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The World in Depression 1929–1939

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An Explanation of the 1929 Depression

We return to the original questions: What produced the world depression of 1929 and why was it so widespread, so deep, so long? Was it caused by real or monetary factors? Did it originate in the United States, in Europe, in the primary-producing countries of the periphery, in the relations among them? Was the fatal weakness the nature of the international capitalist system or the way it was operated, that is, the policies pursued by governments? Were such policies, to the extent they were important, the consequence of ignorance, short-sightedness, or ill will? Were the depth and length of the depression a reflection of the strength of the shock to a relatively stable system, or were they a measure of the system's instability in the presence of a blow or series of blows of normal force (however measured)? Or—to bring the issue back among Paul Samuelson, Milton and Rose Friedman, and me—was the depression a fortuitous event, the consequence of deliberate and misguided monetary policy on the part of the U.S. Federal Reserve Board, or were its origins complex and international, involving both financial and real factors? Inevitably in drawing the threads together there will be a considerable amount of confirmation of preconceptions. I am open to the accusation of having selected statistics, facts, and incidents from the history of the decade which support a position chosen a priori. But I would claim that I have not knowingly suppressed

any facts that do not fit the explanation that follows, nor ignored other explanations, such as U.S. monetary policy (Friedman), misuse of the gold standard (Robbins), mistaken deflation (Keynes), secular stagnation (Hansen), structural disequilibrium (Svennilson), and the like. The chapter is entitled "An Explanation," not "The Explanation."

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 U.S. unwillingness to assume responsibility for stabilizing it by discharging five functions:

(1) maintaining a relatively open market for distress goods;
(2) providing countercyclical, or at least stable, long-term lending;
(3) policing a relatively stable system of exchange rates;
(4) ensuring the coordination of macroeconomic policies;
(5) acting as a lender of last resort by discounting or otherwise providing liquidity in financial crisis.

These functions, I believe, must be organized and carried out by a single country that assumes responsibility for the system.[1] If this is done, and especially if the country serves as a lender of last resort in financial crisis, the economic system is ordinarily capable, in my opinion though not in that of others, of making adjustments to fairly serious dislocations by means of the market mechanism. There will be times when the structural dislocation is so far-reaching that more thoroughgoing measures are called for, such as the Marshall Plan and the British loan after the Second World War. D. E. Moggridge believes that the dislocation was so deepseated in 1929 through 1931 that no rescue loans from France and the United States to Austria, Germany, and England would have served to halt the spiraling

1. Political scientists refer to the leadership position of a single country as "hegemony." I prefer to think of it as responsibility. Hegemony may, however, be more realistic as well as more cynical. It should be noted that political scientists debate whether hegemony is needed for the maintenance of peace and of world economic stability. See Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy*, 1984. Keohane thinks that international regimes can substitute for hegemony. Regimes are institutionalized habits of cooperation. They are more precisely defined as "principles, norms, rules and decision-making procedures around which actor expectations converge in a given issue-area" (Stephen D. Krasner, "Structural Causes and Regime Consequences: Regimes as Intervening Variables," 1983, p. 1).

collapse of currencies.[2] The question is whether the shocks to the system—overproduction in primary products, French insistence on collecting reparations from Germany, U.S. demands for payment of war debts, overvaluation of the pound and undervaluation of the French franc, the halting of foreign lending by New York, the stock market crash, and the like—were so great that they would overwhelm any set of defenses; or whether, in the absence of some country willing and able to act as a stabilizer, any random shock to the system above some minimum level could set the unstable system off toward depression.

My contention is that the difficulty lay in considerable latent instability in the system and the absence of a stabilizer. Before the First World War, Britain stabilized the world by the discharge of the functions listed, more or less, and with the enormous help of gold standard mythology, which internalized both stable exchange rates and coordinated macroeconomic policies. There were occasions when Britain was either not involved or stood aside, as in 1873 when Central Europe and the United States shared a long depression.[3] In 1890, after five years of accelerated foreign lending, the London capital market suddenly stopped. The system was saved, after depression lasting from 1890 to 1895, by a deus ex machina in the form of a substantial flow of gold from the Rand mines of the Transvaal, discovered in 1886.[4] In 1929, 1930, and 1931 Britain could not act as a stabilizer, and the United States would not. When

2. See his "Policy in the Crises of 1920 and 1929." Haberler agrees with the position taken here, that the aftermaths of the First and Second world wars called for different therapies because of differences in the extent of physical, economic, and political devastation and dislocation. See his "Die Weltwirtschaft und das internationale Währungssystem in der Zeit zwischen den beiden Weltkriegen," pp. 288–89. It may be remarked, however, that some years ago Haberler sided with those such as Roy Harrod, Friederich Lutz, Jacob Viner, and Senator Joseph Ball who opposed the notion of "dollar shortage," and in some instances the Marshall Plan, maintaining that stability and growth could be reestablished in Europe right after the war if countries would "halt the inflation and adjust the exchange rate." See the discussion in my *Dollar Shortage*, 1950, pp. 2–6.

For a largely political view that the two postwar eras are of the same piece, together with dissents, see Charles S. Maier, "The Two Postwar Eras and the Conditions for Stability in Twentieth-Century Europe," 1981, with comments by Stephen A. Schuker and me, and a reply by Maier.

3. See my *Manias, Panics, and Crashes*, p. 211.

4. See my "International Propagation of Financial Crises."

every country turned to protect its national private interest, the world public interest went down the drain, and with it the private interests of all.

Maintaining a market for distress goods

Maintaining a market for distress goods can be regarded as another form of financing. Free trade has two dimensions: (1) to adapt domestic resources to changes in productive capacities abroad and (2) to keep the import market open in periods of stress. The first is more readily done by a rapidly growing country which needs to transfer resources out of less productive occupations and is willing to embrace the competition of imports. By holding firm to free trade during depression at some short-run cost to resources in import-competing lines, the second provides a market for surpluses accumulated abroad. Britain clung to free trade from 1846 (or some year thereafter, such as 1860, when all tariffs but those for revenue had been dismantled) until 1916. After 1873, although not growing rapidly, it continued to adhere to free trade since its declining industries were exporters rather than import-competers. Britain's tenacity in adhering to free trade in depression may have been born of cultural lag and the free trade tradition of Adam Smith rather than of conscious service to the world economy.

The contrast is with the Smoot-Hawley Tariff Act of 1930. At the first hint of trouble in agriculture, Hoover reached for the Republican household remedy, as Schumpeter characterized it, in the face of a recommendation of the World Economic Conference of 1927 that nations of the world should adopt a tariff truce. The action was important less for its impact on the U.S. balance of payments, or as conduct unbecoming a creditor nation, than for its irresponsibility. The congressional rabble enlarged protection from agriculture to primary products and manufactures of all kinds, and Hoover, despite more than thirty formal protests from other countries and the advice of 1,000 economists, signed the bill into law. This gave rise to (or at least did nothing to stop) a headlong stampede to protection and restriction on imports, each country trying to ward off deflationary pressure of imports, and all together ensuring such pressure through mutual restriction of exports. As with exchange depreciation to raise domestic prices, the gain for one country was a loss for all. With tariff retaliation and competitive depreciation, mutual

losses were certain. The formula of tariff truce and exchange stabilization proposed for the World Economic Conference of 1933 offered no positive means of raising prices or expanding employment. It would nonetheless have been significant as a means of slowing further decline. With no major country providing a market for distress goods or willing to tolerate appreciation, much less offering to furnish long-term capital or discounting facilities to countries suffering from payment difficulties, the fallacy of composition with the whole less than the sum of its parts ensured that deflation would roll on.

Countercyclical lending

In the nineteenth century Great Britain tended to lend abroad on a countercyclical basis, with some exceptions such as the 1890 episode already referred to.[5] But by and large, and especially after mid-century, foreign and domestic lending were maintained in counterpoint. Domestic recession stimulated foreign lending, while a boom at home caused both lending to be cut back and imports to be expanded, providing an export stimulus abroad in place of domestic investment with borrowed funds. Countercyclical lending stabilized the system.

In the 1920s, U.S. foreign lending was positively correlated with domestic investment, not counterpoised. The boom of the 1920s was accompanied by foreign lending; the depression of the 1930s saw the capital flow reversed. In *The United States and the World Economy*, written in 1943, Hal Lary recorded the fundamental fact that the United States cut down on imports and lending at the same time. The cut in lending actually preceded the stock market crash as investors were diverted from the boom in foreign bonds that followed the Dawes loan to the boom in domestic stocks dating from the spring of 1928. The deflationary pressure on Germany may be debated; the pressure on the less developed countries at the periphery is clear-cut.[6] As Table 1 shows, moreover, Britain joined the United States in reducing its lending in 1929 over 1928.

5. See my "The Cyclical Pattern of Long-Term Lending."
6. Fleisig, "The United States and the World Periphery in the Early Years of the Great Depression."

Stable exchange rates

Exchange rates were stable in the nineteenth century because of the gold standard. The price of gold was fixed in Britain in 1717 and in France in 1726 and maintained, with interruptions for war and crisis, until 1931 and 1928, respectively. Most economists believe that the gold standard was managed by the Bank of England, with occasional help from the Bank of France, the Bank of Hamburg, and the State Bank of Russia. The system was accepted as an objective fact, hardly subject to alteration. It was internalized and thus legitimate.

When after the inflations of the First World War, exchange rates were either restored or adjusted, it was important to get them fixed at equilibrium levels. Attention was devoted to the problem. In most countries, economists worked at calculating purchasing power parities, without, however, always making adequate allowance for structural changes, such as the loss of overseas assets by Britain or the large volume of French capital that in 1926 was waiting abroad for the opportune moment to return to its normal habitat. Italy chose an exchange rate based almost entirely on prestige. The resulting pattern of rates put stress on the system.

Then came the depression and the response of many countries on the periphery, cut off from borrowing and facing sharply declining export prices and values, to depreciate their currencies. A certain amount of competitive exchange depreciation took place. Britain did not care how far the pound sank, but it created the Exchange Equalization Account to keep it from rising. The response of monetary authorities to the chaotic behavior of exchange rates in the 1930s was to adopt fixed rates at Bretton Woods in 1944 as a standard to prevent beggar-thy-neighbor tactics. When the set of rates came under stress as countries pursued independent macroeconomic policies, many economists came out in favor of floating. It was originally thought by many, and is still widely maintained by monetarists, that freely flexible exchange rates provide insulation from world conditions of instability for a given country. Experience both in the 1930s and in the 1970s, however, seems to indicate otherwise. In a world of deflation, as in the 1930s, flexible exchange rates with overshooting are deflationary. Depreciation leaves domestic prices unchanged and reduces prices in countries where exchange rates have appreciated. In a world of inflation, on the other

hand, as in the 1970s, the ratchet works in the opposite sense: depreciation raises domestic prices; appreciation leaves foreign prices unchanged.

Economists have yet to agree on how best to achieve the optimal degree of exchange rate stability, steady in the short run, adjusted in the long as structural changes are called for and macroeconomic policies diverge. Nor is it clear how leadership would provide it today, though the United States dominated the Bretton Woods institutions until the early 1970s.

Coordination of macroeconomic policies

Like exchange rates, macroeconomic policies were coordinated more or less automatically in the nineteenth century under the gold standard. The Bank of England had gradually developed techniques for management of the London money and capital markets, which communicated monetary policy to the rest of the country and the world. Fiscal policy scarcely existed in a world of balanced peacetime budgets, except as the shape of taxes changed. Such changes were designed for resource allocation and income redistribution, not for maintaining stability of national income.

The gold standard basically broke down in the interwar period when the United States and France, accumulating gold, sterilized it. Monetary policy was conducted largely for domestic purposes, except for the episode of 1927, which was later regarded as a mistake. German inflation in 1923 rendered that country paranoid about inflation. Positive fiscal policy was followed practically nowhere, not even in Sweden. And monetary policies went uncoordinated: it was "devil take the hindmost" or *sauve qui peut*.

Lender of last resort

The lender of last resort function has two dimensions, one domestic, one international. On the domestic front, it received timely attention. Montagu Norman of the Bank of England rescued the William Deacons Bank in January 1929. In October of that year, George Harrison of the Federal Reserve Bank of New York rushed into the breach with open market operations well in excess of the limits assigned him by the Federal Reserve Board in Washington in an effort to shore up the liquidity of the New York market. In Italy

a variety of banks were saved secretly in 1930, well before the first bank panic in the United States in November and December of that year. The German record was less positive. A Social Democratic memorandum in July 1931 argued that the Reichsbank should undertake a new issue of banknotes without regard to the legal limits imposed by its gold and foreign exchange reserves, avoiding the danger of inflation by raising the discount rate. It undertook the latter, but not the former.[7] And the Danatbank was allowed to fail, a sin of omission regarded as incomprehensible from today's perspective.[8]

It was, however, in the international dimension that the lender of last resort was most conspicuously missing. The task is a difficult one at best, but Britain tried, up to the last 50 million schillings for Austria in June 1931, when the rest of the world had backed out. After that setback, Britain stood aside from a loan to Germany, while the French and Americans undertook one—"too little and too late," not to mention the stringent French political conditions. When it came England's turn to seek help, the United States and France proceeded with one loan at a time—salami tactics, when the Bagehot prescription was to lend freely—and attached economic conditions to the second loan so severe that they brought the Labour government down. Conditionality in rescue loans raised in Third World negotiations with the IMF today is not a new problem.

British leadership

Not until 1931 was it clear that Britain could not provide the leadership. In the early 1920s there were League of Nations programs for the stabilization of the currencies of Austria and Hungary. These were to a considerable extent British in spirit, with help of experts from Scandinavia, the Low Countries, and the dominions such as staffed the League of Nations Economic, Financial, and Transit Department. Later the Dawes and Young plans to settle German reparations were dominated by British experts, with Americans serving as front men to foster the British hope of tying reparations to war debts. By 1931 British capacity for leadership had gone. In small

7. Holtfrerich, "Alternativen zu Brünings Wirtschaftspolitik in der Weltwirtschaftskrise," p. 6.

8. Irmler, "Bankenkrise und Vollbeschäftigungspolitik," p. 287.

part it had been dissipated in puerile central bank quarrels between Norman and Moreau, although much of the competition for domination over the smaller central banks of Europe was the product of Moreau's imagination. (Benjamin Strong tried hard to arbitrate these quarrels, and his death in 1928 was a loss for the stability of the system.) More significant was the burden of French sterling balances, which inhibited Britain as a lender of last resort. At the World Economic Conference in 1933 it was clear that Britain had turned away from a leading world role, cultivating the Commonwealth and freedom to manage sterling, and largely leaving it to the United States to devise a world program.

Lack of U.S. leadership

Revisionist historians, such as William A. Williams, insist that the United States undertook a leading world role, under Charles E. Hughes, as early as the Disarmament Conference of 1922.[9] It is difficult or impossible to find support for this position in the field of international economics, which holds with the conventional wisdom of such historians as E. H. Carr, that "in 1918, world leadership was offered, by almost universal consent, to the United States . . . [and] was declined."[10] There was interest in the affairs of Europe in New York, in the Federal Reserve Bank of New York under Strong and Harrison, and in the financial community represented by such people as Dwight Morrow, Thomas Lamont, and Norman Davis. A few non–New Yorkers, such as Charles G. Dawes and Andrew Mellon, were brought into international finance and diplomacy. On the whole, however, the isolationism expressed by Henry Cabot Lodge in leading the rejection of the Versailles Treaty and U.S. adherence

9. See, for example, William Appleman Williams, *The Tragedy of American Diplomacy*, 1959, esp. ch. 4, "The Legend of Isolationism." Mr. Williams, a Marxist revisionist historian, states: "Hoover did not grasp the fact that the depression was a sign of stagnation in a corporate economy which was born during the civil war and came to maturity in the decade from 1895 to 1905" (p. 123); and: "From the fall of 1932 Roosevelt and Hull stressed the importance of foreign trade for domestic revival and expansion and for world wide relief of conditions which caused war and revolution" (p. 128). It is difficult to see how a historian could ignore such evidence as the First Inaugural Address, cited earlier, to be able to make such a statement about Roosevelt.

10. Edward Hallett Carr, *The Twenty Years' Crisis, 1919–1939: An Introduction to the Study of International Relations*, 1946, p. 234.

to the League of Nations typified the dominant sentiment. The United States was uncertain in its international role. It felt that the British were shrewder, more sophisticated, more devious in their negotiating tactics, so that the United States came out of international conferences losers. Stimson would have been willing to undertake a major discounting operation to rescue the Reichsmark in July 1931; Hoover, Mellon, and (though from New York) Mills were opposed to sending good money after bad, as discounting calls for. In 1933 James Warburg, Moley, and presumably Woodin and Roosevelt still resisted sending good money after bad. Proposals for embryonic international monetary funds were legion, and even Britain presented one officially. They were uniformly turned down with a lecture on how much the United States had already lost in unpaid war debts and the Standstill Agreement.[11] It was not until 1942 that Harry D. White began preparing a world plan for discussion at Bretton Woods—together with the plan of Lord Keynes—a world plan for limited discounting.

Cooperation

Clarke's conclusion that central bank cooperation was maintained up to mid-1928 but failed thereafter has already been dealt with in some detail. In summary, such cooperation as there was on matters such as hegemony over small central banks or the choice of an equilibrium exchange rate was inadequate before 1926, and the Bank of France supported the pound loyally (and expensively) in the late summer of 1931. A deeper question is whether cooperation as such would have been sufficient. In *America's Role in the World Economy*,[12] Alvin Hansen prescribed for the United States policies of maintenance of full employment at home and cooperation with international efforts at freer trade, restoring capital movements, improvement of the world monetary system, and so on. With the ad-

11. Pedersen blames the liquidity crisis of 1931 on the United States for its failure to support the German mark and, when that had been forced to suspend gold payments, for its failure to underwrite sterling. See "Some Notes on the Economic Policy of the United States During the Period 1919–1932," in his *Essays in Monetary Theory and Related Subjects*, pp. 208–9. This would be agreed today, and Professor Pedersen put it forward himself, as noted earlier, in 1933. As he himself points out, however (p. 210), the United States was acting with "the normal prejudices of the period."

12. Alvin Hansen, *America's Role in the World Economy*, 1945.

vantage of hindsight, it appears that more than cooperation was provided—namely, leadership—and that mere cooperation would not have built the institutions and policies of the Organization for Economic Cooperation and Development, Group of Ten, Bank for International Settlements, International Monetary Fund, International Bank, General Agreement on Tariffs and Trade, and so on. As an acquaintance on the International Monetary Fund staff put it (admittedly to an American), if the United States did not take the leadership, nothing happened. Leadership may lack followership, and foolish or even sensible proposals may be defeated through lack of support. But the most sensible proposals emanating from small countries are valueless if they lack the capacity to carry them out and fail to enlist the countries that do. The World Economic Conference of 1933 did not lack ideas, as that of 1927 seems to have done. But the one country capable of leadership was bemused by domestic concerns and stood aside.

One special form of cooperation would have been joint Anglo-American leadership in the economic affairs of the world. The 1980s equivalent is the frequently proposed troika of Germany, Japan, and the United States, which could furnish the world leadership needed today now that American capacity or will to provide it alone has been dissipated. However, economists and political scientists usually agree that such arrangements, whether duopoly or bilateral monopoly, are unstable. Carr states explicitly that the hope for Pax Anglo-Saxonica was romantic and that Pax Americana "would be an easier contingency."[13] Vansittart, referring to the Standstill agreements and the German occupation of the Rhineland, wrote apropos of the World Economic Conference: "When action was required two years earlier, the two governments [British and American] sheltered behind each other like the British and French governments three years later."[14] With a duumvirate, a troika, or slightly wider forms of collective responsibility such as the Summit of Seven or the Group of Ten, the buck has no place to stop.

Changing leaders

Friedman and Schwartz make a great deal of the role in the great depression of the shift of monetary leadership in the United States

13. Carr, *The Twenty Years' Crisis, 1919–39*, pp. 233–34.
14. Vansittart, *The Mist Procession*, p. 466.

from New York to Washington.[15] They suggest that this sounds far-fetched, since it is a "sound general principle that great events have great origins," but note that small events at times have large consequences through chain reactions and cumulative force. The universality of the asserted principle seems dubious to this observer;[16] the observation that shifts of the locus of leadership give rise to instability does not. Had they not focused so exclusively on monetary conditions in the United States, Friedman and Schwartz might have noted the accentuation of the depression that came with the transfer of the presidency from Hoover to Roosevelt (occurring after the money supply had been greatly enlarged) and the still more significant (in my judgment) transfer of leadership in the world economy from Whitehall to the White House.

This notion of the instability of a financial system with two centers, or of one where leadership is in the process of being dropped by one and picked up by another, is cited by Edward Nevin as crucial to the collapse of the gold standard in 1931. He quotes Sir Ernest Harvey's testimony before the Macmillan Committee: "such leadership as we possess has been affected by the position which America has gained," making a change in the ancient system as set out in the Macmillan Report, under which the bank rate regulated the reserve position of the United Kingdom, and other countries adjusted their positions to that of Britain. He then went on to say, "Better that a motorcar should be in charge of a poor driver than of two quite excellent drivers who are perpetually fighting to gain control of the vehicle."[17] The analogy of two excellent drivers fighting for control of the wheel may be more graphic than apposite. The instability seems rather to have come from the growing weakness of one driver and the lack of sufficient interest in the other. William Adams Brown, Jr., describes the gold standard of the period as "without a focal point," meaning that it had two, but the conclu-

15. Friedman and Schwartz, *A Monetary History of the United States, 1867–1960*, p. 419.
16. Cf. Benjamin Franklin, *Maxims Prefixed to Poor Richard's Almanac*, 1757: "Little strokes fell great oaks" and "A little neglect may breed mischief: for want of a nail the shoe was lost; for want of a shoe the horse was lost; for want of a horse the rider was lost." The exception for cumulative feedback embraces the second quotation, but not the first.
17. Nevin, *The Mechanism of Cheap Money*, pp. 9n., 12, 14.

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sions of his monumental work do not dwell on this critical aspect of the world economy.[18]

Role of the small countries and France

One passenger in the vehicle which did not lack interest was France. And one group which lacked responsibility—to discontinue the metaphor, or perhaps they should be regarded as passengers in the back seat—consisted of the smaller countries: Belgium, the Netherlands, Switzerland, and Scandinavia. The smaller countries can be disposed of first. They are sometimes blamed, as in Born's analysis, for having acted irresponsibly in, say, converting sterling into gold in the summer of 1931 or raising tariffs with alacrity after 1930. There is, however, no universally accepted standard of behavior for small countries. On one showing, they lack power to affect the outcome of great events and are therefore privileged to look after the private national interest rather than concern themselves with the public good of stability in the world economy as a whole. On a somewhat higher ethical level, the small countries may be held to the Kantian categorical imperative, which enjoins them to act only in ways that can be generalized. In such circumstances, of course, they would not have withdrawn credits from Austria in the spring of 1931, nor from Germany and Britain in the summer, nor from the United States in the autumn. The economist chooses between these standards perhaps on the basis of comparative cost. If the Netherlands had known the cost of leaving its sterling unconverted into gold, it seems unlikely that it would have done so, even at the risk of accelerating the collapse of the pound and deepening the world depression. It may be that such countries as Sweden, Canada, and New Zealand that set high standards of international conduct—in foreign aid, contributions to United Nations peacekeeping missions, etc.—do so solely for ethical reasons; or they may choose among occasions to take largely the opportunities that are relatively

18. W. A. Brown, *The International Gold Standard Reinterpreted, 1914–34*, vol. 2, p. 781: "The essential difference between the international gold standard of 1928–29 and that of 1914 was that when the world returned to gold after the war it built its international financial system around a nucleus of London and New York, and not a single center." The title of his ch. 20 is "The Experiment of a Gold Exchange Standard without a Focal Point."

cheap. One may thus note that the small countries contributed substantially to the deflation by the speed with which they cut imports, depreciated, or converted sterling and dollars into gold, but find it hard to blame them for it.[19]

There is another aspect to the role of small countries: they could offer programs for recovery because they knew that the major cost of programs adopted would fall on other countries. Proposals for an embryonic international monetary fund in the Washington discussions preceding the World Economic Conference of 1933 were put forward by Poland, Turkey, Belgium, the ILO, and one was made by Britain, though this latter was quickly withdrawn when the United States frowned on it. Lacking resources to make these schemes effective, small countries were reduced to advisory roles without conviction, even when the proposals were sound. An essential ingredient of followership is to convince the leaaer that he is the author of the ideas that require the use of his resources.

The case of France is different. France sought power in its own national interest, without adequately taking into account the repercussions of its positions on world economic or political stability. Its intransigence in the matter of reparations or the attempt to attach political conditions to the second Austrian credit of June 1931 or the contemplated German loan of July of that year illustrate the position. Hurt in the depreciation of sterling in September, the Bank of France, under strong political pressure at home, converted its dollars into gold in the private national interest during 1931–32, all the while protesting its cooperation and concern for the interest of the United States. The rivalry between the Bank of France and the Bank of England over which should take over the leadership in restoring independence to central banks and stabilization of currencies in Eastern Europe would be pathetic, had it not run risks of instability for the system as a whole when the French threatened to withdraw balances from London.

Not quite big enough to have responsibility forced on it, nor small enough to afford the luxury of irresponsibility, the French po-

19. For an interesting political model of countries that are free-riders behind the leadership of others, see Norman Froelich and Joe A. Oppenheimer, "I Get Along with a Little Help from My Friends," 1970. But note (p. 119) that leadership is rewarded in this model rather than made to pay for the privilege, as implied where the responsibilities of leadership are maintaining an open market for goods, a countercyclical export of capital and a mechanism for rediscounting in crisis.

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sition in the interwar period was unenviable. It had the power to act as a destabilizer, but it was insufficiently powerful to stabilize.[20] "Great Britain and the United States together were the active nucleus that replaced the single centre of prewar days, but the position and policy of France actively affected their mutual as well as their joint relations to the outlying countries."[21] In these circumstances France could be (and was) blamed for upsetting the system when she had no capacity to take it over and run it in the presence of two larger powers, one feeble, the other irresponsible.

Public versus private interest

Cynicism suggests that leadership is fully rewarded for its pains in prestige and that no matter how much it protests its commitment to the public welfare, its fundamental concern is private. Bismarck insisted that free trade was the weapon of the dominant economy anxious to prevent others from following in its path. "The white man's burden" is an expression used today only in mockery. A country like France deliberately setting out to achieve prestige suggests that those with a concern for problem solving are either perfidious or self-deceiving. Nevertheless, there is a difference between accepting and declining responsibility for the way the system is run. The British accepted responsibility, although, as the 50 million schilling loan emphasizes, they were unable to discharge it. The French and the United States were unwilling to underwrite stability. Under Coolidge and Hoover, the United States refused to commit itself to any program of foreign reconstruction or currency stabilization, leaving these questions to the Federal Reserve System.[22] There was hardly any improvement in Roosevelt's commitment to the world economy until timidly in 1936, at the time of the Tripartite Monetary Pact, and ultimately during the Second World War. Inside France, as between France and the other leading powers, "all groups thought their opponents more united and dedicated than they were, and a concern for the general interest was virtually absent."[23]

20. See my "International Monetary Politics of a Near-Great Power: Two French Episodes, 1926–36 and 1960–70," 1972.

21. W. A. Brown, *The International Gold Standard Reinterpreted, 1914–34*, p. 785.

22. Chandler, *Benjamin Strong*, p. 255.

23. Sauvy, *Histoire économique de la France entre les deux guerres*, vol. 1., p. 73.

Unable to cope with the public good, the British more and more turned their energy to the private. Keynes's advocacy of a tariff and the refusal to contemplate stabilization after 1931 are examples. One may find a hint or two in the documents that the initiative came from the dominions rather than Britain.[24] For a time, until well after the war, the British economics profession and public almost drew the lesson that each country should take care of itself without regard to external effects.

The point is illustrated in the memorandum written by Hubert Henderson at the British Treasury in 1943, entitled "International Economic History of the Interwar Period."[25] This summarizes the crude view that the depression resulted from nationalism and tariffs, the collapse of world trade, bilateralism and preferences, and disregard of the advice of the League of Nations, leading to the conclusion that after the war there is need for the world to be more resolute in avoiding economic nationalism and attempting to construct a freely working economic system with international credits, the reduction of trade barriers, and the outlawry of qualitative regulation.[26] Henderson states that the history of the interwar period provides no support for this view. He opposes exchange depreciation: "There can be little doubt that the depreciation of the pound was in part responsible for the sharper fall in gold prices, and disillusionment is general in the United Kingdom and still more in the United States on the power of exchange depreciation to promote national recovery."[27]

> But the conventional view is false in all essential respects. The old international order has broken down for good. Nothing but

24. See *Documents diplomatiques français, 1932–39*, 1967, vol. 3, no. 470, Bonnet to Paul-Boncour, July 9, 1933, p. 871: "One fact is evident: it is that Britain is not free. Its dominions and in particular Canada whose Prime Minister Bennett is a man of extraordinary violence have a predominant influence on her, to the point of modifying totally her opinion in the space of a few seconds." This is doubtless hyperbole. For an up-to-date account of the origins of imperial preference written by a Canadian, see Drummond, *Imperial Economic Policy, 1917–39*.

25. See Hubert D. Henderson, *The Interwar Years and Other Papers*, 1955, pp. 236–95.

26. Ibid., pp. 236, 290.

27. Ibid., pp. 260, 262; see also p. 291: "Of the various expedients which different governments employed in the 1930s, none produced more unfortunate results than deliberate exchange depreciation. It was the least helpful to the countries which tried it, and the most harmful to other countries."

> futility and frustration can come from the attempt to set it up again. Individual countries must be free to regulate their external economies effectively, using control of capital movements, quantitative regulation, preferences, autonomous credit policies, etc.[28]

This foot-dragging, which Keynes shared during the 1930s and until late in the war, is understandable. It misses the main lesson of the interwar years, however: that for the world economy to be stabilized, there has to be a stabilizer—one stabilizer.

Relevance to the 1980s and 1990s

Leadership is a word with negative connotations in the 1980s, when participation in decision making is regarded as more aesthetic. Much of the overtones of *der Führer* and *il Duce* remain. But if leadership is thought of as the provision of the public good of responsibility, rather than exploitation of followers or the private good of prestige, it remains a positive idea. It may one day be possible to pool sovereignties to limit the capacity of separate countries to work against the general interest; such pooling is virtually attained today in some of the functions needed to stabilize the world economic system, such as the Basel arrangements for swaps and short-term credits, which, pending a world central bank, serve as a world rediscounting mechanism in crisis. In this area, and in the world agencies for maintaining freer trade and a liberal flow of capital and aid, however, leadership is necessary in the absence of delegated authority. That of the United States is slipping. It is not yet clear that the rising strength of Europe in an enlarged European Economic Community or of Japan will be accompanied by an assertion of leadership in providing a market for distress or aggressive goods, in stabilizing the international flow of capital, or in providing a discount mechanism for crisis. Presumably the Basel arrangements for the last will endure. There are indications that the European market for goods will remain ample, except in agriculture, which is an important exception from a world viewpoint. There is still some distance to go to stabilize the flow of capital countercyclically.

As the U.S. economic leadership in the world economy falters and Europe and Japan gather strength, three outcomes are politically stable, three unstable. Among the stable outcomes are contin-

28. Ibid., p. 293.

ued or revived U.S. leadership, after the exchange controls of 1963 to 1968 and the recent wave of protectionism have been reversed; an assertion of leadership and assumption of responsibility for the stability of the world system by Europe, Japan, or some unsuspected third country such as Brazil; or an effective cession of economic sovereignty to international institutions: a world central bank, a world capital market, and an effective General Agreement on Tariffs and Trade. The last is the most attractive, but perhaps, because difficult, the least likely. As between the first two alternatives, the responsible citizen should be content with either, flipping a coin to decide, if the third alternative proves unavailable, simply to avoid the undesirable alternatives.

The three outcomes to be avoided because of their instability are: (1) the United States, Japan, and the EEC vying for leadership of the world economy, (2) one unable to lead and the others unwilling, as in 1929 to 1933, and (3) each retaining a veto over programs of stability or strengthening of the system without seeking to secure positive programs of its own. The articles of agreement of the International Monetary Fund (IMF) were set up to provide the United States with a veto over action it opposed. In the 1969 reform that legislated the addition of Special Drawing Rights (SDRs) to the monetary system, quotas of the IMF were adjusted to provide a veto to the EEC as well. This leaves open the possibility of stalemate, as in the United Nations Security Council, when two major powers are unable to agree. In the circumstances of the Security Council there is a danger of regressive spiral into war; the analogue in the economic field is stalemate—and depression.

The third positive alternative of international institutions with real authority and sovereignty remains pressing.