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THE GOLD STANDARD AND THE GREAT DEPRESSION

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ABSTRACT

This paper, written primarily for historians, attempts to explain why political leaders and central bankers continued to adhere to the gold standard as the Great Depression intensified. We do not focus on the effects of the gold standard on the Depression, which we and others have documented elsewhere, but on the reasons why policy makers chose the policies they did. We argue that the mentality of the gold standard was pervasive and compelling to the leaders of the interwar economy. It was expressed and reinforced by the discourse among these leaders. It was opposed and finally defeated by mass politics, but only after the interaction of national policies had drawn the world into the Great Depression.

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The Gold Standard and the Great Depression

Historians continue to treat the depression of the 1930s as one of the great unsolved mysteries of the 20th century. John Garraty opens his book on the topic by saying that it "was a worldwide phenomenon composed of an infinite number of separate but related events."[1] Although economists claim to understand many aspects of the development of contemporary economies, their failure to provide a coherent explanation for the Great Depression, according to this view, betrays the limitations of their conceptual apparatus. This ostensible inability of the economics profession to agree on a consistent explanation for the signal economic disaster of modern times leaves a gap at the core of historical studies of the social consequences of mass unemployment, the evolution of the instruments of economic management, and the emergence of the postwar policy consensus in the West.

This view betrays a misunderstanding of the state of scholarship in economics and economic history. There now prevails a remarkable degree of consensus among specialists about the causes of the Great Depression. Recent scholarship has resulted in striking agreement on the reasons for the crisis; the modern literature can be regarded as having substantially solved the riddle of the Great Depression. That literature focuses on the gold standard as the mechanism that turned an ordinary business downturn into the Great Depression.[2] The constraints of the gold-standard system hamstrung countries as they

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[1] Garraty added on the next page that, "modern experts have not added a great deal to what [contemporary] observers understood." Garraty, 1986, pp. 2-3.

[2] Eichengreen and Sachs, 1985; Temin, 1989; Eichengreen, 1992.

struggled to adapt during the 1920s to changes in the world economy. And the ideology, mentalité and rhetoric of the gold standard led policy makers to take actions that only accentuated economic distress in the 1930s. Central bankers continued to kick the world economy while it was down until it lost consciousness.

We argue here that this new consensus reflects methodological innovations familiar to historians from other contexts. The modern literature on the Great Depression emphasizes mentalité, discourse, mass politics, and the eclipse of the nation state. By mentalité we mean the social mind set of policy makers, which shaped their notions of the possible. The gold-standard mentalité powerfully shaped contemporaries' conceptions of feasible and desirable economic policies. Developed to cope with a world that no longer existed and sustained by social and political pressures that discouraged its abandonment, this intellectual construct spawned policy responses which were directly responsible for economic catastrophe.

This mentality and the actions and institutions it supported limited the ability of governments and central banks to respond to adversity and prescribed policies that made their condition worse instead of better. In response to balance of payments deficits and gold losses, governments could only deflate the economy, restricting credit with the goal of reducing domestic prices and costs until international balance was restored. Critical to this process was the effort to reduce wages, the largest element in costs. As F.C. Benham summarized the conventional understanding in 1931,

> "The loss of gold or the higher bank rate, then, can restore international equilibrium only by reducing internal prices. Of these, the most important is the price of labour. Wages and other incomes from labour may be reduced. This will have a double effect. On the one hand, wage-earners and others will have less to spend on everything, including imports. On the other hand costs

will be reduced in all industries, including export industries. Imports will be checked and exports stimulated until the two flows once more balance."[3]

The problem was that in the increasingly structured and politicized labor markets of the interwar period, wages lacked the flexibility they once possessed. The fluidity of labor costs was limited by the spread of unionism, the growth of internal labor markets and personnel departments in the United States, and a general preoccupation with the relationship of one's wage to that of other workers. For this reason the conventional gold-standard adjustment mechanism no longer operated as before.

But even prewar levels of flexibility might not have sufficed to resolve the turmoil of the 1930s. The deflationary shock in 1929 was superimposed on radical shifts in the pattern of international settlements, requiring extensive changes in prices and costs for external balance to be restored. In any case, these problems did not penetrate the consciousness of those beholden to the gold-standard mentalité, who refused to question the advisability of pursuing the deflationary route.

By discourse we mean the rhetoric of policy debate and the rhetoric of the gold standard in particular. This discourse helped to form and sustain the gold-standard mentalité. The Victorian and Edwardian virtues of thrift, reliability, stability and cosmopolitanism were invoked ritually as attributes of the monetary system. Gold was moral, principled and civilized; managed money the opposite. The former was preserved by deflation, and the rhetoric of deflation was to cut wages. Only "speculators" disagreed. This rhetoric delegitimized the arguments of those who dared question the merits of gold convertibility.

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[3] Benham, 1932, pp.250-251.

Mass politics refers to the impact on financial markets, public policy and the Depression itself of the actions, attitudes and influence of actors other than the political elites. It was in these other segments of society, and the working classes in particular, that opposition to gold-standard ideology and policies boiled over in the 1930s. Before the Great War the workers who suffered unemployment when central banks raised interest rates had few ways of making their objections felt. The franchise was limited. Trade unionism was restricted to a few trades. Socialist and labor parties were in their infancy. The working classes lacked the political capacity to challenge the financial status quo.

The Great War transformed this situation by encouraging unionization, impelling extensions of the franchise, and improving the electoral prospects of the socialist and labor parties. This shift in the positions of the investing and earning classes subverted the social basis of prewar gold-standard policies. Political leaders asked for the first time whether repeated doses of the standard deflationary corrective might undermine their political security. Once they hesitated, the market pounced, destabilizing the currency, destabilizing the exchange rate, and destabilizing the economy. The need to defend the gold standard with deflationary initiatives became all the more pressing.

But the same working-class pressure that aggravated the Depression by breeding doubts about governments' willingness to stay the course and heightening the need for deflationary action also provided the means of escape. When officials wedded to the gold-standard ideology refused to see the light, voters turned them out of office in favor of others less wedded to the status quo. These new leaders abandoned the gold standard, although the central bankers with whom they had to work remained reluctant to embrace the new rhetoric of reflation.

By the eclipse of the nation state we mean the increasing importance of sociopolitical and socioeconomic factors operating at levels other than the national. In the present context this finds reflection in an emphasis on the operation of the international system. Many historians and economists have sought the causes of the Depression in events in the United States.[4] Their search has proven less than satisfactory because they neglected the international dimension of the slump--that is, the fact that events in the international domain set the stage for the 1929 downturn and transformed the ordinary recession that followed into a great depression.[5] The problem lay in the functioning of the international monetary and financial system and in its interaction with changes in the pattern of international settlements wrought by World War I. Historians have pondered why policy makers failed to counteract the Depression and why the actions they took in fact aggravated its severity. The recent literature shows that they saw no other option, given the international system they confronted and the ideological lens through which they viewed it.

We do not assert that one idea alone was sufficient to produce the Great Depression. Instead, we argue that the mentalité of the gold standard is an essential element among many contributing factors. The recent literature therefore ties together previous contributions in ways that reveal their essential unity. The modern analysis of the Great Depression began with Friedman and Schwartz.[6] Writing about the United States, they concentrated on policy

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[4] Friedman and Schwartz, 1963; Romer, 1993.

[5] As we explain later, Freidman and Schwartz, 1963, themselves invoked the role of the gold standard despite their apparent focus on entirely domestic events.

[6] Friedman and Schwartz, 1963.

actions and inaction by the Federal Reserve System, which they characterized as mistakes. More recent work has revealed that the Fed continued to act in the early 1930s according to the patterns it had established in the previous decade.[7] These patterns, as we will describe below, were designed to defend and maintain the gold value of the dollar against attack, not to promote domestic economic activity.

Kindleberger expanded the focus of the economic literature to encompass the world depression.[8] He emphasized the role of the missing hegemon: No longer London, not yet New York. But why was a hegemon needed? It was to manage the gold standard as it had been managed from London before the Great War.[9] Kindleberger's argument therefore is one aspect of the view presented here, not an alternative to it.

Several writers have seized on the level and inflexibility of wages as the prime cause of the Great Depression. Borchardt and James have argued this view for Germany; Bernanke more generally.[10] As we show below, the argument that wages were too high was an important part of the gold-standard rhetoric of the time. High wages were a problem within the gold standard. While the modern discussion isolates wage rigidity as an important component in an essentially Keynesian view of the Depression, contemporary policy makers tried to arrest the Depression by cutting wages -- a response that led to disaster.

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[7] Wheelock, 1991.

[8] Kindleberger, 1973.

[9] Eichengreen, 1992.

[10] Borchardt, 1991; James, 1986; Bernanke, 1995.

The First World War was a shock to the world economy, as it was to Edwardian society. Ford Maddox Ford's tetrology, *Parade's End*, captures the mood in Britain which felt the shock keenly, but the sense of a new and somewhat unpleasant world was pervasive.[11]

The by-gone world had been an international one. As John Maynard Keynes famously wrote in The Economic Consequences of the Peace,

> The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early deliver upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could despatch [sic] his servant to the neighbouring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language, or customs, bearing coined wealth upon his person, and would consider himself great aggrieved and much surprised at the least interference. But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable.[12]

Educated people -- businessmen, bankers and their professional children -- moved easily among capital and industrial cities from Moscow to Chicago, or at least from Berlin to New York. The authorities governing these cities promoted the economic stability that allowed persons and finance to move between them by adhering to the gold standard. The policy of buying and selling gold at a fixed price -- adhering to the gold standard, in other

[11] Ford, 1924-28.

[12] Keynes, 1919, p. 6-7.

words -- appeared to guarantee both economic stability and civilized interchange.

The gold standard had this power for both real and symbolic reasons. It symbolized the mentality and patterns of conduct of intellectual and economic elites. It was integral to the emergence of what Keynes referred to as "the investing class," whose members perceived saving and investing as a duty and a delight. "The morals, the politics, the literature, and the religion of the age joined in a grand conspiracy for the promotion of saving. God and Mammon were reconciled."[13]

More concretely, saving and investing were encouraged by the stability of money values. Thrift was rewarded because there was no danger of the real value of a financial asset being inflated away.[14] The gold standard, which promised stable prices and restrained the financial freedom of governments, was the guarantor of this belief. Because the gold standard was an international system, it stabilized the value of money contracts worldwide. The exchange rate stability it provided encouraged unprecedented levels of foreign investment. That countries like Britain and France invested a quarter to a third of their savings abroad between 1880 and 1913, fueling the expansion of the international economy, was a consequence of the gold standard and at the same time worked to enforce it.[15]

In order to maintain the policy of buying and selling gold at a fixed price, governments had to conduct their affairs within certain bounds. This disciplined behavior in

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[13] Keynes, 1923, p.6.

As Keynes pointed out, "so rooted...has been the conventional belief in the stability and safety of a money contract" that the law in many countries required those who oversaw trust funds to invest exclusively in gilt-edged bonds (Keynes, 1923, p.7).

On foreign investment and the gold standard, see Feis (1930), White (1933) and Edelstein (1982).

turn promoted economic stability in countries that adhered to the gold standard.[16] And the ability of governments to maintain this discipline was taken as a marker of the extent of the civilized world. The struggling countries of Latin America and Eastern Europe kept trying and failing to adopt the gold standard, making adherence to this policy a hallmark of a developed economy. Asian and African societies out of the orbit of European and American industry made no effort to join this club.

It seemed logical during and after World War I that reconstructing the gold standard (suspended during this war as in past wars) was essential to recover what was good in pre-war society. Even if internationalism would never be as absolute as before, the gold standard could still resume its dual functions. It could promote economic stability and delimit the range of modern society. As Benjamin Strong, Governor of the New York Federal Reserve Bank, put the point in a 1925 memo to Montagu Norman, Governor of the Bank of England:

> Mr. Norman's feelings, which, in fact, are shared by me, indicated that the alternative — failure of resumption of gold payments — being a confession by the British Government that it was impossible to resume, would be followed by a long period of unsettled conditions too serious really to contemplate. It would mean violent fluctuations in the exchanges, with probably progressive deterioration of the values of foreign currencies vis-à-vis the dollar; it would provide an incentive to all of those who were advancing novel ideas for nostrums and expedients other than the gold standard to sell their wares; and incentive to governments at times to undertake various types of paper money expedients and inflation; it might, indeed, result in the United States draining the world of gold with the effect, that, after some attempt at some other mechanism for the regulation of credit and prices, some kind of monetary crisis would finally result in ultimate restoration of gold to its former position, but only after a period of hardship and suffering, and possibly some social and political disorder.[17]

Bordo and Rockoff, 1996

[17] Strong Memorandum, January 11, 1925, quoted in Temin, 1989, p. 14.

This litany of evils that would result from forsaking the gold standard echoes the sermon preached to young Stephen Daedalus which told of the cumulative horrors of hell endured by those who abandoned the Catholic Church.[18] It speaks of dark forces -- financial and intellectual -- that would be unleashed by the failure to restore prewar monetary arrangements. The remedy Strong envisaged for these satanic forces is the reconstruction of the gold standard. The irony, of course, is that his memo anticipated events in the early 1930s actually precipitated by adherence to -- not abandonment of -- this monetary system.

But that was in the future; the past offered tranquility. There had always been economic fluctuations, of course. The Americans had roiled the financial markets during the election campaign of 1896, when William Jennings Bryan insisted, "You shall not crucify mankind upon a cross of gold," and investors wondered if the United States would continue to honor its obligation to sell gold at its fixed price. The resulting panic sent interest rates soaring and disrupted international financial transactions. But this panic was short-lived; it was not in the forefront of many minds in the aftermath of the Great War. The United States had shown restraint in external relations; its domestic politics disturbed but did not derange the international economy.[19]

More vivid and revealing was another crisis of the pre-war gold standard: the Baring Crisis of 1890. Speculation in South American land had been encouraged amid a tremendous expansion of Argentinean government debt. Eventually the government of that country found itself unable to service the accumulated debt. The London firm of Barings was caught in the

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[18] Joyce, 1922.

[19] Calomiris, 1994.

ensuing debacle. William Lidderdale, Governor of the Bank of England in 1890, understood his role in the world economy. The Argentineans could do what they wanted, but their excesses were not to threaten the gold standard. By involving a noted British firm in their dealings, they created conditions where their problems could generate panic in London.

To avoid a financial panic, Lidderdale had to accumulate reserves, discouraging thoughts that the Bank might run short, and encourage creditors not call in loans that might destabilize the markets. The first goal was accomplished by selling bonds to the government of Russia, borrowing through Rothschilds from the Bank of France, and securing guaranteed offers of loans from London joint-stock banks. The second was achieved by reaching an understanding with the banks not to liquidate loans they had made to bill brokers financing the American trade. When one bank began to call in loans nonetheless, Lidderdale informed its manager that if it continued to call in loans, he would close the bank's account at the Bank of England and announce that action in the evening papers. He gave the manager an hour to decide.[20] In this high-handed and successful operation, Lidderdale was not so much exhibiting the power of the Bank of England to maintain the gold standard as revealing the need for both international and domestic cooperation in a joint effort.

The Great War was a larger shock to the world economy than the Baring Crisis and appeared to policy makers as beyond their range of historical experience. The Bank of England could raise funds to deal with the short-lived increase in demand during the Baring Crisis but it could not finance the war by such means. The government borrowed on its own, and the Bank of England used its powers of moral suasion to discourage London banks from

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[20] Powell, 1915, p. 527.

undertaking transactions in precious metal. A key provision of the prewar financial system, the right to import and export gold without restriction, was limited by the high wartime costs and hazards of ocean shipping. Central-bank stabilization of the dollar-pound exchange rate was substituted for gold flows. Gold exports were prohibited only in 1919.

Like the Baring Crisis, the war was a temporary disruption. The lesson of history was clear. Temporary modification of the gold standard was only to accommodate the needs of war and postwar reconstruction. Once reconstruction was underway, Britain should go back on the traditional gold standard as it had done after defeating Napoleon a century earlier. But however clear the lesson, the dislocation of the Great War and its resultant inflation meant that resumption would not be straightforward. The problem of postwar economic organization was recognized during the war in Britain. The Lords Commissioner of His Majesty's Treasury appointed the Cunliffe Committee to consider the question and report back to the government. It did so in 1918.

The report of this committee and the reaction to it foreshadow the economic history of the interwar years. The report argued that the best defence against economic instability was the gold standard, and it invoked the stability of the past to predict that the same institution would generate stability in the future: "In our opinion it is imperative that after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay."[21] The restoration envisaged by the committee was the free purchase and sale of gold at prewar parities. Such expressions of the gold-standard mentalité would pervade discussions in the 1920s.

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[21] Great Britain, 1918, p. 5.

But the end of American support for the pound in 1919 and its subsequent depreciation meant that adopting the Committee's recommendation would require deflation, as had similar policies after the Napoleonic Wars. Reluctant to impose the costs of reducing wages onto returning soldiers, the government postponed the resumption of virtue for five years. It was the cry of the sinner in the old saw: Save me, God, but not quite yet. This doubt about the usefulness of the gold standard at all times and in all conditions anticipated doubts that would deepen in the course of the 1920s to undermine the policies that grew from the dominant mentalité.

The same traditional modes of thought affected financial policies in France and Italy. But while the Italians tried to emulate Britain and deflate in order to restore the prewar parity of the lira, the French were unable to reform their internal fiscal system in order to reduce even government expenditures. French rentiers counted on German reparations to restore their traditional prosperity. Even when occupation of the Ruhr led to German passive resistence rather than increased reparations, the French parliament refused to relinquish its memories of prewar prosperity.[22] In discussions about the value at which to fix the franc in 1926, one of the participants, Quesnay, hoped that they could "maintain the gold value of French prices below world prices and thus facilitate the life of country."[23] The accomplishment of this goal, at least for a few years, generated a massive accumulation of gold in France and contributed to the crisis of the gold standard a few years later.

The Italians followed the British example of deflating to reestablish prewar parity.

[22] Schuker, 1976.

[23] Quesnay, 1926, quoted in Mouré, 1991, p. **.

They sought to remain within the gold-standard club with all the benefits attributed to it. Italian government officials and central bankers were less responsive to the public will and instituted deflationary measures. According to Forsyth, Giolitti's assignment of "higher priority to financial and monetary stabilization than to cultivating the political support of the mass parties" led to fiscal retrenchment that in turn led to the March on Rome. At the same time that restoration of the gold standard was reviving the flow of capital into Italy, Mussolini was exploiting the domestic strains needed to achieve this result.[24]

The Germans fell into a policy of financial excess, ending in hyperinflation. Their experience was considered one of the object lessons proving the value of the gold standard. When stability was restored in 1924 through the Dawes Plan, the mark resumed its prewar parity. Adherence to the gold standard and its mentalité was intense in Germany after the experience of hyperinflation.[25]

Opposition to deflation was endemic in Britain, although it was far more orderly than in its continental neighbors. After the Labour Party was defeated in 1924, it adopted a program of "socialism now" which meant in practice a minimum wage and state-provided family allowances. These radical proposals were legitimated by the workers' contribution to the war effort; they were required because the reduction in costs required for the restoration of gold payments at the pre-war parity was threatening to reduce real wages.

Falling wages were noted most prominently in the coal industry, long a hotbed of labor activism. The demand for coal received a temporary boost in 1923-24 during the

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[24] Forsyth, 1993, pp. 236-38.

[25] Feldman, 1993.

French occupation of the Ruhr. The union and management reached an agreement during that time whereby workers were guaranteed a minimum wage. But the resolution of the conflict on the continent led to a renewed decline in the demand for British coal, and the agreement collapsed. The Prime Minister was brought into the renewed negotiations to repeat the mantra of the gold standard: "...all the workers of this country have got to take reductions in wages to help put industry on its feet"[26]

This of course is just one way of putting industry on its feet. But it is the only way open under the gold standard, since alternatives involving higher prices are not admissible. Calling for lower wages is the discourse of the gold standard because this call follows from the mechanics of the monetary system. Countries on the gold standard cannot devalue their currencies and allow the demand for exports to determine their exchange rate. They cannot expand the money supply to stimulate domestic demand, for doing so would push up prices, provoke gold exports, and weaken the exchange rate. For them, the only way to reduce prices is to reduce costs of production, and the largest of these costs is labor. It did however impose short-run costs to which the Prime Minister was alluding.

The unions were reluctant to bear these costs for a variety of reasons. They did not share the apocalyptic vision of the central bankers. They were not secure enough to trade current sacrifices for purported future gains. They had participated in the war effort and now expected recompense. Their reluctance to agree to wage reductions rendered the restored gold standard of the interwar years fragile and inflexible and transformed it from the guarantor of stability into the transmitter of the Great Depression.

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[26] Mowat, 1955, p. 292.

The Prime Minister's intervention and the subsidy he offered eased tensions on Red Friday, July 31, 1925. The Royal (Samuel) Commission recommended many measures for the coal industry the following spring, but insisted that wages had to be lowered in the short run. Like the Prime Minister, the Samuel Commission was using the rhetoric of the gold standard. The mine owners based their offer in the subsequent negotiations on the Commission's recommendation and insisted on lower wages and longer hours. The result was not only a coal strike, but a general strike. The strike ended in the defeat of labor, but also in solidification of opposition to the constraints of the gold standard that would weaken both the Tory government (defeated in 1929) and Britain's commitment to convertibility (abandoned in 1931).

Wages were less flexible after World War One in other countries as well. Borchardt argued that high German wages in the 1920s were the cause of Germany's economic collapse. Borchardt's assertion about the level of wages has been contested, and the issue is unresolved.[27] But that is not the issue here. The argument itself presupposes that German wages were inflexible. Otherwise, how could they have been out of line?

But we do not need to infer indirectly that German wages had become less flexible. Postwar changes in labor-market institutions limited the flexibility of German wages in the second half of the 1920s.[28] The number of workers covered by collective contracts rose enormously between 1913 and the mid-'twenties, although only a fraction of these contracts

[27] Borchardt,1991, Chap. 10; Kershaw, 1990.

[28] See Angell, 1929; James, 1986.

were national in scope.[29] This fragmented structure of collective bargaining was ill-suited for coordinating economy-wide adjustments and macroeconomic shocks.[30] It was buttressed by compulsory arbitration, first introduced in wartime but reintroduced at the end of 1923 in response to the labor unrest incited by the hyperinflation. Ministry of Labor officials responsible for appointing these arbitrators were less than enthusiastic about wage reductions. Henrich Brauns and Rudolf Wissell were the labor ministers of the period; Brauns came from a Catholic tradition stressing the importance of just wages, while Wisell was a trade unionist himself. Thus, the spread of unionism, collective bargaining and compulsory arbitration supplanted decentralized labor markets without constructing a coherent alternative compatible with the imperatives of gold-standard adjustment.

Moreover, the disturbances that had to be accommodated through the operation of this mechanism were all but unprecedented in scope. World War I had weakened the position of European producers in international markets and strengthened that of other nations. European exports to Latin America having been interrupted during the war, U.S. producers established

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As of January 1928, 1.4 million workers were covered by Reich contracts, 3.4 million by district or regional agreements, and a still larger number by company- or plant-level contracts.

Theory suggests that highly centralized and highly decentralized labor market have the greatest capacity to accommodate shocks. Highly decentralized markets can rise or lower wages through competition. If wages are too high, unemployment will result, and the competition for jobs will bid them down. In centralized markets, the same outcome can be achieved through a single centralized decision to adjust wages. Problems arise when markets are neither highly centralized nor decentralized. Groups covered by collective bargaining are too large for the impact of their agreements on the labor market as a whole to be negligible but too small to have the incentive to take those impacts into account. When the time comes for wage concessions, no regional or industrial union will be willing to move first. See Calmfors and Driffill, 1987. This would seem to be an apt characterization of the German situation in the 1920s.

marketing and distribution networks there and proved difficult to dislodge. The same result followed when British exports to India were disrupted and Japanese producers established a beachhead there. The additional burden of war debts and reparations then was superimposed on this shift in Europe's competitive position. So long as the United States continued to lend its balance-of-payments receipts back to Europe, adjustment could be delayed. But once the Fed applied the harsh medicine of the gold standard, higher domestic interest rates curtailed U.S. capital outflows, and the chickens came home to roost.

Faced with these uncomfortable facts, Montagu Norman, Governor of the Bank of England, simply denied that the gold standard and domestic conditions were related. Churchill secretly expressed his concern in early 1925 that Britain's return to gold could require Bank rate to rise, imposing "a very serious check . . . to trade, industry and employment." Norman responded: "Cheap money is important because 9 people out of 10 think so: more for psychological, than for fundamental reasons."[31] This, of course, is nonsense. When the Bank of England raised Bank rate to offset an outflow of gold, it damped domestic investment and employment just as surely as it attracted foreign reserves.

The sanctimonious quality of the restored gold standard can be seen also in the various missions sent by the United States to help the Weimar economy. The Dawes and Young Commissions, in 1924 and 1929, have been celebrated for their part in restoring and attempting to prolong stability in Weimar. The Agent-General for Reparation Payments appointed under the Dawes Commission, S. Parker Gilbert, was clear that his primary mission was to preserve the gold standard. As he explained the motivation for the Dawes Plan he

[31] Moggridge, 1972, Appendix 5.

administered, "The Experts' Plan thus established a protected system, which was intended to safeguard the German exchange against the danger of instability through excessive reparations transfers."[32] There was no need in Gilbert's mind to do more than assert the link between a stable exchange and a stable economy.

An earlier historiography suggests that some of these ills might have been avoided had countries returned to gold at more realistic parities.[33] This perspective suggests that higher prices and parities might have limited the need for deflationary adjustments in the 1920s. But they would not have removed the need for a radical reduction of wages and prices of a sort that politicized markets found it impossible to deliver once the Great Depression struck..

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Like the Baring Crisis and the Great War before it, the Great Depression was a shock to this happy world. Like the Great War, it was not immediately apparent that it would be as severe and last as long as it did. Nor was it inevitable. The Great Depression started out as an economic contraction like those before it. This recession was converted into the Great Depression by policies that accentuated the deflationary forces. Economic policies, in other words, did not act to alleviate the Depression in the early 1930s; they acted to intensify it.

Policies were perverse because they were designed to preserve the gold standard, not employment. Maintenance of the gold standard would in time restore employment, central bankers thought, while attempts to increase employment directly would fail. The collapse of output and prices and the loss of savings as banks closed their doors were precisely what the

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[32] Gilbert, 1927, p. 172.

[33] See for example Hume, 1970.

gold standard promised to prevent. Reconciling outcomes with expectations consequently required interpreting these exceptional events in unexceptional terms. Where the crisis was most severe, blame was laid on the authorities' failure to embrace the gold-standard mentalité. The Federal Reserve and the Bank of England in particular had succumbed to the lure of managed money. Having refused to play by the rules of the gold-standard game, they had committed "abuses of credit." They had sterilized international gold flows, preventing them from exerting their normal stabilizing influence on credit conditions. This prevented prices and costs from adjusting.

Louis Germain-Martin, French minister of finance in 1932, 1934 and 1935, argued that the attempt to use monetary policy to manipulate prices, in violation of gold-standard strictures, had brought on the depression.[34] Cheap credit had fueled an unsustainable boom, culminating in the inevitable crash, financial distress and depression. His advisor Charles Rist saw the slump as resulting directly from the artificiality of the preceding boom.

> [I]creased production would have provoked a general decline in the price level earlier if efforts had not been made from all sides to stimulate consumption artificially and to maintain it at a level superior to that corresponding to real income. It is there, in our view, that it is necessary to seek the specific origin of the present crisis."[35]

Prices and costs had to fall to reconcile growing domestic and international transactions with an inelastic supply of monetary gold. Thrift, that intrinsic Victorian predicate of the gold standard, would bring this about if central banks did not manipulate interest rates to

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[34] Germain-Martin, 1934, pp.20-21.

[35] Cited in Mouré, 1991, p. 33.

discourage saving and unnaturally stimulate consumption.

This same view prevailed in Washington D.C. and in the regional reserve banks of the Federal Reserve System. Even as unemployment spiralled upward, Lynn P. Talley of the Federal Reserve Bank of Dallas wrote George Harrison of the New York Fed that his directors were not "inclined to countenance much interference with economic trends through artificial methods..."[36] Treasury Secretary Andrew Mellon notoriously advised President Hoover that the only way to restore the economy to a sustainable footing was to "liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate...purge the rottenness out of the system..." As a result, Mellon continued, "people will work harder, [and] live a more moral life." The puritanical strand of gold-standard dogma continued to carry the day. Hoover himself regarded the gold standard as "little short of a sacred formula."[37] Any deviation he dismissed as "collectivism," an all-embracing label for economic and social decay. And the failure of governments and central banks to single-mindedly embrace this liquidationist dogma only made things worse. As Clement Moret, the newly appointed governor of the Bank of France, told his shareholders in January 1932,

> In order to bring the depression to its conclusion, it would have been necessary to stop the abuses of credit that have contributed so largely to the creation and spread of the crisis. In fact, there has been no movement toward a sufficient contraction of banking credits, so powerful were the efforts brought into play to maintain at any cost, by an artificial policy of cheap and easy money, the spirit of enterprise and the taste for speculation. This tendency has undoubtedly served to increase the disorders it was intended to mitigate."[38]

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[36] Talley to Harrison, letter, July 15, 1930, cited in Friedman and Schwartz, p.372.

[37] Warren, 1959, p. 280.

[38] Cited in Mouré, p. 37.

Britain was subject to the economic crisis, in this view, because the Bank of England had thwarted the gold standard's operation. "The real cause of the formidable crisis with which the world is struggling," the French financial journalist Frederic Jenny wrote in L'Information in January 1931, "is none other than the mistaken monetary policy which England has followed for the past ten years..." As his colleague Jacques Rueff put it, "an artificially low Bank rate and open market purchases had prevented production costs, including wages, from being forced down." The only option now was to let adjustment run its course. Expanding the money supply in violation of gold-standard precepts would only encourage further speculative excesses, leading to another crash and an even more catastrophic depression. Joseph Caillaux, Radical chairman of the French Senate's Finance Committee, echoed Mellon in arguing that weak enterprises had to be purged by deflation to permit the financial excesses of the 1920s from continuing to debilitate the international system.[39]

Where the Depression was late in arriving, this good fortune was ascribed to unqualified acceptance of the gold standard's dictates. That France was initially spared the worst effects of the slump was attributed to the strength and stability of the franc, the Bank of France's determination to comply with the dictates of the gold standard, and its seemingly inviolable gold reserve. Gallic conviction of the virtues of gold, evident in the pronouncements of Jenny, Germain-Martin, Moret and Rist, was reinforced by the country's experience a decade before. France had suffered a socially-divisive inflation in the first half of the 'twenties, when gold convertibility was in abeyance. The budget had run out of control

[39] Caillaux, 1932.

until the government was again subjected to gold-standard discipline. Commentators came away convinced that disregard for the gold standard led to financial excesses, economic chaos, and social turmoil. Similar views prevailed in other countries that had suffered high inflation. As Karl Helffrerich, banker and one-time German finance minister, put it in the sixth edition of his classic work, Money, abandoning the gold standard would make money a "bone of contention between brutal interests."

> "[A] fight would result between the interests concerned, and this fight would, in the absence of an objective criterion, be decided in advance, not by reason and justice but by brute force only. On the one side we should have all those who owe money fighting for the greatest possible issue of money and for the largest possible diminution in the value of money, and on the other side we should have creditors and all those in receipt of fixed salaries, dividends, and wages who would be interested in the preservation and the increase in the value of money. The fight which would be waged round the value of money would, more than any other economic conflict between various interests, necessarily lead to the demoralisation of economic and of social life."[40]

That the solution to the Depression might lie in rejecting gold was beyond the pale. The British Committee on Finance and Industry (the Macmillan Committee), reporting on financial problems in the summer of 1931, was prepared to entertain the heresy of a tariff before recommending that the gold standard be abandoned. British leaders were ready to turn their backs on nearly a century of free trade before jeopardizing sterling's hallowed status. Keynes, the committee's leading intellectual light, "was willing to try anything -- a tariff, quotas, a national treaty on wages, profits and rents, foreign lending restrictions -- anything except suspending the gold standard, which was too drastic to contemplate."[41]

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[40] Helffrerich, 1927, p. 621.

[41] Boyce, 1987, p.293.

The gold standard consequently was not abandoned. Its rhetoric was deflation, and its mentalité was of inaction. Central banks therefore stood ready to withstand financial panics like the Baring Crisis but not to preserve production or employment. The Federal Reserve System inferred from low interest rates and excess bank reserves that no panic was in sight and counselled inaction. When there was a threat to the US commitment to gold in 1931, the Fed responded by raising interest rates sharply and driving the country deeper into depression.

Support for the gold standard, however, was not as strong as the Rock of Gibraltar. A labor prime minister, no friend of the Bank of England, had occupied Downing Street since the summer of 1929. While a Republican still resided in the White House, Hoover announced in March 1930 that "the worst effects of the crash on unemployment will have been passed during the next sixty days," and the recovery for which he hoped did not materialize. The odds on his reelection lengthened dramatically. Both the Bank of England and the Federal Reserve enjoyed independence of action, but their autonomy was not guaranteed.

The authorities may have been hesitant to abandon the gold standard, but the rise of unemployment rendered them equally reluctant to vigorously defend it. Balancing the budget was a conventional remedy, but governments were hesitant to raise taxes or cut support for veterans, pensioners and the unemployed given the present economic distress. Left-leaning governments like Britain's were least prepared to apply such cuts, but they were also particularly obliged to convince the markets of their fiscal rectitude if their defense of the gold standard was to succeed. If they failed to raise taxes, the markets would attack, and the government might fall for having failed to defend the financial foundations of the nation. If they did raise taxes, they might be blamed for failing to defend the interests of its core constituency and fall anyway. Currency traders saw that officials had no way out. As Philip Snowden, the Labour Chancellor, succinctly explained the sterling crisis in his autobiography, "The opposition of the Labour Party to the Budget proposals had given the impression abroad that the country was not united."[42]

Nor were central banks prepared to raise interest rates as required to defend the system. When the sterling crisis struck London in July, the Bank of England, confronted by a 20 per cent unemployment rate, hesitated to raise its discount rate for fear of lengthening the dole queues. It waited nearly two weeks to raise Bank rate. When the first increase failed to halt gold losses, the rate was raised again. But this was the final change until the suspension of convertibility on September 19th. According to Kunz, "With business already very depressed, neither management nor labour nor their representatives in Parliament were willing to pay the price which such a high Bank rate would exact."[43]

The authorities were cornered. If they hesitated to raise rates, the gold standard might succumb to market pressures. If they did raise rates, they might be forced from office by political pressures. Anticipating that the rate rise was politically unsustainable, the markets might attack anyway. Panic flights of hot money, unleashed by the realization that countries like Britain had no escape from this dilemma, soon dwarfed the trade deficits and external debt service that dominated the balance of payments at other times. Central banks joined the fray, liquidating their own foreign securities to avoid capital losses in the event of

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[42] Snowden, 1934.

[43] Kunz, 1987, p. 184.

a foreign devaluation. Even true believers like Herbert Hoover were forced to acknowledge that gold and financial flows had become "a loose cannon on the deck of the world."[44]

The central bankers of the main industrial countries used their friendship to draw together in an attempt to keep the ship afloat. Norman of the Bank of England was in daily communication with Harrison of the U. S. Federal Reserve. He called on July 8, 1931 to say that he had heard from Luther, head of the Reichsbank, that Luther was going to fly one of the new aeroplanes to London the next day for an hour, then travel to Dover together with Norman. Luther would go to Paris to consult with Moret of the Bank of France, while Norman continued on to Basle.[45] This small group of men traveled around to impose their vision on a world not involved in their day-to-day decisions and hardly aware of the personal relations and constant communication of the central bankers.

In this unstable environment the gold standard became an engine for deflation. Supplies of money and credit were linked to the gold and foreign exchange reserves of central banks. But as uncertainty mounted about the stability of key currencies, central banks liquidated their foreign exchange balances to build up their gold reserves. The share of foreign exchange in global monetary reserves fell to 11 per cent by the end of 1931, down from 37 per cent three years before.[46] The Bank of France sold its sterling- and dollar-denominated bonds and presented the proceeds at the Bank of England and the Fed for conversion, forcing those central banks to defend their gold hoards. They restricted credit,

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[44] Hoover, 1952, vol. 3, p. 67.

[45] Clarke, 1967, p. 194.

[46] Nurkse (1944), Appendix A.

destabilizing commercial banks and depressing prices, production and employment. Bank closures disrupted the provision of credit to households and firms, forcing the former to cut their consumption, the latter to curtail production.[47] Deflation magnified the burden of outstanding debt, forcing debtors to curtail their spending still further in the effort to maintain their credit worthiness.[48] As the gold-exchange standard collapsed back into the kind of pure gold-based system that Moret associated with financial stability, markets were destabilized as never before.

The kind of foreign support that Lidderdale organized in 1890 at the time of the last great peacetime financial crisis was the obvious response, but such support was more difficult to assemble in 1931. Central bankers, preoccupied by problems at home, lost sight of their mutual dependence. What had been a world of interconnected markets had already begun to disintegrate under the pressure of the economic collapse. The disruption of trading relationships by World War I, the new tariffs adopted by the revenue-starved successor states to the Austro-Hungarian Empire and by industrialization-minded Latin American governments, and tariff hikes in countries whose domestic industries were devastated by the slump, all rent the fabric of the international system. The tangle of war debts and reparations and ill will bequeathed by the Versailles Treaty further soured the prospects for cooperation.

When the Credit-Anstalt crisis struck Vienna in May of 1931 and Austria sought foreign help, the French, led by the nationalistic Pierre Laval, demanded that Austria first renounce all intention of forming a customs union with Germany. Although New York and

[47] The most influential recent statement of this mechanism is Bernanke, 1983.

[48] This is the famous debt-deflation view of the Depression of Irving Fisher, 1933.

London provided some assistance, Brussels and Rome sided with Paris. When the crisis spread to Berlin and the German government solicited foreign aid, Moret demanded that Chancellor Brüning first withdraw his request to reopen reparations negotiations and halt the construction of pocket battleships. Harrison of the New York Fed agreed to contribute to the German loan only if the Reichsbank limited its credit to the banks, rendering that assistance useless for supporting the German financial system. The masochistic strand of the gold-standard mentalité grew stronger as the crisis mounted.[49]

This mentalité extended to the economic advisors of the governments and central bankers. Lionel Robbins, the youngest member of the Macmillan Committee, argued in 1934, "If it had not been for the prevalence of the view that wages rates must at all costs be maintained in order to maintain the purchasing power of the consumer, the violence of the present depression and the magnitude of the unemployment which has accompanied it would have been considerably less."[50] As always in the rhetoric of the gold standard, lower wages would have allowed the deflation required by the monetary system.

In the end, what led to that system's downfall was not just agitation on the Left but the challenge to the hegemony of gold-standard ideology from the fact of economic and financial distress. The more governments rededicated themselves to gold-standard policies, the worse economic conditions became. As the patient's condition continued to deteriorate, even true believers began to consider unconventional remedies. So long as France, Switzerland and the Benelux countries resisted the worst effects of the Depression, they could

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[49] Bennett, 1962.

[50] Robbins, 1934, p. 186.

ascribe the plight of their neighbors to their failure to cleave to gold-standard orthodoxy. Once their own economies were infected and repeated doses of strychnine only aggravated the condition, not even the most sacrosanct of economic doctrines was secure.

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As the Depression deepened, opposition to this ideology gathered strength, economically and politically. Yet the central bankers and political leaders who espoused the gold standard clung desperately to their faith in the face of economic reality and even the disintegration of the gold standard itself.

The British, caught on the horns of its dismal dilemma, abandoned their commitment to exchange British currency for gold at a fixed rate in the fall of 1931. The government's decision to suspend convertibility was earth shattering. For Jackson E. Reynolds, President of the First National Bank of New York, it was "like the end of the world..."[51] Tom Johnson, former parliamentary secretary for Scotland and Lord Privy Seal, famously exclaimed, "Nobody told us we could do that!" His comment is celebrated precisely because it aptly summarizes the prevailing sense of astonishment.

With hindsight, one can argue that this end should have been foreseen. Sustaining the gold standard required a stomach for harsh medicine, as the true believers incessantly repeated. Labor was reluctant to ingest this caster oil. Deflation that once might have elicited mute acceptance from the workers now provoked hunger marches and mass demonstrations. In Germany, the Communist-led Reich Committee of the Unemployed took to the streets in December 1929. International Unemployment Day (March 5, 1930) was

[51] Cited in Kunz 1987, p.113.

marked in the United States by large gatherings and serious clashes with the police.[52] The British National Unemployed Workers' movement staged a series of high-profile demonstrations. Hunger and despair often had led to alienation from organized politics and disenchantment with organized political parties, but dissatisfied workers now were better able to voice their objections due to the rise of socialist and labor parties and the spread of universal male suffrage. Even conservative governments intellectually committed to deflationary measures hesitated to stay the course for fear of inciting a political backlash.

Nowhere was this more apparent than in Britain, where deflation had been associated with high unemployment for a decade. Keynes, in publications like The Tract on Monetary Reform and private evidence to the Macmillan Committee, educated labor leaders like Ernest Bevin about the connections between Bank rate and unemployment. When Norman was called to testify before the committee, he met a double-barrelled attack from Keynes and Bevin. Bevin soon concluded that a replacement should be found for the gold standard, from which "only the rentier classes stood to gain." "[T]he deterioration of the conditions of millions of workers," he lamented, "was too high a price to pay for the maintenance of...international banking in London."[53] While Bevin signed the final report of the Macmillan Committee, he also drafted a dissent arguing that the system should be abandoned.

But even while freeing the economy from this strait-jacket, the Bank of England could not free itself from the gold-standard mentalité. It hesitated to reduce interest rates after devaluation in order to avoid inflation. Inflation! In the most deflationary setting the world

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[52] Garraty 1986.

[53] Williamson, 1991, pp.195-96.

has ever known, when prices in all industrial countries were falling about 10 percent a year. It was, in an observer's trenchant words, "to cry, Fire, Fire, in Noah's flood."[54] As late as June 1932, the Cambridge economists James Meade and Roy Harrod still felt compelled to draft a circular letter to The Times advocating the reduction of interest rates and the remission of taxes (or at least no increase). Still the Bank of England hesitated to cut interest rates and provide some stimulus for recovery. Eventually, in the second half of 1932, the Bank saw the light. But even then, "the old gold mentality" continued to hold "almost universal sway" except in Great Britain, parts of its Empire and Scandinavia.[55]

As a result of the banking crisis that set the stage for the British devaluation, the German government restricted transactions in foreign exchange. Even though Weimar did not devalue, the free purchase and sale of currency that was the hallmark of the gold standard was no longer allowed. Yet Brüning, like the Bank of England, could not free himself from the mentalité of the gold standard. Nor could other politicians in Weimar Germany. They continued to speak of Germany as being on the gold standard because the mark was maintained at parity, even though currency controls violated the fundamental activity of the gold standard -- as noted in the Cunliffe Commission and elsewhere--and made the maintenance of parity, a purely administrative matter.[56] Haunted by memories of hyperinflation and by Helfferich's words, Brüning continued to pursue policies designed to compress spending and preached the deflationary rhetoric of the gold standard. His famous

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[54] Hawtrey, 1938, p. 145.

[55] Blackett, 1932, p. 75.

[56] Borchardt, 1984.

decree reducing all prices was issued in December, 1931, six months after Germany effectively had abandoned gold.[57]

Across the ocean, Mellon and Hoover kept the faith, remaining staunch in their belief in the curative powers of the gold standard even as the American economy collapsed around them. The Fed raised interest rates sharply in October 1931. This contractionary policy in the midst of rapid economic decline was not "inept"; it was the classic central-bank reaction to a gold-standard crisis. Friedman and Schwartz acknowledged the power of the gold standard in this action in the course of their account of the American contraction:

> The Federal Reserve System reacted vigorously and promptly to the external drain, as it had not to the previous internal drain. On October 9, the Reserve Bank of New York raised its rediscount rate to 2 1/2 per cent and on October 16, to 3 1/2 per cent--the sharpest rise within so brief a period in the whole history of the System, before or since. . . . The mainenance of the gold standard was accepted as an objective in support of which men of a broad range of views were ready to rally.[58]

Even after losing the election of 1932, Hoover kept trying to enlist the president-elect in support of the gold standard. As late as February, 1933, Hoover tried to chide Roosevelt into a commitment to support the gold price of the dollar, arguing that devaluation would lead to "a world economic war, with the certainty that it leads to complete destruction, both at

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[57] Brüning of course had mixed motives. The goal of restoring prosperity vied with the aim of ending reparations. Brüning could argue that the gold standard forced him to take deflationary actions whose results he then could use as evidence against Germany's ability to pay reparations. But these added complications do not diminish the importance of the gold-standard mentalité. For Brüning could not have undertaken to prostrate the German economy without support from the rhetoric of the gold standard. And one suspects his motives may have been no more mixed than those of Secretary Mellon who was so eager to liquidate everything in sight. See James, 1986, pp. 32-35.

[58] Freidman and Schwartz, 1963, pp. 317, 382. "Inept" is Freidman and Schwartz's characterization of Fed policy. See Ibid., p. 407.

home and abroad."[59]

None of these people appear to have escaped from their mentalité under even the most extreme pressure. Brüning and Hoover maintained their deflationary policies for as long as they were in office, and they continued to champion them even after they lost power. Twenty years later, Hoover repeated approvingly his 1932 claim that the effect of maintaining the gold standard was good for the United States: "We have thereby maintained one Gibraltar of stability in the world and contributed to check the movement of chaos."[60] Brüning said he had fallen 100 meters from the goal.[61] He meant the end of reparations, not the recovery of employment, but he revealed no doubt that the proper policy had been to stay within the rhetoric and framework of the gold standard even after abandoning convertibility itself.

Given the hold of the gold-standard mentalité on central bankers and politicians, it took a change of leadership to change policy. The ideological constancy of Brüning and Hoover are only the most famous examples of members of Keynes' "investing class" who clung to their mentalité during many lean years. It took pressure from the laboring classes to change public policies, by changing leaders if their rhetoric proved inviolate.

Unemployment rose in the early 'thirties to cataclysmic proportions. The effects of this rise were legion, from the physical hardship of feeding a family to the demoralizing effect of being out of work. The postwar world allowed two forms of protest. One was mass demonstrations. They were tried on some occasions, but the pervasive unemployment

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[59] Hoover, 1933.

[60] Hoover, 1952, v.3, p. 189.

[61] James, 1986, p. 35.

made strikes less attractive and powerful as an expression of labor's will.

The second form of protest was the vote. Limitation of the franchise before the Great War was one way in which the ideology of the gold standard could rule without challenge. But the gradual extension of the franchise had given workers in industrial societies an avenue to express their views. Not as often as they may have liked, perhaps, but enough to voice their opposition to the gold standard after two or three years of economic contraction.

German voters began to abandon the traditional political parties soon after the Depression began. The Socialists were as committed to the gold standard as Brüning, which they showed by rejecting calls within their party for more expansionary policies.[62] German voters transformed the Nazis from a fringe party to a presence in the Reichstag in the 1930 election by increasing their seats from 12 to 107. The voters then vented their spleen on the traditional parties in July, 1932, when the Nazis won 230 seats. Voting analysis has not found a strong correlation between unemployment and Nazi votes in these elections. But it is hard to argue that the spectacular rise in the Nazi vote was independent of the economic contraction. The link was there, filtered through the rhetoric of protest rather than taken straight as a function of unemployment.[63] Still, no one could mistake the rhetoric of the Nazis for the rhetoric of the gold standard.

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[62] Woytinsky, 1961, pp. 462-72.

[63] Voters did not vote the Nazis into a majority position. In fact, they decreased their support for the Nazis in the second election of 1932 when Brüning's successors made the first tentative steps toward abandoning the rhetoric and policies of the gold standard. Instead the voters conferred enough respectability on the Nazis to allow Hindenburg, the Weimar President, to invite the Nazis into the government. It was all the Nazis needed to take over German society and cause endless grief to their own and many other people. See Hamilton, 1982; Childers, 1983.

Voters in the United States had to wait longer. So long as Hoover remained president, the investing classes shaped policy. Given a choice in November, 1932, the workers voted for someone who sounded not at all like the dour mavens of the gold standard, someone who heralded "reflation," not deflation, as the cure for America's ills. Roosevelt fulfilled their mandate by abandoning the gold standard shortly after taking office in March, 1933 and then refusing to contemplate a return at the World Economic Conference in July. Called to salvage what could be saved of the tattered gold standard, the conference had little promise in the horrendous conditions of 1933. Roosevelt blasted it before it even opened, signalling to the other members of the international investing class his sharp turn from the rhetoric of the gold standard. In Roosevelt's words: "The world will not long be lulled by the specious fallacy of achieving a temporary and probably an artificial stability in foreign exchange on the part of a few large countries only ... The sound internal economic situation of a nation is a greater factor in its well-being than the price of its currency."[64]

This change was still three years in coming in France, where the mentalité of the gold standard was particularly strong. The Bank of France operated with large gold reserves, and its appetite for more gold had contributed to the disintegration of the gold standard at the beginning of the 1930s. Despite multitudinous changes in government, the French barred anyone who disagreed with gold-standard rhetoric from power even after most of the world abandoned gold and began an economic recovery as a result. They organized the remaining true believers into a gold bloc in the aftermath of the abortive World Economic Conference,

[64] Nixon, 1969, p.269. The ordeal of the Depression had altered discourse so that now the gold standard was "artificial." Previously, deviations from gold-standard orthodoxy were said to yield "artificial" results.

and they repeated the tired rhetoric of the gold standard in the face of continued economic decline.

French opposition to this status quo developed only slowly, for anyone who advocated modifying the gold standard was accused of reopening the distributional conflict that had seized the French Republic in the first half of the 1920s. Advocates of devaluation were denounced as "heretics." Defenders of the parity launched a "crusade" against devaluation. The religious fervor with which true believers in the gold standard were imbued was clear to see.

Slowly but surely the heretics multiplied. Georges Boris, editor of La Lumiere, a weekly newspaper independent of the major political parties, was among the first to call for devaluation. Another independent journalist, Raymond Patenotre, argued for devaluation in 1932 as a way of promoting economic activity and permitting the adoption of public works initiatives. Patenotre was influenced by the example of countries like England, where there were already signs that devaluation had revived the economy. The first mainstream politician to join their ranks was Paul Reynaud, who called for devaluation in 1934. Reynaud, a former minister of finance on the moderate right of the political spectrum and long-time supporter of the gold standard, was converted by the persistence of the slump and, perhaps more importantly, by the inability of French governments to successfully apply the standard deflationary medicine.

By mid-1935 it could be said that French opinion was "becoming more and more reconciled to devaluation."[65] But those in power found it impossible to embrace the new perspective. The middle-of-the-road Liberal and Radical governments of the period toyed with a variety of reflationary initiatives but only to the extent that doing so did not jeopardize the inviolable gold-standard commitment. It took the 1936 election, which brought the Popular Front to power, to transform the rhetoric and mentality of economic policy. Under the Popular Front, further deflation was ruled out. The only options were devaluation, as in Britain, or exchange controls, as in Germany. For France, there was no question of which national example to follow. Even staunch defenders of the gold standard like Rist and Germain-Martin saw the adoption of German-style policies as unpalatable and enlisted as reluctant supporters of devaluation.

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The mentalité of the gold standard had developed during the long boom of the late 19th and early 20th centuries. It survived the shock of World War I and promised a safe haven for ships of state buffeted by stormy social, political and economic seas. Its anchor, however, proved a millstone around their necks. Rather than keeping the economies afloat, it helped to sink them.

The world economy, most observers agree, is endowed with powerful self-correcting tendencies. When activity turns down, its inner workings provide a tendency for it to bounce back. Only sustained bad policies can drive the world economy so far off this path that it

[65] British Public Record Office T188/116, "Note of an Interview with M. Monick on 16th May 1935," cited in Eichengreen, 1992, p. 370.

loses its capacity to recover.[66] And only a hegemonic ideology can convince leaders to persist in such counterproductive policies.

The gold standard provided just such a hegemonic ideology, supported by a rhetoric of morality and rectitude. Its rhetoric dominated discussion of public policy in the years before the Great Depression, and it sustained central bankers and political leaders as they imposed ever greater costs on ordinary people. The mentalité of the gold standard proved resistant to change even under the most pressing of economic circumstances. "What is astonishing," Basil Blackett observed in 1932, "is the extraordinary hold which what is called the gold mentality has obtained, especially among the high authorities of the world's Central Banks. The gold standard has become a religion for some of the Boards of Central Banks in Continental Europe, believed in with an emotional fervour which makes them incapable of an unprejudiced and objective examination of possible alternatives."[67]

Countries only began the struggle to restore prosperity under new leadership, that of individuals who had not been party to the rhetoric of the gold standard in previous lives. Thomas Kuhn argued years ago that scientific revolutions often take place when old scientists who steadfastly adhered to an old paradigm are replaced by new ones advocating an alternative.[68] So it was with the gold-standard paradigm. It proved easier in the 1930s to

[66] Perhaps the clearest recent statement of the conventional view among mainstream economists, as applied to the Great Depression, is Bernanke, 1995.

[67] Blackett, 1932, p.71. And not only on the Continent. Even at the depths of the Depression, people like Lionel (later Lord) Robbins could call for further deflation. Robbins continued to believe that "no really impartial observer of world events can do other than regard the abandonment of the gold standard by Great Britain as a catastrophe of the first order of magnitude." Robbins, 1933, p.117.

[68] Kuhn, 1962.

replace leaders inculcated with this ideology than to convert them.

Ultimately, this political class and the gold-standard ideology with which it was imbued contained the seeds of their own destruction. "The hard-boiled deflationists and bitter-end liquidationists of this era simply overplayed their hands," as one contemporary put it. "They recognized no limit of endurance on the part of the public, no end to the amount of punishment that the people could take...They had been run over by a steam roller they had not seen coming, namely, the human equation. They still think it wicked that this steam roller came along."[69] The world paid a high price before the mentality of the gold standard was flattened by this human steam roller, removing the obstacles to economic recovery.

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[69] Edie, 1934, p. 227.

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