

Currency Stabilisation in the 1920s: Success or Failure?

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ABSTRACT

The currency stabilisation process of the 1920s - going back to gold - has been much maligned by scholars past and present. That it had defects and eventually collapsed in the 1930s should not obscure our view of the motives for the return. Given the chaotic currency and financial situation following the First World War, it was inevitable that stabilisation would involve some form of fixed exchange rate system. The new gold standard was by no means perfect but in the conditions obtaining at the time it is very likely that this would have been true of any form of fixed exchange rate system. However, for most countries and, for the global economy, stabilisation appears to have been economically beneficial.

1. INTRODUCTION

THE INTERWAR years are remarkable in many ways, not least for the variety of exchange rate experiences. In contrast to the prewar period when the gold standard had reigned supreme in the major countries, the interwar period saw several different regimes. Following the general abandonment of the gold standard, either during or shortly after the war, there was a period of free floating, with very little government intervention, when many currencies often fluctuated quite violently, but generally in a downward direction against the dollar which emerged from the war as the strongest currency and one that became the yardstick for the subsequent stabilisation of other currencies. The floating period lasted until the mid-1920s, though there was no clean break since stabilisation was a haphazard and uncoordinated affair, each country stabilising its currency as and when it thought fit to do so, which in practice meant when it had brought its internal finances under control. By 1925, when Britain and the Dominion countries returned to gold, there were a sufficiently large number of countries back on the gold standard (or rather the gold exchange standard) to refer to a fixed exchange rate regime. This system lasted until the early 1930s when it disintegrated under the impact of the great depression and financial crisis of these years. A short period of floating ensued, when currency fluctuations were as violent as those of the early 1920s, to be replaced by a mixed system of semi-managed currencies within regional currency zones or blocs, such as the sterling area,

the gold bloc, the Reichsmark bloc and the dollar and yen zones.

The postwar gold standard has generally received a bad press following its dramatic break-up in the early 1930s. Conventional wisdom suggests that it was a mistake to resurrect a system which was more suited to nineteenth century conditions and which failed to work in the very much altered world after 1918 (see Condliffe 1941, pp. 102-3). Here we present an alternative scenario: that policy makers felt they had little option but to restore a fixed exchange rate system given the dreadful experience with freely floating rates in the early 1920s; and that the new gold standard was not an unmitigated disaster nor could it be held responsible for many of the economic problems of this period. In fact it was a strategy that yielded some benefits.

This paper examines the motives behind currency stabilisation and the return to the gold standard in the 1920s. It then assesses the costs and benefits of the restoration of exchange rate stability. The primary focus is on the European exchange rates.

2. THE BACKGROUND TO INTERNATIONAL MONETARY RECONSTRUCTION

Few countries emerged from the war with their monetary and currency systems unscathed. It is true that many countries retained the legal fiction of the gold standard during the period of hostilities by artificially maintaining the exchange rates of 1914, which meant that by the end of the war most of the Allied and neutral countries had a pattern of exchange rates not very dissimilar from that of prewar. However, once the tie with gold was formally broken and pegging operations ceased, most currencies lost their stability and depreciated against the dollar, then the world's strongest currency, by varying amounts. Thus by early 1920 (February) sterling had dropped to 35 per cent below its former par value (Yeager 1976, p. 319). Ex-enemy countries fared rather worse. The German, Austrian and Hungarian exchange rates continued to sink during the war and by the end of 1918 they had depreciated by 50 per cent or more against the dollar. Several other countries, including Belgium, Finland and Portugal, also experienced a substantial deterioration in their exchange rates (League of Nations 1920). In the years ahead many countries were to suffer much greater depreciation of their currencies (see Table 1).

The loss in exchange values was scarcely surprising given the fact that the war had seriously weakened the productive mechanisms of many economies; it had given rise to serious balance of payments problems, especially with dollar area countries; while large budgetary deficits to finance wartime commitments had stoked up inflationary pressures. Thus before currency stability could be regained it would be necessary, as Moggridge (1989, p. 258) notes, to clear away much of the financial debris of war, and in many cases that of reconstruction.

The restoration of currency stability was recognised as a matter of some urgency after the war, though initially the turbulent postwar conditions made it difficult to make any progress towards this goal. The return to the prewar liberal economic order - embracing freedom from controls, free trade in commodities and factors of production, and, above all, fixed exchange rates under a gold standard system - was regarded almost universally as a basic priority of policy (Arndt 1944, p. 223). The perceived virtues of the gold standard (for example price stability and fiscal rectitude) were never questioned, and its restoration was seen as the key to the return of world prosperity and stability. Both the Brussels and Genoa International Conferences of 1920 and 1922 stressed the urgency of returning to fixed gold parities (Orde 1990, p. 299; Fink 1984, p. 235; Kemmerer, 1944, pp. 109-10). The same message had already been transmitted loud and clear to the world by the Cunliffe Report of 1918, such that the return to gold

‘devint une affaire de prestige, un point de dogme, presque une question de religion.’ (van der Wee and Tavernier 1975, pp. 79-80).

**Table 1: Exchange values of European countries
(December averages, par value = 100)**

<i>Country</i>	<i>1918</i>	<i>1920</i>	<i>1923</i>
Austria	31.3	3.2	0.01
Belgium	71.2	49.8	23.8
Bulgaria	-	13.7	4.2
Czechoslovakia	-	10.0	14.4
Denmark	101.0	70.1	66.4
Finland	62.6	15.9	12.9
France	95.2	47.9	27.2
Germany	50.8	8.8	See note (1)
Greece	100.0	84.9	9.8
Hungary	40.7	15.5	0.03
Italy	81.5	39.6	22.5
Netherlands	106.2	94.2	94.5
Norway	103.7	76.9	55.6
Poland	-	6.3	See note (2)
Portugal	61.5	30.9	3.3
Romania	-	18.2	2.7
Spain	106.8	101.1	67.4
Sweden	108.6	80.6	98.1
Switzerland	106.9	95.5	90.7
UK	97.8	78.3	89.6
Yugoslavia	-	25.7	5.9

Notes: (1) 0.000,000,000,084; (2) 0.000,034. **Source:** League of Nations (1943, p. 42)

Whether the merits of the gold standard were as significant as most contemporaries imagined is a debatable issue (Yeager 1976; Triffin 1968); but, notwithstanding any reservations on this score, there was good reason why statesmen should have been anxious to restore the prewar international monetary system. Apart from questions of prestige and national honour, especially relevant to countries such as France and Italy, the fact was that European currencies and international finance generally were in a chaotic state for several years after 1918. The floating exchange rate system, which emerged after the war, gave rise to large and erratic swings in exchange rates, with a general depreciation of most European currencies against the dollar, which served to exacerbate inflation through import price pressures. Admittedly many

of the more violent movements in exchange rates were no doubt a product of the lax monetary and fiscal conditions in the constrained conditions of the period, but that did not alter the fact that they were seen as a major impediment to European reconstruction and recovery. Pigou, in his memorandum to the Brussels Conference of 1920, had warned that wide fluctuations in exchange rates were a great hindrance to trade and credit transactions (Pigou 1920, p. 12). A similar view was expressed somewhat later by the Head of the League of Nations Intelligence Service when he argued that trade could scarcely flourish when 'European exchanges for seven years danced and jumped with spasmodic and tireless energy. . . . That instability has not only rendered the transaction of business from day to day extraordinarily difficult and risky, but has for some years excluded the possibility of laying down any elaborate economic programme for the future.' (Loveday 1931, p. 31). Whether speculative activity on foreign exchange markets exacerbated fluctuations in exchange rates, as many contemporary commentators believed (see League of Nations 1944), is an issue which has given rise to lively debate in recent years. For the moment one might recall that more recent experience (post-1973) with the vagaries of floating exchange rates now affords somewhat greater sympathy with the motives of statesmen in the 1920s who were keen to restore an orderly and predictable pattern of exchange rates.

Contemporaries were understandably alarmed by the instability of exchange rates in the first half of the 1920s, and believed that no sound recovery of trade and output was possible until they had been stabilised. As the League of Nations (1920, p. ix) commented in one of its early reports: 'Everywhere currency and exchange disorder is hampering trade and retarding reconstruction. In some countries it is a prime factor amongst those which are causing a breakdown of the economic and social system.' Free floating was associated, rightly or wrongly, with currency depreciation and inflation and unsound finance. It was also deemed to induce excessive speculation in the exchanges causing exchange rates to overtrack from their true equilibrium levels. Such speculation was considered to be inherently destabilising, though recent research has cast some doubt on the veracity of this assumption (Aldcroft and Oliver 1998, Ch. 1). Be that as it may, for contemporaries, getting back to a fixed exchange rate system was not simply a nostalgic wish for the good old days, but a pragmatic response to unstable conditions. In virtually every discourse on the economics of postwar Europe, stabilisation was the key word; inevitably this foreshadowed a rapid return to what was seen as the golden Eldorado of before the war, since the gold standard and all that went with it was seen as 'the very anchor of the socio-political tradition and thus of stability.' (Barkai 1993, pp. 3-5). Even the iconoclast Keynes saw the wisdom of stabilising the exchange rates as soon as possible in order to encourage trade and investment. Though he rejected the old-fashioned gold standard as a 'barbarous relic', and was not in favour of a managed gold standard with the United States central to the system, since this would have left Britain in thrall to that country, he nevertheless advocated, through the pages of the *Manchester Guardian* in the Spring of 1922, an early stabilisation of the key currencies in Europe providing that no attempt was made to restore the old parities of those currencies which had depreciated by more than 20 per cent (Moggridge 1992, pp. 377-8; 382-3; *Manchester Guardian*, 6 April 1922; Keynes 1971, pp. 138-40, 1977, pp. 354-69, 1978, p. 40).

3. THE PROCESS OF STABILISATION

In contrast to the negotiated settlement on exchange rates following the second world war, the process of currency stabilisation in the 1920s was a long drawn-out and piecemeal affair.

Despite the resolutions of the Brussels and Genoa conferences calling for a degree of coordination, at least among central banks, there was no systematic plan to stabilise currencies, or groups of currencies, simultaneously, and as a consequence insufficient attention was paid to the vast changes which had taken place in world finance and the world economy through the period 1914-20 (Fink 1984, p. 235; League of Nations, 1946, p. 91). In practice currency stabilisation was a protracted process, with most countries acting independently of one another by stabilising their exchange rates at different times throughout the decade, as and when it best suited their needs, which usually meant when they had managed to regain control of their domestic financial systems. Delays were encountered due to friction over which groups in society should bear the costs of stabilising. This often involved a war of attrition between different socio-economic groups until the more conservative elements gained the upperhand and imposed the costs on the weaker members of the community, France being the classic case in this respect (Alesina and Drazen 1991, pp. 1173-4). Questions of prestige and national honour also played a large part in determining the nature of the restoration. Britain and the Scandinavian countries were intent on returning to their prewar parities irrespective of the economic consequences. Similarly, Mussolini pledged to 'defend the lira to the last breath, to the last drop of blood', in order to consolidate his power and enhance the prestige of his regime, even though this entailed the overvaluation of the lira (Cohen 1972, pp. 647-9).

In the convoluted process of securing political consolidation little room was left for rational consideration being given to the relative shifts in costs and prices which had taken place since 1914 when choosing new exchange rates. The chief objective was to choose a dollar rate that was thought to be defensible, though even this was disregarded when prestige or questions of honour were at stake, or when it was felt that a competitive edge could be secured by undervaluation. Furthermore, as de Cecco (1995, pp. 122-4) has shown, the timing of formal stabilisation was also influenced by the machinations of the two most influential bankers of the period, Montagu Norman (UK) and Benjamin Strong (US), who were keen to ensure that European countries did not select exchange rates that were too competitive. Britain also was anxious to maintain her former role as the leading financial centre which was one reason why Norman sought to persuade countries to adopt the gold exchange standard.

Table 2 provides details of the dates and levels of currency stabilisation for a selection of countries. One of the first to achieve success was Latvia which, without financial aid, brought a halt to inflation in the summer of 1921 and a new unit of account, the *Lat*, was introduced to replace the multiple currency system (Wolf 2001). Lithuania followed suit soon afterwards by introducing its own currency, the *Lit*, to replace the previously circulating foreign currencies, while Austria was the first of the hyperinflationary countries to bring in a new monetary unit. Czechoslovakia avoided the worst ravages of inflation by taking a hard-line fiscal and monetary policy which permitted a successful stabilisation in 1923. During the next two years several other countries returned to their prewar parities including Switzerland, Sweden, the Netherlands and the UK. By contrast, Germany, Hungary and Poland had to introduce new monetary units following the collapse of their currencies through hyperinflation. Britain's return to the gold standard in April 1925 provided the cue for the British Dominions and several other countries to stabilise their exchange rates. By early 1926 exchange stability had been achieved in 39 countries, 17 of which were in Europe, two in North America, 12 in Central and South America, two each in Africa and Asia and four in Oceania. In the latter half of the decade

the process was more or less completed. Several countries such as France, Poland, Estonia and Bulgaria moved from *de facto* stabilisation to a *de jure* basis, while a number of others, including Italy, Norway, Greece, Brazil, Argentina, Ecuador, Paraguay and Peru stabilised their exchange rates. By then most of the countries of the world had returned to gold and the number of gold standard countries was greater than ever before (Kemmerer, 1944, pp. 110-11). Several countries however, notably Japan, Portugal, Romania and Yugoslavia, had still to finalise their currency stabilisations, while Spain and Turkey continued to allow their currencies to fluctuate with the result that they depreciated significantly during the 1920s (Brown 1940 I, pp. 395-402; League of Nations 1937, p. 30; Keyder 1981, p. 69, pp. 84-5). China, Persia and Abyssinia were the main silver standard bearers. Spain is an interesting case, which is worth further study, since despite a fluctuating exchange rate, the country enjoyed remarkable price stability and avoided a deflationary stabilisation policy - the exception to the rule that paper currencies are more unstable than metallic ones (Hawtrey 1939, p. 245).

Table 2: Dates and levels at which currencies stabilised

<i>Country</i>	<i>Stabilisation date*</i>	<i>% of prewar value</i>
Austria	1922	new currency
Belgium	1926	14.3
Bulgaria	1924(1928)	3.7
Czechoslovakia	1923	14.3
Denmark	1926	prewar parity
Estonia	1924(1927)	1.1
France	1926(1928)	20.0
Finland	1923	12.5
Germany	1923(1924)	new currency
Greece	1928	6.7
Hungary	1924	new currency
Italy	1927	25.0
Japan	1930	prewar parity
Latvia	1922	0.8
Netherlands	1924	prewar parity
Norway	1928	prewar parity
Poland	1926(1927)**	new currency
Portugal	1929(1931)	4.6
Romania	1927(1929)	3.0
Sweden	1922	prewar parity
Switzerland	1924	prewar parity
United Kingdom	1925	prewar parity
Yugoslavia	1925(1931)	9.1

Notes: *Dates of *de jure* stabilisation where different from those of *de facto* stabilisation are shown in brackets. **Poland initially stabilised the gold value of its currency in 1924 but was forced to abandon it the following year. **Source:** League of Nations (1946, pp.92-3).

External financial aid played a rather variable role in assisting the process of currency stabilisation and but only in a few cases was it of crucial importance. Only in the case of Austria, Belgium, Hungary, Poland and Danzig was *de facto* stabilisation formally effected with the help of specific loans, credits or reconstruction schemes. The majority of countries managed to stabilise without drawing on external aid, though many did in fact arrange temporary forms of credit in case of emergency. The role of the League of Nations in financial reconstruction and currency reform was somewhat limited and haphazard. Only when economies were on the point of disintegration and the damage had already been done did the League step in with a reconstruction scheme, and even then its assistance was not always of crucial importance. This was true of Austria (1922), Hungary (1924), Germany (1924), Poland (1927) and Estonia (1927), all of which were helped by the League (League of Nations 1946, pp. 95-7). The League's efforts usually involved some measure of control over the financial affairs of the countries in question, which they were often unwilling to accept until things became really desperate (League of Nations 1930, 1945). For this reason countries were reluctant to turn to the League for assistance and so most of the credits and loans arranged in connection with stabilisation were provided by the major central banks.

Though lines of credit or loans arranged ostensibly for stabilisation purposes through the banks were fairly common, it is doubtful whether external aid in general was of vital significance in ensuring the technical success of currency reform. It is true that it could act as an important confidence booster when trust in the currency was being eroded by capital flight. On the other hand, much of the aid was too small or too late to serve a really useful purpose and, in any case, many of the credits were never utilised. Moreover, none of the specific stabilisation loans was raised for that purpose alone and hence it is difficult to determine what proportion of funds was used for the express purpose of currency reform. In some of the more extreme inflationary situations it is also doubtful whether external aid would have been much use however large the amount. The German experience provides a good case in point. Stability of the exchange rate ultimately depended upon domestic monetary reform and as long as inflation was allowed to continue, no amount of foreign aid would have saved the mark from headlong depreciation. But once inflation had been brought under control and preliminary stabilisation effected, then it was possible for a foreign loan to consolidate the final reform. Even when the basic conditions for exchange rate stability had been met, external assistance was rarely indispensable, though in the case of Austria and Hungary it may have had a favourable psychological impact (League of Nations 1926a, 1926b). The fact is that many countries never really required foreign assistance and that they had recourse to credits or loans in one form or another was largely because 'they had become almost a fashion in the twenties' (League of Nations 1946, p. 131). A fashion which had unfortunate consequences since, according to Meyer (1970, p. 3), credit and loan negotiations among central banks gave rise to friction and divisions of opinion which served to destroy international monetary and financial cooperation.

The format of the restored gold standard differed considerably from that of prewar. In few countries was the prewar monetary organisation fully restored in its original form. The full gold standard or specie standard, in which gold coins circulate internally and fiat money is readily convertible into gold, was abandoned almost everywhere with the odd exceptions of the United States, Sweden, the Netherlands and a few Latin American countries. Most countries adopted a watered-down version of the full standard with restrictions on the convertibility of

non-commodity money into gold and on the export of gold. In the few countries which adopted the gold bullion standard (for example Britain, Denmark and Norway) notes could not be readily converted into gold on demand except for export and then only at a fixed price and in large minimum amounts. Many countries in fact adopted the gold exchange standard whereby a country's monetary authority tied its currency to gold indirectly by dealing on the foreign exchange market to maintain a fixed exchange rate with a foreign currency which was on either a gold coin or gold bullion standard. By the end of the 1920s, 30 or more countries had adopted the gold exchange standard in one form or another and in each case there was legal provision for the central bank to hold foreign exchange reserves against notes and deposits. Only a small number of countries (including the US, UK, Canada, Australia, New Zealand, South Africa, the Netherlands, Sweden, Norway and Switzerland) were without legal provisions permitting the inclusion of anything but gold in the reserves of their central banks, though in practice most of them were substantial holders of foreign exchange (Brown 1940 II, p. 732; Jack 1927, pp. 43-4; Palyi 1972, pp. 116-17).

Although many countries originally harboured dreams of returning to the full gold standard at prewar parities, in practice the majority could never aspire to this ideal. The wide variation in domestic cost and price changes since 1914 relative to those of the United States, whose currency served as benchmark for the realignment of most other currencies, meant that the crucial question was *when* they could stabilise, and the rate at which they did was of secondary importance. Thus for most countries the best they could achieve was a gold exchange standard at a depreciated rate, and even this proved a struggle to achieve and maintain in many cases. Much depended on how willing and how quickly countries could get their domestic financial affairs under control and eradicate the inflationary pressures which were such a common feature of the early postwar years.

The manner in which stabilisation was carried out and the consequences of currency reform varied from country to country and it would be impractical to analyse each case. Dornbusch (1992, p. 418) identifies three indispensable steps which featured in most stabilisations: fixing the exchange rate, balancing the budget and securing the independence of the central bank, though not necessarily either simultaneously or in any specific order. It is possible to classify countries into three broad categories. The first of these comprised a select band of countries which managed to re-establish their prewar parities: the UK and the Dominions, Denmark, Sweden and Norway, Switzerland, the Netherlands and Japan. At the other extreme were five countries - Austria, Hungary, Germany, Poland and Russia - which were forced to bring in new monetary units after hyperinflation had destroyed the value of their original currencies. The third group, and by far the largest, included all the countries which retained their old monetary units but were forced to stabilise at a devalued rate. Stabilisation levels varied widely, as can be seen from Table 2, with the largest divergencies from parity occurring in East and South-eastern Europe.

4. THE COSTS AND BENEFITS OF STABILISATION

Most contemporary observers, as noted earlier, were strongly in favour of returning to a fixed exchange rate system, under the guise of a watered-down version of the prewar gold standard. This was regarded as essential for the stability and sustained prosperity of the European and international economy. Recent commentators have been rather more critical of this general accord, and with the benefit of historical hindsight and especially the experience of the 1930s,

have focused on the rigidity of the system and its impact on the great depression. Our argument here is that policy makers had little option, given the circumstances of the time, but to pursue the stabilisation strategy and that at least in the short-term it was a strategy that yielded some benefits.

For the purpose of this exercise it seems appropriate to focus attention on the real economic performance of the three groups of countries identified earlier:

- (1) *The Anglo-Saxon countries*: the UK, Sweden, Norway, Denmark, Switzerland and the Netherlands, all of which returned to their prewar dollar parities.
- (2) *The hyperinflationary countries*: Germany, Austria, Hungary and Poland. Russia is ignored here because of its special domestic factors.
- (3) *Countries with moderate to severe inflation and currency depreciation*: the selection here is confined to France, Belgium, Italy and Greece.

Countries returning to prewar parity tended to be at a disadvantage *vis-à-vis* those countries experiencing continuous inflation and currency depreciation. The elimination of inflation at an early stage in the Anglo-Saxon countries through severe macroeconomic retrenchment meant that they experienced a sharp downturn in the early 1920s, caused by a combination of internal recession and a decline in exports as the world-wide postwar boom collapsed and exchange rates became overvalued, especially against countries with depreciating currencies. The need to maintain a tight policy stance to bring about the internal price adjustment necessary to restore currency parities, also meant that subsequent growth potential was somewhat constrained. Thus the UK, Switzerland and the Scandinavian countries had a rather weak economic performance, especially in manufacturing, in the years prior to the return to the gold standard (UK 1925, Switzerland 1924, Sweden 1922, Denmark 1926, Norway 1928). The Netherlands, on the other hand, appears to have had a more robust growth record than the other countries which restored their former parities. However, it is perhaps misleading to make judgment solely on the basis of the pre-stabilisation years. Once return to gold was completed most of these countries, apart from the UK, performed quite creditably (see below).

When judging the hyperinflationary countries, the main point to bear in mind is the post-stabilisation effects. For a time these countries enjoyed some benefit from inflation and currency depreciation. Output and employment were more buoyant in the early 1920s than was the case in the Anglo-Saxon countries. In all cases there was a noticeable stimulus to investment, even though it may have been prompted by the desire at times to convert cash into hard assets to avoid the ravages of inflation. But the good times did not last. Inflation was driven to such extremes that currencies eventually became worthless; in time the beneficial effects of inflation dwindled and in the final stages they became negative. Economic activity then seized up and real earnings declined dramatically. Thus when new currencies were introduced there followed a post-stabilisation setback, with rising unemployment, while many of the former gains proved ephemeral. Even the investment boom was something of a mixed blessing since many of the assets created in the inflation period were not always consistent with sound long-term economic growth. Arguably however it was the longer-term political and social consequences arising from the inflationary episode, especially in Germany, that were the most disturbing (Aldcroft 1997, Ch. 3). As Feldman (1993, p. 837) points out, the legacy of inflation was to be found in every corner of Germany society and the spectre of inflation lingered on for many years to come. It not only weakened support for the Weimar regime, especially from

those groups who had lost their savings, but it also conditioned the policy reaction to the depression of 1929-33 which in turn completed the disintegration of Weimar democracy and Weimar capitalism (Balderston 1985).

The moderate to severe inflators (France, Belgium, Italy and Greece) appear to have got the best bargain. There were some lasting benefits without the disasters suffered by the second group of countries. Inflation and currency depreciation played an important role in the reconstruction and recovery of the French economy. The decline in the value of the franc helped to modify the impact of the recession of 1921, which was much less severe than in the Anglo-Saxon countries. It gave a sharp boost to exports and the tourist trade. Exports rose by no less than 56 per cent between 1922 and 1926, by which time they were around one third higher than in 1913 (Maddison 1982, pp. 250-51). Nor did the stabilisation of the franc pose a serious problem since France adopted a rate which undervalued the currency. Belgium's experience was somewhat similar though the recovery effort was not as impressive. One factor accounting for the difference was the poor record in exports which languished badly in the first half of the decade, still well below the 1913 volume in 1925, despite currency depreciation on par with that of France (van der Wee and Tavernier 1975).

The Italian and Greek experiences are less clear-cut partly because of the intervention of other factors. The Italian record was somewhat mixed despite inflation and a depreciating exchange until the lira was stabilised at an overvalued level in 1927. The expansion of total output was not especially impressive, but manufacturing surged ahead strongly for most of the decade, no doubt influenced heavily by the industrial promotion policies of the new fascist state. In the case of Greece it is particularly difficult to distinguish the influence of inflation and currency depreciation from that of other factors. Until the mid-1920s Greece suffered quite severe inflation and exchange depreciation due to lax fiscal and monetary policies arising from the war and political instability. Industrial production showed an impressive rate of growth of 7.5 per cent a year between 1921 and 1927. While inflation and currency depreciation no doubt imparted a short-term stimulus to industry, one should also bear in mind that manufacturers benefited from heavy tariff protection together with a sharp fall in real wages after 1921 due to the depressing effects on the labour market of a large increase in the country's population arising from the influx of expatriates, many of whom were urban workers, following defeat by Turkey in Asia Minor (over 1.5 million Greeks, or one quarter of Greece's population, were exchanged for some 400,000 Turks resident in Greece). It should also be noted that industrial expansion subsided somewhat when the authorities moved to stabilise the currency in 1927-8 (Lazaretou 1996, pp. 649-50, p. 664; Herschlag 1968, p. 24; Pentazopoulos 1962, p. 18).

How do the three groups of countries compare taking the decade overall? It is important to look at the 1920s as a whole since performance in the aftermath of inflation did not always match that of the inflation period, while early stabilisers could later reap some benefit from their financial rectitude. The record seems to confirm these suppositions. The hyperinflationary countries had the worst record overall through 1913-29. Exports failed to recoup their prewar levels; manufacturing performance was easily the weakest on average and the same was true for GDP growth. Austria and Poland were probably the two worst cases. By contrast, the Anglo-Saxon countries, apart from the UK, performed quite creditably. On average output, manufacturing and export growth were much better than in the case of the hyperinflationary countries, and compared favourably with that of the moderate inflators (see Tables 3-5).

On balance therefore, countries which experienced very severe inflation and loss in currency value had a distinctly desultory economic performance over the long haul compared with many of the confirmed stabilisers. The performance of the moderate inflators was commendable but by no means exceptional. The Netherlands and the Scandinavian countries for example, had a better overall performance on average than either France or Belgium (Tables 3-5). Accordingly, the conclusion would appear to be that inflation and currency depreciation were not necessarily a winning combination in the recovery effort.

Table 3: Volume of gross domestic product (1913=100)

<i>Country</i>	<i>1918</i>	<i>1919</i>	<i>1920</i>	<i>1921</i>	<i>1922</i>	<i>1923</i>	<i>1924</i>	<i>1925</i>	<i>1929</i>
Austria	73.3	61.8	66.4	73.5	80.1	79.3	88.5	94.5	105.1
Germany	82.0	72.3	78.6	87.5	95.2	79.1	92.6	103.0	121.3
Belgium	67.8	79.2	92.5	94.1	103.3	107.0	110.5	112.2	125.5
France	63.9	75.3	87.1	83.5	98.5	103.6	116.6	117.1	134.4
Italy	133.3	111.0	101.3	99.8	104.9	111.3	112.4	119.8	131.1
Finland	76.0	80.9	90.5	93.5	103.4	111.0	113.9	120.4	145.6
Denmark	93.8	105.9	110.9	107.7	118.6	131.1	131.5	128.5	153.0
Netherlands	90.7	112.4	115.8	122.9	129.6	132.8	142.5	148.5	117.4
Norway	96.3	112.6	119.7	109.8	122.6	125.3	124.7	132.4	158.6
Sweden	84.5	89.4	94.6	91.1	99.7	105.0	108.3	112.3	135.9
Switzerland	89.4	95.3	101.5	99.0	108.5	114.8	119.1	127.8	154.5
UK	113.2	100.9	94.8	87.1	91.6	94.5	98.4	103.2	111.9

Source:Maddison (1995, pp. 148-50)

It might be argued that there was a superior alternative to the stabilisation strategies so far considered, namely stabilisation at an early date and preferably with an undervalued currency. Obviously such a strategy was not available to all countries, not least because of the difficulties that many countries faced in restoring financial order. Latvia's early stabilisation seems to have been very successful judging by the remarkable recovery and restructuring of her economy in the 1920s after the appalling wartime devastation and loss of the Russian market (Wolf 2001, pp. 46-8). Czechoslovakia and Finland, both of which experienced substantial inflation in the immediate postwar years with sharp fluctuations in exchange rates in 1921 and 1922, soon adopted tight macroeconomic policies and by 1923 inflation had been brought under control and exchange rates stabilised at one seventh and one eighth respectively of their prewar levels (League of Nations 1925, p. 53). Keynes (1923, pp. 146-7) criticised the harsh policy in Czechoslovakia, which for a short-time caused an industrial setback and serious unemployment, but also recognised that the country was better placed than most other European nations to reconstruct her economy on the basis of a sound and fixed currency. In both cases the strategy was subsequently vindicated since in manufacturing production they outpaced most other countries. These examples are suggestive rather than conclusive evidence that alternative strategies were worth considering.

5. THE NEW GOLD STANDARD

Though there were still a number of stabilisations to be effected, most countries were back on fixed rates in the latter half of the 1920s (see Table 2), so one can speak legitimately of a fixed

Table 4: Volume of exports (1913=100)

<i>Country</i>	<i>1918</i>	<i>1919</i>	<i>1920</i>	<i>1921</i>	<i>1922</i>	<i>1923</i>	<i>1924</i>	<i>1925</i>	<i>1929</i>
Austria	-	-	-	-	-	-	75.6	82.1	86.3
Germany	15.0	17.0	36.7	44.4	61.3	52.9	50.8	65.3	91.8
Belgium	-	-	-	-	-	-	-	72.8	107.2
France	28.0	45.0	86.0	83.0	86.0	103.0	119.0	124.0	147.0
Italy	48.9	75.1	105.5	70.7	80.8	93.7	117.3	127.4	122.7
Finland	11.4	51.2	77.6	72.4	102.7	108.7	124.9	138.9	161.4
Denmark	39.9	38.6	77.9	87.2	96.6	123.2	142.5	138.4	181.0
Netherlands	23.8	81.3	87.4	83.0	93.4	103.7	124.6	134.9	171.2
Norway	61.1	67.1	90.5	76.0	97.8	104.5	110.8	121.8	167.1
Sweden	65.1	66.5	75.8	59.1	81.2	79.7	95.8	106.0	156.1
Switzerland	-	-	-	62.6	70.1	74.4	87.3	89.7	100.7
UK	37.7	54.7	70.7	49.3	68.0	74.7	76.0	74.7	81.3

Source: Maddison (1991, pp 316-18)

exchange rate standard. However, the new regime had very short life, 1925-31 at best, and for purposes of comparison even shorter since after 1929 the ravages of the great depression make comparisons somewhat meaningless. Effectively, therefore, we are dealing with the period 1925-29.

During these years things were much more stable and congenial to economic progress than they had been in the chaotic postwar years. Reconstruction in Europe was nearing completion by the middle of the decade and 'real progress began to take the place of a painful struggle to regain a plateau of prosperity which had been lost' (Loveday 1931, p. 47).

The new standard was widely acclaimed by many contemporary observers as a panacea for international stability and recovery (Sayers 1976, p. 111). Speaking on the eve of the depression, O. M. W. Sprague, financial adviser to the US Government and for several years also to the Bank of England, had this to say:

The gold standard has emerged triumphantly from the welter of disorganised currencies of the World War period and gold has now become more universally than ever before the foundation of the structure of credit throughout the world. This return to the haven of familiar monetary practice is significant of the widespread conviction that the gold standard is an essential factor in the maintenance of a reasonable measure of international stability, for which there is no promising or practical substitute (League of Nations 1930, p. 53).

The short-term costs entailed in its restoration were considered worthwhile since much was expected from it. Referring to Britain's return to gold, Cassel (1936, p. 40) believed that

the moderate deflation required was a price well worth paying since ‘the relatively small sacrifices involved in that step were much more than counterbalanced by the restoration of international confidence and by the stimulus given to international trade through the replacement of

Table 5: Indices of manufacturing production (1913=100)

<i>Country</i>	<i>1920</i>	<i>1921</i>	<i>1922</i>	<i>1923</i>	<i>1924</i>	<i>1925</i>	<i>1926</i>	<i>1927</i>	<i>1928</i>	<i>1929</i>
Austria	48.0	64.0	76.0	81.0	82.0	95.0	95.0	106.0	116.0	118.0
Germany	59.0	74.7	81.8	55.4	81.8	94.9	90.9	122.1	118.3	117.3
Hungary	-	64.0	80.0	56.6	66.6	76.7	83.4	98.7	108.0	113.9
Poland	35.1	46.8	73.9	71.2	56.8	63.1	58.9	76.1	86.1	85.9
Belgium	67.3	55.8	80.6	92.1	104.4	100.0	117.4	127.7	137.4	139.9
France	70.4	61.4	87.8	95.2	117.9	114.3	129.8	115.6	134.4	142.7
Italy	95.2	108.1	119.3	140.7	156.8	162.8	161.2	175.2	181.0	164.0
Denmark	127.8	106.9	112.6	125.1	136.2	126.4	126.4	127.9	138.3	160.6
Netherlands	-	109.9	115.2	117.4	127.5	141.8	147.4	159.9	174.5	187.3
Norway	101.9	71.8	90.0	99.8	107.2	117.0	104.2	106.5	118.2	131.2
Sweden	97.2	74.7	87.2	96.8	100.9	112.7	123.5	126.8	136.0	150.8
Switzerland	94.5	71.4	76.0	86.7	93.3	95.5	90.0	103.2	109.8	117.5
UK	92.6	55.1	73.5	79.1	87.8	86.3	78.8	96.0	95.1	100.3
Czechoslovakia	69.8	100.0	91.8	96.7	129.0	136.4	130.4	153.8	166.0	171.8
Finland	87.4	88.5	104.5	119.7	123.6	152.5	164.7	186.1	202.6	197.6
World	93.2	81.1	99.5	104.5	111.0	120.7	126.5	134.5	141.8	153.3

Source: League of Nations (1945, pp.134-7).

the pound sterling in its old position as the principal currency of the world's trade.’ Most countries faithfully believed that its restoration would solve the economic problems left outstanding from the war. Even some later writers conceded that its resurrection had some merit even though they were conscious of its shortcomings (Sayers 1960, p. 324; Kunz 1987, pp. 189-90; Hardach 1995, p. 187; Brown 1940, II, p. 801).

Generally however the gold exchange standard has been much maligned by more recent writers, and even the faith of contemporaries was somewhat shattered following its rapid disintegration during the depression. To some extent subsequent criticism has been based on misconceptions on what the new gold standard could or could not do within the context of the period.

The main issue is how the economic variables performed post-stabilisation. As might be expected, nominal values in prices and exchange rates were remarkably stable compared with what had gone previously. The average yearly depreciation of European currencies was a

mere 0.2 per cent between 1927 and 1931 as against around 6 per cent during 1923 and 1926 (excluding Germany), while exchange rate variability was minimal (Simmons 1994, p. 109). World production rose steadily after 1924 in all regions, and in contrast to the early 1920s world trade rose more rapidly than output. The sustained expansion of the latter coincided with the marked improvement in currency stability after 1923, as shown by the figures for Europe's trade in Table 6 (Woytinsky and Woytinsky 1955, pp. 39-42; Svernilson 1954, p. 292). However, it should be noted that there was also a strong gain in trade volume between 1921 and 1922 even when currency instability was near its peak. But there were exceptional factors operating here, notably a sharp rebound in Anglo-Saxon trade following the postwar slump and also the trade gains arising from currency depreciation in the hyperinflationary countries. On balance however, this does not detract from the proposition that stable exchange rates were more conducive to sound trade growth. Moreover, as we have already noted, once countries had got over post-stabilisation adjustment they were in a better position to secure sound growth than had been the case in the disturbed conditions of the first half of the decade.

Thus the main thrust of the argument here is that whatever the defects of the new standard, it was preferable to the chaotic conditions prevailing in the early 1920s. That it disintegrated in the early 1930s should not lead one to conclude that stability of exchange rates was something to be ignored or that fixed exchange rate systems were unworkable, providing there are no serious misalignment of exchange rates. These conclusions are reinforced by the experience of the 1930s: in the first instance by the re-emergence of disorderly rate movements after

Table 6: European trade and currency fluctuations, 1922-1927

	1922	1923	1924	1925	1926	1927
Trade (1)	100	105.5	123.8	129.5	130.2	145
Currency Fluctuations (2)	13.2	10.7	2.6	1.4	1.6	-

Notes: (1) Index of volume of Europe's foreign trade; (2) Weighted index based on average monthly percentage variations in dollar value of European currencies

the collapse of the gold standard, followed by more stable exchange rates within regional currency blocs.

If stable exchange rates were important for economic progress, then why has the restored gold standard received such a bad press at the hands of later researchers? There are several possible reasons. First, too much was expected of the new standard. Contemporary observers fully anticipated that it would correct the postwar maladjustments, a view based on the misinterpretation about the working of the gold standard before 1914 and its operation in a different economic context postwar (Miller 1934-36, p. 87). As Brown (1940 II, p. 801) succinctly put it: 'Before 1925 concentration upon the goal of a return to normal and upon the achievement of stable exchange rates, and after 1925 the splendours of a stable exchange standard blinded the eyes of bankers and of the world in general. The illusion that the economic maladjustments would be corrected by automatic forces was dominant in the world's financial thinking.' It was not that there was anything intrinsically wrong with a fixed exchange rate standard as such; rather the problem lay in the manner in which it was restored, which meant

that currency values were out of kilter from the start. The postwar gold standard has been criticised on many grounds, but probably its most serious defect was the unsystematic way in which exchange rate stability was rehabilitated. Lack of coordination gave rise to an unworkable system of exchange rates many of which were out of equilibrium from their inception. The most glaring examples were the undervaluation of the French and Belgian currencies, the overvaluation of sterling, the lira and the Scandinavian currencies, and possibly the German mark. No system, however good in principle, could be expected to work smoothly starting out from an initial position of disequilibrium. Any fixed exchange rate system is only as good as the sum of its component parts and since these were often found wanting disintegration was only a matter of time. The position was well summarised by the League of Nations (1944, p. 117): 'The piecemeal and haphazard manner of international monetary reconstruction sowed the seeds of subsequent disintegration. It was partly because of the lack of proper coordination during the stabilisation period of the twenties that the system broke down in the thirties.'

Another reason why it fell into disrepute was that it was associated with unemployment, especially in countries which returned to parity with Britain being the standard test case. Again this is a rather generalised misjudgment of the issue. All the unemployment of the 1920s cannot be laid at the door of the gold standard since there were structural problems arising partly from the dislocations caused by the war and also as a result of technical changes, which meant that unemployment would rise. An increasingly protectionist environment also tended to work in the same direction. In any case, currency stabilisation, at whatever value, was bound to involve a temporary setback to economic activity and a rise in unemployment. The control of inflation and currency stabilisation are virtually always followed by a short-term setback to economic activity. Some countries, the UK in particular, suffered from an overvalued exchange rate following stabilisation but others gained from undervalued currencies. It is probably Britain's unfortunate experience that was partly responsible for giving the gold standard a bad name.

But probably the major factor, which conditioned views about the gold standard, is the fact that it eventually became associated with depression. That it disintegrated in the early 1930s after such a short life would seem to offer conclusive proof that it was inherently defective compared with its classical predecessor. In a sense it was, both in the nature of its restoration and the manner in which it was operated. More pertinently, it has been seen as a significant contributor to depression in its own right (see Bermanke 1995 for a review). The links forged by the fixed exchange rates of the gold standard assured that the decline once begun would be world-wide for, as Friedman and Schwartz (1963, p. 359) pointed out, no major contraction involving a substantial fall in prices could develop in any one large country without those links enforcing its transmission and spread to other countries. In turn, the pressures this imposed on countries eventually led to the disintegration of the gold standard itself. Additionally, the gold policies of the central banks may also have contributed to the turning point of the cycle. The sharp rise in gold reserve ratios from the autumn of 1929, indicative of a contractionary stance in central bank policies, had an important influence on the subsequent price decline. According to Sumner (1991, p. 379) 'shifts in central bank demand for monetary gold were of sufficient magnitude to have had a major impact on the world price level during the period from 1926-1932.' Whereas the world gold reserve ratio had increased at a rate of 2.53 per cent a year between December 1926 and October 1929, it rose by no less than 9.62 per

cent in the following twelve months.

More recently Johnson (1997, p. 186) has re-examined the wider question of world liquidity. He maintains that the price and profit deflation of the late 1920s and early 1930s were symptomatic of a world-wide liquidity shortage, caused by undervaluation of the price of gold, diminished gold production and national policies, which encouraged gold hoarding and sterilisation. The French were the major culprits; their appetite for gold was insatiable following the *de jure* stabilisation of the franc and the active policy of sterilising incoming gold further shrank the superstructure of world credit. Thus although the degree of concentration of gold resources was little different from that prevailing before 1914, the postwar monetary system was faced with the intractable problems of diminished world liquidity and national policies, which aggravated rather than relieved the situation.

Whether international collaborative effort by the major powers to take corrective macroeconomic action to combat depression would have retrieved the situation and saved the gold standard has become something of an academic debating point in recent years. Some see possibilities on this score (Foreman-Peck, Hallett and Ma 1996). But the arguments are tenuous and less than convincing. Sumner (1992, p. 315) reckons that policy coordination would have done no more, at best, than allowed the world to muddle through until the second world war dealt the final blow to the system. Some would question whether the gold standard was worth saving in view of its inherent structural defects and its contribution to depression. Johnson (1997, 182) concludes that it may have been too late by 1931 to save it: 'If the underlying liquidity problem could not be alleviated, it was better for the world economy that the gold standard fail.' Even contemporaries were doubtful about its viability in a disordered world. To quote Miller (1934-36, p. 86), 'The world was too disorganised, on both the economic and financial side, to provide the conditions essential for the satisfactory operation of the gold standard.'

The details of the chain of events leading to the disintegration of the gold standard need not concern us here. Suffice to say that cracks in the system began to appear in 1929-30 when several countries along the periphery abandoned the standard. But it was Britain's departure in September 1931 that effectively spelled the end of the system. 'England's abandonment of the gold standard', wrote one contemporary, 'was . . . a bomb loaded with enough dynamite utterly to shatter the international price and monetary structure' (Hansen 1934-36, p. 66). Many other countries followed Britain's example and the process was all but completed when the United States broke the link with gold early in 1933. After a short period of free floating, managed currency systems became the order of the day.

6. CONCLUSIONS

The new system of international monetary relations established so painfully during the 1920s had many defects as most commentators have recognised. But this is scarcely surprising given the chaotic conditions out of which it was carved. The fact that the new gold standard collapsed in the 1930s is not sufficient justification for castigating its role in the stabilisation process. Whatever its defects, which arose partly from the manner in which it was restored, one should recognise that any system of fixed exchange rates would probably have suffered from similar attributes in the circumstances of the time. Given the difficult economic conditions prevailing in the postwar period and the extreme volatility of exchange rates, there was little question, as far as most contemporaries were concerned, that currency reform meant fixed not floating rates

of exchange, and since the apparent success of the prewar gold standard was still fresh in the minds of policy makers it was inevitable that some form of the previous international monetary standard would be put in place.

The motives and objectives of those responsible for the restoration of fixed exchange rates were therefore sound enough. And, for a time at least, currency stabilisation proved beneficial for many countries and for the world economy as a whole. There were, it is true, short-term costs involved in the stabilisation process itself, but for the most part the majority of countries benefited thereafter. The few that faltered, for example Germany, Poland, Austria and the UK, either had suffered from hyperinflation or had pitched their currencies at too high a level.

Whether the 1920s provides a good laboratory case study for the analysis of fixed versus floating rates of exchange is a matter which has exercised the minds of many economists and economic historians since that time. Traditional wisdom and plain common-sense would seem to suggest that the extreme volatility of exchange rates under free floating of the early 1920s was harmful to macroeconomic stability. But whether one can conclude from that experience that floating is always pernicious and that it tends to lead to overtracking of exchange rates through self-aggravating capital flows is another matter. As Tsiang (1959-60, p. 245, p. 273) noted, the underlying instability of exchange rates in this period can be traced to a supply of money and credit, which was extremely elastic with respect to interest rates. This view would seem to accord with the belief of Dornbusch (1983, p. 4) that flexible rates perform badly under conditions of significant monetary and fiscal disturbance, and hence they require as much managing as fixed rate regimes. Thus, if there is a greater tendency for the abrogation of sound monetary and financial policies under free floating regimes, which eventually results in chaos in the exchanges, the case for preferring fixed exchange rate systems would seem to be strengthened.

ENDNOTE

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