In Search of Monetary Peace[*]

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Let us begin with a clarification about the starting and ending points of the present contribution, ca. 1919 and 1920 respectively: Both years are to be taken not in strict and binding chronological succession, but rather in a logical, historical and historiographical sense. Considering both published and unpublished papers, one finds that already before the economic crisis of 1907 some of the best financial minds of the time (from Lexis to Wolf, from Knapp to Luzzatti) operated in a classic gold-standard multipolar system. They rooted their theoretical positions not only in specific disciplinary dictates (anchoring them to more or less intrinsic links with domestic policies and international economies), but also in the concepts (or principles) of credibility and cooperation. Barry Eichengreen says that this echoed public confidence in the commitments made by government to a certain policy line. He insists on the importance of the links between finance and the real economy, sustained with different arguments by Kindleberger and Temin, as well as by Friedman and Schwartz, who relate those links to the propagation of the effects of crises. This was particularly evident in the United States, marked by bank failures and a subsequent

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liquidity crunch, as pointed out by numerous authors, from Rozenraad to Bonelli.

Some instances of the above-mentioned issues can be found not only in contemporary events, but also in the acts of the Latin Union, the Scandinavian Union and the German Union, and in the monetary conferences of 1867, '78, '81,'85 and, especially, '92 when Julius Wolf outlined the idea (later partially implemented in Bretton Woods) of depositing a gold reserve in a neutral country in order to issue international bank notes. On this point Wolf basically agrees with Luzzatti, although the latter's views are fuelled not only by realism, but also, so to speak, by ideality. In truth, this difference is not to be underestimated, especially when there is a shortage of liquidity, when there is a need for money and the solvency of the national economy and especially of bank notes is called into question. Fast and effective help is then required. Such financial assistance can consist in transferring gold from an issuing bank to a kindred bank of another State, although establishing rigid rules and stipulating contracts a priori could, at the very least, be risky, given the different economic circumstances and political relations of the parties involved. Banks that at any given time are still able to offer gold to other countries should not, however, commit themselves in the long term, so that agreements only contemplate the opening of negotiations when the need arises. In other words, it would be a matter of establishing a practice that would occur without any binding provision. Such an agreement would necessarily be more formal, but in times of scarcity every bank could keep its gold for itself, since its position would become weaker if it tried to strengthen that of other parties. It is therefore necessary to keep an eye on services that cannot easily be regulated, for, as Wolf points out, they can be rendered even less easily.

Knapp starts from a different viewpoint, supporting the chartalist thesis that money does not have an intrinsic value per se but is a "creation of law". If the argument is simply that a State can "declare legal tender an object […] or pay-token or ticket", and that such a "proclamation" has "considerable effectiveness" in imparting on that same warrant "a certain value", this is an obvious truth, indeed even "a platitudinous one"; if, instead, the contention is that the action of the State is sufficient to determine "the value of that pay-token", this assertion results in "an interesting but false proposition".

Luzzatti appreciates Wolf and Knapp, but has even greater esteem for Lexis, a professor at the University of Göttingen and perhaps the greatest student of monetary questions in the early twentieth century. Luzzatti is familiar not so much with Lexis's statistical writings, but rather with his so-called mark-up theory. In what does Luzzatti follow Lexis and where do they differ? A point of convergence lies in the shared goal of desiring to avoid financial crises as far as possible and to find forms of international monetary cooperation: this objective comes from afar, in the sense that some traces of it can be found in the mid-1850s and still more from the mid-1870s onwards, when Luzzatti, studying the methods used by the National Bank of Belgium to defend its gold reserves, proposed that the National Bank in the Kingdom of Italy be authorized to hold part of its reserves in interest-bearing accounts with foreign banks and in foreign bills, thus anticipating a gold-exchange-standard logic. In other words, Luzzatti understands that, especially for small countries, the problem of monetary stability lies in the cost of the reserves and in the difficulty of getting gold or silver "when large financial centres [...], by raising the discount rate, convince their short-term investors to temporarily repatriate their capital". It follows that small debtor countries are subjected to "sudden departures of metal, finding themselves forced to repay their debts on demand".

Luzzatti's beliefs are supported by other events during the 1880s, when the abolition of the fiat money system and the restoration of metallic convertibility at nominal parity occurred amidst potential national and international instability that would worsen in the following decade. These developments came on top of the tensions caused by the new polycentrism of the financial system, which changed the patterns of pre-existing economic relations and stoked the main central banks' appetite for gold. To slow this "gold rush", Luzzatti suggests creating a supranational body with the aim of "automatically recycling reserves between financial centres that lose them and centres [...] that gain them as a result of short-term capital movements induced by interest rate rises". This leads to his proposal not only to create a stable body to deal with the international circulation of gold, the regulation of stock exchanges and the unification of international financial law, but also to promote an international convention empowered to dictate shared rules in order to guarantee a monetary order. One of these rules is to regulate gold advances that banks should grant each other, not excluding, and indeed foreseeing, the ability to examine banks' portfolios.

How to achieve this hoped-for banking solidarity? Whatever the answer, issuing banks, in order to honour their obligations, trade tickets at any time and return deposits without delay, need security and must be able to collect advances and loans when they fall due. American treasury bills issued against gold and having coupons payable in Europe are accepted with confidence by issuing banks, even without complying with their statutory provisions. As for Luzzatti, he agrees with Lexis that issuing banks do not make loans in gold because of "fraternal feelings". Gold, he explains, "has no guts! But it is the clear and prominent vision of economic interest that has often led the Bank of France to help that of England and which has persuaded the Austro-Hungarian Bank to help [that] of the German Empire". This does not mean that in such affairs the sentiment of brotherhood should replace the logic of self-interest. Instead, it can be affirmed that "in trade treaties, in postal and telegraphic unions, in all other economic institutions that consider the world in its great entirety, it is not a feeling of brotherhood that determines the commonality of business, [but rather] it is retrospectively that of the usefulness of common affairs that gives rise to the persuasion of the existence of a human brotherhood".

At an operational level, considering how to contain gold movements and money market tensions, Luzzatti looks, on the one hand, at the Postal Union, which by then had become a large and efficient clearing house, and, on the other, at small issuing banks, which on several occasions had taught "what big ones should have done". The reference is not only to the National Bank of Belgium, but also, for example, to the Bank of Romania, as well as to the national banks of Norway and Sweden, whose collaboration in 1905 was decisive at the time of the political separation between the two countries. Already in 1912, in Brussels, Luzzatti asked and obtained that the International Economic Union be an active party in setting up a clearing agreement between participating issuing institutions. He supported the use of monetary conventions, as "indispensable means to make possible the cooperation among issuing banks in exceptional contingencies".

In August 1915, during the Italo-French conference in Cernobbio, Luzzatti proposed that an international committee be set up in Paris to curb speculation and lay the foundations for a world clearing house. This proposal was later taken up in the International Trade Conference held in the French capital in 1916, during which Luzzatti recommended an agenda that would lead to the appointment of a standing committee charged with "studying and suggesting all measures capable of attenuating gold movements and of establishing a clearing house with the aim of moderating exchange tensions amongst allied countries".

After the hostilities ended, monetary instability became a problem not only in Italy but also in France and England, where operations to support the respective currencies ceased. This situation was generated both by a veritable "ticket flooding" and by the disappearance of a robust system whose core lay in the free trade of gold. But how to restore a framework of stability? This question could be answered only after other issues had been solved, first and foremost the dilemma: price stability or exchange-rate stability? Plainly, the immediate resumption of the convertibility of gold tickets was neither necessary nor possible. In contrast with the past, the mechanism of gold points was altered by what Ugo Papi termed "one of the most serious problems of the post-war period", namely gold specie movements. Paul Einzig claims that these were promoted mainly by various countries' issuing to increase their reserves, by international loans, which by convention had to be settled in gold, and by forecasts of unfavourable developments for the exchange rate and domestic currency in some countries. These phenomena threw the question of the stability of the value of money into even greater relief, fuelling a lively debate which, in addition to the classic contrasts between inflationists and deflationists and between chartalists and advocates of a return to gold, saw old projects dusted off in an attempt to escape what De Stefani called the "severe and overbearing law of gold". In this regard, let us cite the 1867 idea of the "Commission on International Coinage" to create an international currency, later developed by Jevons, and the plan for the "compensated dollar" proposed by Fisher. Also, Nicholson's far-sighted proposals, Martello's project to suppress the legal relationship between gold and silver and to create a new commodity currency, Messedaglia's considerations on the "immaterial currency" ideal, and Lehr's complicated system based on the so-called "enjoyment unit", not to mention Solvay's "social accounting" and Lowe's "tabular system".

Severe monetary disturbances made the limitations of some of these projects even more evident, injecting the poison of monetary instability. In the past, gold had been used de facto as an international currency which could serve as a fairly precise, though not fixed, measure of the value of any other currency. However, during the war and after it, gold was no longer able to represent the exact measure of prices in the relationships among different countries, for it had largely vanished from circulation and was unequally distributed. Monetary stability becomes the leitmotiv of every economist: from Keynes to Hawtrey, from Gide to Pigou, from Alessio to Pantaleoni, not to mention Achille Loria, who offers a merciless analysis of the reference framework in *Le peripezie monetarie della Guerra* [The Monetary Twists and Turns of the War]. On closer inspection, the 1922 Genoa conference reached the same conclusion: "An essential condition for Europe's economic reconstruction is that every nation can stabilize its currency". But how to achieve stability? Some paid attention to the modified concept of stability: with the shift from the *gold standard* to the *gold exchange standard*, stability would depend not only on gold but also on the stability of currencies equivalent to gold. Obviously, it would be relative stability, set in an international context of economic instability, where many projects collided with what Einaudi called "the myth of the immutable monetary unit". This helps explain the different solutions that were proposed, some of them definitely original: – for instance, Euby Vanderlip's project, presented at the Portorose Conference, to create a federal bank among European States, modelled on the US Federal Reserve; or Dundas White's idea for an international gold coin, called *dor*.

Those who harked back to the pre-war gold system to bring the circulation back to "normal" conditions suggested that it was necessary to pursue rigorous budgetary policies, limit fiduciary circulation, strengthen metal reserves, and aim at balancing external accounts. The question was whether to reduce the value of the legal currency to that of the real currency, due to its devaluation, or to consider a revaluation of the legal currency that would make the currency's real price match its legal footprint. As Lexis points out, this controversial matter also poses legal questions, for where a premium has existed for many years, the prices of goods adapt to the decrease in the currency's value. It follows that all bonds are measured according to the less valued monetary unit, unless payments in gold are expressly agreed upon. In this situation, bringing the real value of a long-depreciated currency back to its legal value would imply an unfair burden on debtors and an illegitimate enrichment for creditors. Moreover, while there was indeed an attempt to restore the gold standard, it soon became clear that restoring the gold standard and defining pre-war parity were not synonymous, and that restoring the gold standard could not be the end goal of economic policy but rather a legitimate ambition. In this regard, we recall that in January 1918 the Cunliffe Committee did not pay any great attention to the pound's return to the gold standard, taking it for granted. The only questions to settle were timing, methods and exchange-rate fixing. Keynes's critical judgment of the Cunliffe report is well known, as is his view that the gold standard was a "barbarous relic".

However, many believed that gold-based monetary systems were not suited to the new circumstances. In this respect, Cassel writes: "The only quality necessary for a monetary regime to promote trade and the world's well-being is stability. If the war and what it brought about have upset the world monetary regimes, this is not a reason to try and re-establish the situation that existed before the war. In itself, it had no essential character. Its main advantage was the high degree of stability achieved at that time, and it is this stability that we must try and restore".

Paolo Baffi remarks that the efficiency loss of the regulatory mechanisms that followed the First World War created the need for greater collaboration in general and, still more, with respect to the relationships among individual countries or groups of countries: that is, among the countries issuing reserve currencies, between those countries and France, a major gold holder, and between creditors and debtors of war loans and reparations.

It is beyond the scope of this short contribution to dwell on the meanings of the term "collaboration", or on the differences between issuing institutions and central banks. In 1920, Gérard Vissering, addressing the Brussels conference, considered cooperation between central banks to be "indispensable", but collaboration between the latter and private banks is no less important. To be clear, the control that the Bank of England exercised for many years on the money market would be incomprehensible without considering its relationship with the *big five*.

While collecting his *Note e cifre su la circolazione cartacea e il mercato monetario* [Notes and Figures on the Circulation of Paper Money and the Money Market], a revised version of which would be translated into French on the eve of the Brussels Conference, Bonaldo Stringher, Director of the Bank of Italy, wondered: Will domestic efforts be sufficient without an effective concurrence of international agreements? But above all, to what extent is the stability of a currency linked to operators' expectations? It was hoped that the Brussels Conference would provide an answer, but, according to Luzzatti, the conference was poorly organized and reached unsatisfactory results. The gathering, which should have led to the creation of a "standing committee able to monitor, adjust, regulate [...] the great monetary flows of the world", turned – I quote – into a "colourful financial conference". Similarly, Stringher, in the Bank of Italy's 1920 report to shareholders, declared: "The financial conference in Brussels, [...] though full of news and studies, and even richer in memories and scientific discourses, proved sterile, in reality, as far as practical results are concerned".

In the "Babel of Brussels", what Luzzatti had feared actually occurred. The resolutions were concise, an expression more of good intentions than of concrete measures, except for the "rudimentary" design of an international bank and, above all, the recommendation to the League of Nations to create an International Clearing House for currency exchanges.

The numerous and complex reasons for that failure were not purely cyclical. Doubt was cast on credibility and cooperation, elements underpinning the classical gold standard, and, as Eichengreen points out, the system that was gradually taking shape, "despite the similarities with its predecessor, shares few of its virtues". It should also be borne in mind that in the immediate post-war period, in the choice between stability and growth, many European countries, starting with Italy, opted to stress growth, in a context in which gold, as Demaria observed, was "scarce and poorly distributed".

The transition from the *gold standard* to the *gold exchange standard* reproduced in a supranational perspective the issue of abandoning gold circulation in favour of a fiduciary paper currency convertible into gold. Historically, this constituted the preparatory step to the adoption of a fiat money system, if only because the promise of convertibility weakened as the issuing institutions printed paper in excess of its coverage. This brought the final stage closer, corresponding to the Platonic ideal of conventional money. As Peter Mathias explains, the problem was exacerbated by the fact that central banks lost their autonomy, becoming instruments of State policy and conducting actions that violated the very essence of their traditional behaviour. Furthermore, cooperation followed the same method as secret diplomacy, working behind closed doors. At various monetary conferences, leadership rested with the main central banks or, better, with the two men who headed them in that context: Benjamin Strong and Montagu Norman.

The importance of personal relationships and the complexity of the circumstances escaped neither Attilio Cabiati, who offered a lucid examination of them in his essay "Problemi economici dell'Italia alla Conferenza di Parigi" [Italy's Economic Problems at the Paris Conference] nor Francesco Saverio Nitti, who worried that Europe might well risk decline more because of peace treaties than because of war. The same can be said of Luzzatti, for whom monetary stability was the precondition not just for monetary peace but for peace in general.