREY, *A Century of Bank Rate*, London: Longmans, 1938, pp. 47-8.

At the centre of the international economy, the downturn in economic activity came in the course of 1929 (except in the case of France, where it came in 1930). At the periphery, in many cases the downturn came earlier.<sup>34</sup> During 1928-9 primary producers faced a variety of problems; — prices were weak, stocks were rising, capacity levels often were excessive, levels of borrowing had been high for some years and debt service loomed large. Exacerbating these problems were various attempts to raise producers' prices through schemes designed to restrict output and/or hold stocks from the market. Overseas borrowing often played an important role in financing these schemes. During 1928-9 borrowing for these purposes became more difficult as a result of the sharp decline in American overseas lending and the repercussions of this and the Wall Street boom on European capital markets.<sup>35</sup> The upshot of output restrictions, weakening prices and reduced overseas borrowing was often balance of payments difficulties. Peripheral countries met those difficulties in part by financing — by the use of official reserves and short-term borrowing — but they also turned to other measures — additional deflation, protection and exchange depreciation. These problems and policies had repercussions at the centre of the system because falling investment, falling incomes, increased protection and exchange depreciation reduced the demand for exports of manufactures from the industrialised centre—and had, for example, an important role in initiating the British recession.<sup>36</sup> So too did their methods of financing balance of payments deficits: for example the large gold movements from the periphery eased London's position in 1930, while the reduction of sterling balances by

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<sup>34</sup> As, for example, in Canada and Australia.

<sup>35</sup> H. FLEISIG, 'The United States and the non-European Periphery during the Early Years of the Great Depression', in H. VAN DER WEE (ed.), *The Great Depression Revisited*, The Hague: Mouton Nijhoff, 1972, pp. 151-7; D. WILLIAMS, 'The 1931 Financial Crisis', *Yorkshire Bulletin of Economic and Social Research*, XV (2) 1963, pp. 92, 96, 98.

<sup>36</sup> D. C. CORNER, 'Exports and the British Trade Cycle: 1929', *Manchester School*, XXIV (2) 1959, pp. 124-50.

proto-sterling area countries, plus their demands for short-term accommodation made her position more difficult.<sup>37</sup>

Although economic activity in many peripheral countries, as well as in Britain and Germany had turned down *before* the United States moved into recession in the summer of 1929, American events made the situation more difficult. The relative impact of the various proximate causes of the American recession remain a matter of controversy, as do those which turned a severe recession into a great depression.<sup>38</sup> However, falling incomes and industrial production at the centre resulted in a sharp decline in international trade and a decline in the demand for primary products, which, with the large stock overhangs of the late 1920s and borrowing difficulties, led to a fall in prices, the collapse of many restriction schemes, further falls in prices and further difficulties for producers, which, of course fed back into the system.<sup>39</sup>

The collapse on Wall Street brought a cautious easing of monetary policy at the centre.<sup>40</sup> By June 1930, discount rates in New York and Paris were down to 2½ per cent, while in London and Berlin they stood at 3 and 4 per cent. However the reductions in discount rates probably exaggerate the easing of the monetary situation. In Britain, interest rates on long-term government securities remained at the level of early 1929, while both high-powered money and the money stock fell in the first half of 1930.<sup>41</sup> In the United States as well, bond yields remained high (and probably rose slightly if one allows for reclassifications),

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<sup>37</sup> D. WILLIAMS, 'London and the 1931 Financial Crisis', *Economic History Review*, 2nd series, XV (3) 1963, pp. 518-9; L. S. PRESSNELL, 1925: 'The Burden of Sterling', *Economic History Review*, 2nd series, XXXI (1) 1978, pp. 31-2.

<sup>38</sup> See, for example, T. MAYER, 'Money and the Great Depression: A Critique of Professor Temin's Thesis', *Explorations in Economic History*, XV (2) 1978, pp. 127-45.

<sup>39</sup> LARY, *The United States in the World Economy*, pp. 170-1.

<sup>40</sup> SAYERS, *Bank of England*, I, pp. 229-32; L. V. CHANDLER, *American Monetary Policy 1928-1941*, New York: Harper and Row, 1971, pp. 149-52; WICKER, *Federal Reserve*, pp. 144-51.

<sup>41</sup> HOWSON, *Domestic Monetary Management*, p. 68.

while the money stock declined from its pre-slump level.<sup>42</sup> True, in both countries there was some revival in overseas lending from 1929 levels. But in London, except for an Austrian Government Loan, the Young Loan (which did not result in any flow of funds overseas) and a last loan for Brazilian Coffee Valourisation, controls prevented any lending to governments outside the Empire.<sup>43</sup> Whilst in New York beyond the Young and Austrian Government loans, the major borrowers were Canada and Argentina.<sup>44</sup> Even at this stage some overseas debtors were experiencing financial difficulties and were finding their access to financial markets barred.<sup>45</sup> There was also an expansion of lending from Paris and Amsterdam, but total lending remained below the 1925-8 level,<sup>46</sup> and French lending sometimes had unfavourable repercussions on London.<sup>47</sup> In the second half of the year long-term lending dropped sharply and defaults increased. After the year's end there were to be proposals for an international institution to expand the volume of lending, particularly to ease the German situation, but these foundered on American and French opposition.<sup>48</sup>

The lack of longer-term accommodation was, to some extent, offset by short-term lending from the United States and some stronger Continental centres, but not by enough to avoid balance

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<sup>42</sup> FRIEDMAN and SCHWARTZ, *A Monetary History*, pp. 307-8; P. TEMIN, *Did Monetary Forces Cause the Great Depression?* New York: Norton, 1976, pp. 104, 107.

<sup>43</sup> D. E. MOGGGRIDGE, *British Monetary Policy 1924-1931: The Norman Conquest of* § 4.86, Cambridge: Cambridge University Press, 1972, pp. 212-13.

<sup>44</sup> LARY, *The United States in the World Economy*, p. 100.

<sup>45</sup> C. B. SCHEDVIN, *Australia and the Great Depression: A Study of Economic Development and Policy in the 1920's and 1930's*, Sydney: Sydney University Press, 1970, chs. VI and VII; B. R. TOMLINSON, 'Britain and the Indian Currency Crisis 1930-32', *Economic History Review*, 2nd series, XXXII (1) 1979, pp. 89-93.

<sup>46</sup> Royal Institute of International Affairs, *The Problem of International Investment*, London: Oxford University Press, 1937, p. 282.

<sup>47</sup> S. V. O. CLARKE, *Central Bank Cooperation 1924-1931*, New York: Federal Reserve Bank of New York, 1967, p. 171.

<sup>48</sup> *Ibid.*, pp. 179-80.

of payments problems in a number of countries, which added to the widespread deflationary pressures already present in the system. In the second half of 1930, both Britain and Germany came under increased balance of payments pressure, thus joining much of the periphery, as gold flows to the United States resumed while those to France accelerated.<sup>49</sup> The gold flows to countries in surplus, which also included stronger European countries such as Switzerland and the Netherlands, exceeded new supplies of monetary gold by a large margin, with the result that most countries experienced a further fall in reserves. The typical responses followed with added twists of retaliation for the sharply increased American tariff. Towards the end of the year the Bank for International Settlements, the Federal Reserve and the Bank of France provided a modicum of assistance to the Reichsbank and the Bank of England, but the prospects of further central bank co-operation were not bright.<sup>50</sup>

As 1930 progressed many of the problems which were to preoccupy central bankers and governments in 1931 became evident. In November, a series of bank failures and a scandal in Paris brought a large movement of French balances from London and forced the Bank of France to intervene in the exchange market to stabilise the situation. During November and December, the slump in the United States took a more serious turn as 608 banks, including the infamous Bank of United States, closed their doors causing precautionary changes in the deposit/currency and deposit/reserve ratios.<sup>51</sup> Even Britain had her banking difficulties.<sup>52</sup> Moreover, on the international scene the outlook was hardly encouraging. The Young Loan, issued in June 1930,

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<sup>49</sup> LARY, *The United States in the World Economy*, p. 153; M. WOLFE, *The French Franc between the Wars*, New York: Columbia University Press, 1951, appendix 111.

<sup>50</sup> CLARKE, *Central Bank Cooperation*, pp. 173-6; SAYERS, *Bank of England*, I, p. 233.

<sup>51</sup> FRIEDMAN and SCHWARTZ, *A Monetary History*, pp. 308-12; TEMIN, *Did Monetary Forces etc.*, pp. 91-3.

<sup>52</sup> SAYERS, *Bank of England*, I, ch. 10B.

remained well below par, standing at a discount of almost 30 per cent by year's end, a reflection of the growing uncertainty about Germany's ability to maintain reparations payments in a slump and the increasing power of domestic political opponents of the reparations settlement.<sup>53</sup>

With a brief respite in the early part of the year, the difficulties of 1930 became more acute in 1931. For a time, even the mark and the pound sterling enjoyed a reduction in the pressures of earlier months, although in these countries informed, inner opinion was hardly optimistic.<sup>54</sup> Between March and June another wave of bank failures in the United States occurred. In the months following 11 May, four days after the Governor of the Bank of England first heard of the difficulties of the Credit Anstalt and three days before the last internationally concerted reduction in discount rates of the period, the system fell apart. The spark which set off the 1931 explosion could have come from any number of places, for banking difficulties were widespread, reaching London at the height of the crisis.<sup>55</sup> With the collapse of the Credit Anstalt, the largest bank in Austria, events took a more serious turn. The Austrian authorities and the international central banking community moved to pick up the pieces and limit the repercussions of the collapse. But the international community moved slowly, constrained by caution, domestic worries, political considerations (more prominent, given recent Austro-German behaviour) and a lack of awareness of the real magnitude of the problem.<sup>56</sup> In the meantime, foreign creditors and residents ran down their

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<sup>53</sup> J. S. DAVIS, *The World Between the Wars: An Economist's View*, Baltimore: Johns Hopkins University Press, 1975, pp. 245-6.

<sup>54</sup> HOWSON, *Domestic Monetary Management*, pp. 69-71; HOWSON and WINCH, *Economic Advisory Council*, pp. 82, 86-7; SIR HENRY CLAY, *Lord Norman*, London: Macmillan, 1957, p. 371; CLARKE, *Central Bank Cooperation*, pp. 177-8.

<sup>55</sup> SAYERS, *Bank of England*, I, ch. 10D, II, p. 530-3.

<sup>56</sup> CLARKE, *Central Bank Cooperation*, pp. 183-9; CLAY, *Lord Norman*, pp. 375-7; E. W. BENNETT, *Germany and the Diplomacy of the Financial Crisis, 1931*, Cambridge: Harvard University Press, 1962.

Austrian assets until standstill arrangements, later backed by exchange controls, made this impossible.

The Austrian crisis also led bankers to attempt to improve the average quality of their assets by withdrawing funds from other weak centres. Hungary experienced an almost immediate run, as did many of the other small countries of Eastern Europe, but from the end of May the important country in difficulties was Germany, whose bankers were known to be involved in Austria and whose overseas short-term liabilities were huge. Again the resulting support operations were subject to delays resulting from lengthy negotiations at every turn, largely the result of French attempts to use the crisis to win political concessions from Germany but also the result of British attempts to use the crisis to make more far-reaching changes in the international economic order.<sup>57</sup> The delays meant that at each stage the assistance when granted was probably too little, as the situation had deteriorated sharply in the interim, culminating in the failure of the Danatbank on 13 July, bank holidays and the beginnings of exchange control.

From 13 July, the crisis switched to London, the third largest short-term creditor to Germany and the premier international money market in Europe.<sup>58</sup> By this time sterling had been under a cloud for some months, given the by then widespread acceptance that it was overvalued at \$ 4.86 and the existence of continuing budget deficits in the home of the high priests of sound finance,<sup>59</sup> but, as yet, the authorities had done nothing beyond appointing expert committees on the unemployment insurance system and the budgetary problem and making alarmist noises about the situation. It was the conjuncture of these circumstances with a very weak underlying balance of payments situation (on which see below pp. 67-68) the freezing of substantial British

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<sup>57</sup> *Ibid.*, Chs. 6-8; CLARKE, *Central Bank Cooperation*, pp. 189, 201, CLAY, *Lord Norman*, pp. 377-83.

<sup>58</sup> RIIA, *Problem of International Investment*, p. 238.

<sup>59</sup> SAYERS, *Bank of England*, II, pp. 390-1.

short-term assets in Central Europe and the publication of the Macmillan Report, which revealed, albeit incompletely the magnitude of Britain's net foreign short-term debtor position, that made the British crisis so difficult to deal with.<sup>60</sup>

As in the previous cases on the Continent, international financial co-operation came into play as the Bank of England and the Government raised credits totalling \$ 650 million in New York and Paris, initially to hold the exchange rate while preparing a programme of financial retrenchment and then to put into operation a programme acceptable to the financial community. The assistance came relatively promptly, despite the difficulties of making a public issue for the second credit in the liquidity conscious New York market.<sup>61</sup> In this case however, the ample assistance merely prolonged the crisis, while a number of misunderstandings and tactical mistakes probably shortened it. Reports of unrest in the Royal Navy over pay cuts resulting from the retrenchment programme, election uncertainties in Britain after the fall of the Labour Government and the appointment of a National Government, fresh financial difficulties on the Continent (this time in Holland), and the impossibility of obtaining any further financial support led the authorities to decide on 18 September to suspend gold convertibility on 21 September.<sup>62</sup>

The repercussions of Britain's decision to suspend gold convertibility were immense. It led to further crises elsewhere which took other countries from the gold standard and engendered another wave of exchange controls in Central and Eastern Europe. It led to attempts to liquidate the remnants of the gold exchange standard which resulted in large gold outflows from the United States, a sharp, orthodox tightening of American monetary policy and another, even more spectacular wave of bank failures

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<sup>60</sup> *Ibid.*, II, p. 390; CLARKE, *Central Bank Cooperation*, pp. 185, 202.

<sup>61</sup> MOGGRIDGE, *British Monetary Policy*, p. 196; D. E. MOGGRIDGE, 'The 1931 Financial Crisis', *The Banker*, CXX (534) 1970, p. 839.

<sup>62</sup> SAYERS, *Bank of England*, II, 404-10; MOGGRIDGE, *British Monetary Policy*, 194-6.

in the United States. Moreover, the new wave of exchange depreciations, exchange controls, banking crises, tariffs and retaliating trade controls which followed 21 September put even more deflationary pressure on the countries remaining on gold and on the gold price level, even if it somewhat eased the pressure amongst the depreciating countries. In the circumstances, it is of course worth asking whether more short-term accommodation — a lender of last resort — might have improved matters.

Before attempting to answer that question we should realise that the 1931 financial crisis did involve a large amount of supportive lending. The sum of such lending between May and September amounted to roughly \$1 billion or 10 per cent of international short-term indebtedness or just under 5 per cent of the (slump diminished) value of world imports.<sup>63</sup> Such a sum compares favourably with the relationship between *total IMF quotas* and world imports in 1976 and 1977,<sup>64</sup> which hardly suggests an inadequate volume of assistance, especially if one were to compare it with the amounts that had gone before. One might argue that the sums involved were dissipated unwisely, but to take that tack is to change the basis of the argument.

Moreover, to evaluate the experience of 1931 as it finally turned out, one must have some idea as to what would have happened in the alternative situation. Even without the international liquidity crisis many underlying balance of payment positions were in substantial disarray. The British case is perhaps the most important here, for any alternative scenario which failed to keep British on gold would probably have produced results similar in kind to those which actually occurred. Between 1929 and September 1931, despite the decline in the volume and value of Britain's

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<sup>63</sup> Bank for International Settlements, *Annual Report for the Year ended 31 March 1932*, Basle, 1932, pp. 12-13; A. MADDISON, 'Growth and Fluctuations in the World Economy, 1870-1960', *Banca Nazionale del Lavoro Quarterly Review*, No. 61, 1961, table 23.

<sup>64</sup> International Monetary Fund, *Annual Report*, Washington, 1977, p. 40.

exports, the deterioration in her balance of trade was minimal, of the order of £5 million. However, over the same period, the slump reduced the invisible surplus by 30-40 per cent, as income from overseas investment, shipping and short interest and commissions declined sharply. Yet by September 1931, the invisible deterioration *by itself* implied a current account deficit for Britain of the order of £90 million for 1931 even leaving aside any J-curve effects of the post-21 September depreciation and shipments of goods anticipating protection after the National Government's electoral landslide in October.<sup>65</sup> And this deficit ignores any net new overseas lending which Britain might undertake. To finance successfully a deficit on current and long-term capital account in the circumstances of 1931, Britain could not, as she had in the case of a similar deficit in 1926, depend on French and Continental refugee capital or on reserve accumulations of the proto-overseas sterling area countries: the former was falling as the French government drew on its London balances to meet a budget deficit, as French banks drew down their sterling secondary assets to increase their cash reserves and allow for deposit and currency expansion and as foreigners tended to reduce their London balances in the face of low interest rates, while the latter were themselves in difficulties. Even without the liquidity crisis of 1931, Britain faced a serious balance of payments problem, whose situation entailed a substantial measure of additional deflation if the authorities were to avoid depreciation.<sup>66</sup> Whether Britain, or the international economy could have coped with such additional deflation is arguable. But in a world where devaluations of the sort that characterised the Bretton Woods system were almost unthinkable it is likely that any additional assistance to meet

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<sup>65</sup> MOGGRIDGE, 'The 1931 Crisis', pp. 832-6; HOWSON and WINCH, *Economic Advisory Council*, pp. 243-54.

<sup>66</sup> Ignoring international repercussions a £60 million reduction in imports would have required a fall in national income of something like £200 million. Given output per man at the time, such a fall in national income would entail a 10 per cent fall in employment — this at a time when unemployment already exceeded 20 per cent.

Britain's underlying balance of payments problem would have carried such deflationary conditions, as of course did the second round of lending to Britain during the liquidity crisis.

Britain, moreover, was not the only country in underlying balance of payments difficulties. Among the countries at the centre, Germany had seen her international competitive position decline since 1929, despite acceptance of international deflationary forces and reinforcement of them through domestic policies.<sup>67</sup> Nevertheless, despite the marked improvement in her current account position between 1928 and 1931, Germany's position was precarious even before the crisis, given the domestic repercussion of deflation, which affected short-term capital flows, and the need to make substantial reparations payments. No wonder international opinion was doubtful as to Germany's future in 1930. Perhaps Clay was right to suggest that if 'a chance of checking the slide into insolvency existed, it was offered by the Hoover proposal'.<sup>68</sup> Perhaps it might have been if it had come earlier, but again this is hardly a lender of last resort operation.

In conclusion, although it is arguable that a single rather than multi-centred international monetary system may be more stable, I must admit that I find the international lender of last resort types of arguments put forth by Professor Kindleberger rather incomplete and unconvincing in the light of the experiences of 1920 and 1929. With respect to 1920 Professor Kindleberger seems to beg the underlying rationale of the doctrine of the lender of last resort in that, whatever else happened, there was hardly a financial crisis, despite the sharpness of the recession. In fact, perhaps the real need was for an international reconstruction and rehabilitation programme in 1919-20. This is not to deny that there were mistakes in policy formulation and

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<sup>67</sup> MOGGRIDGE, *British Monetary Policy*, table 8 and 9.

<sup>68</sup> CLAY, *Lord Norman*, p. 380.

execution that brought with them great costs: it is merely an attempt to avoid confusing an already difficult set of issues. As for the period after 1929, the situation is more complex. In this case there were a number of financial crises. As well, there was a substantial amount of emergency assistance by both earlier and later standards — even if it may have come at the wrong times and in the wrong places. Events might have turned out differently if the \$1 billion actually raised had found use earlier in Austria and Germany rather than later in Britain. Even if the available assistance had been used more effectively, however, there remained the underlying sources of disequilibria in the international economy such as American economic policy, French gold accumulations, the post-war position of Germany and the underlying weakness of the British balance of payments at the post-1925 exchange rate in a world recession. Such problems would have remained, at least to some extent, and threatened the pattern of exchange rates which Kindleberger seems determined to preserve. As a result I am inclined to the view that continued emphasis on and further investigation of the more traditional areas of inquiry is still probably more fruitful, either for understanding the past or obtaining 'lessons from history' than bringing the existence or non existence of a lender of last resort to support an unspecified pattern of exchange rates into the argument at such an early stage.

