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Chapter 4

British hegemony and the international gold standard

4.1 Introduction

This chapter will consider in what way, if any, the operation of the international monetary system of the period 1880–1914 was due to the hegemonic role that Britain is often held to have played. As argued above, there are various ways in which a British hegemon might conceivably have helped stabilise the system, dependent in part upon how one sees the gold standard adjustment mechanism as having operated in practice. Many authors have emphasised the way in which the '*Pax Britannica* . . . determined the general structure of international relations until the collapse of the system under the impact of World War I.'[1] Gilpin elaborates on what we have termed the basic rule-provision and enforcement function of hegemony:

> [A] primary objective of British foreign policy became the creation of a world market economy based on free trade, freedom of capital movements, and a unified international monetary system. The achievement of this objective required primarily the creation and enforcement of a set of international rules protecting private property rights rather than the more costly and less beneficial task of conquering an empire. [Great Britain therefore] assumed the responsibility of organising and defending the world market economy; [it] promoted free trade, provided investment capital, and supplied the international currency. In effect, [it] provided the public goods necessary for the functioning of efficient world markets because it was profitable for [it] to do so.[2]

Similarly, Britain is often held to have promoted policy consistency and facilitated the gold standard adjustment mechanism by establishing

and maintaining the 'rules of the game' outlined in the previous chapter.[3] Many have gone further to argue that the structure of the pre-1914 international financial system was such that the so-called gold standard was in fact a gold exchange standard or even a key currency standard centred upon sterling. This supposedly allowed Britain to act as a world monetary manager. As Cohen argues:

> [T]he classical gold standard was a sterling standard – a hegemonic regime – in the sense that Britain not only dominated the international monetary order, establishing and maintaining the prevailing rules of the game, but also gave monetary relations whatever degree of inherent stability they possessed . . . It did not regard itself as responsible for global monetary stabilisation or as money manager of the world. Yet this is precisely the responsibility that was thrust upon it in practice . . . The widespread international use of sterling and the close links between the larger financial markets in London and smaller national financial markets elsewhere inevitably endowed Britain with the power to guide the world's monetary policy.[4]

The notion that Britain was able to manage and stabilise the international monetary system of the decades before 1914 because of its dominant role in the world's commercial and financial markets is one which recurs in much of the recent literature. Kindleberger argues in similar fashion that the stability of this system was due to the international public goods that Britain provided: international banking services, an international currency, an open market for the rest of the world's exports and in the event of a global liquidity crisis, lender of last resort assistance.[5] Even some radical authors have suggested that financial instability in the pre-1914 world capitalist economy was alleviated by British hegemony, although they refrain from using the language of international public goods.[6]

The growing consensus that Britain played a crucial management role in the pre-1914 international monetary system necessitates that this chapter focus largely upon this idea, though we shall also deal briefly with the claim that British dominance assisted the establishment of the operating rules of the system. Before going on to discuss these monetary questions, we need to consider the basis of British 'hegemony' in this period.

4.2 Britain's international position, 1870–1914

Even at the height of its relative international preponderance in 1870, the aggregate size of the British economy was probably smaller than that of the US and Russia, although its head-start had made it by far

the largest industrial power of the time (table 5.3 – page 120).[7] Britain's share of global industrial production has been estimated at 32 per cent in 1870, with 23 per cent for the US, 13 per cent for Germany and 10 per cent for France. By 1913 Britain's share seems to have declined dramatically to around 14 per cent, with the US share having increased to more than double Britain's, Germany's about 16 per cent and France's only 6 per cent. Additional evidence suggests that the rates of growth of output per head in the four decades after 1873 were faster in the US and Germany than in Britain.[8]

Such estimates, while suggesting caution in the attribution of 'hegemonic' status to Britain in the three or four decades before 1914, understate that country's unique role in the world economy in these years. Around 1860, Britain had an unrivalled lead in modern industries, producing around half of the world's iron, coal and lignite and consuming just under half of its raw cotton output.[9] This was reflected in its dominant position in world trade. British trade in the decade 1860–70 represented perhaps a quarter of world trade, more than double the share of the nearest rival, France. With the spread of industrialism in Europe and the rest of the world, this share gradually declined to around 16 per cent by 1900–13, though was probably still larger than that of Germany, France and the US.[10]

Britain's share of world trade in manufactures seems to have shown less erosion over the period. In 1899, this share was estimated at 33 per cent, her nearest rivals being Germany and France with 22 per cent and 14 per cent respectively. By 1913, the same source has the British share falling to 30 per cent, Germany's growing significantly to 27 per cent, the US's share 13 per cent and France's 12 per cent.[11] We can tentatively conclude that during the period of the international gold standard, Britain was the world's most important importer and exporter of manufactured goods, and the largest importer of raw materials, but that over time its lead eroded to the extent that on the eve of World War I, the assumption of this mantle by Germany was within sight. This view is reinforced by evidence which suggests that Germany and the US were probably ahead of Britain in the development of 'leading edge' industries such as chemicals and electricals at the end of the nineteenth century.[12]

British industrial pre-eminence was not, as Kennedy has pointed out, entirely reflected in military terms.[13] Britain was a naval power rather than a land power, with a tenuous commitment to intervention in the European balance of power. The other major economic powers were certainly not dependent upon Britain for their security in the way that they were upon the US after 1945. Britain's naval and imperial dominance was in part due to its lack of entanglement with great

powers in Europe and abroad, and the consequent absence of a large army. By the turn of the century, this situation had dramatically changed and probably contributed to the rapid erosion of Britain's lead.

In addition to its naval and commercial pre-eminence, one of the most telling measures of Britain's international position was its international financial role. Here Britain's relative dominance did not decline as dramatically over the 1870–1913 period as did its relative economic size and trading position. During these decades London remained the world's premier gold, money and financial market, acting as a financial centre in which foreign actors held significant liquid assets (convertible into gold) and which channelled long-term capital abroad. Over this period, sterling bills and short-term credits financed perhaps 60 per cent of world trade.

London was also an international clearing centre, due to Britain's pivotal position in the structure of international trade and payments. British trade deficits with Europe and North America and surpluses with the Dominions and Colonies assisted the rise of clearing in sterling, effected through the London banking system. London's role as the world's major insurer, carrier and commodity market was also due in part to its central position in the Empire's international trade, which contributed to growing invisible earnings and an important vehicle and denomination role for sterling.[14]

The patterns of international trade and finance were such that foreigners with large international commitments came to hold sterling assets in order to be able to deal with fluctuations in their external position. This process was assisted by the decline of the bill of exchange from the late nineteenth century and the increasing use of short-term sterling deposits to finance international trade. This included central banks, initially those of the British Empire, which held claims on overseas London banks.[15] There are few reliable figures on Britain's liquid liabilities before World War I, though Lindert guesses that in 1913 sterling balances held by foreign monetary authorities were more than two and a half times Britain's gold reserves of $170 million. Including privately held sterling balances would give an external liquid liability to gold reserve ratio close to the 4.67:1 that the Macmillan Committee estimated for the end of 1928. Lindert also estimated (for 1913) that compared with world official gold reserves of $4,900 million, foreign exchange reserves totalled about $1,125 million, though it is doubtful that even a majority of this was held in sterling balances, with German marks and French francs making up a considerable proportion. German marks may have been used by more countries as a reserve currency than was sterling, though it was mainly on the

Table 4.1 Discount rates and open market rates in the major economies, 1876–1914 and 1925–38.

	Before 1914		*1925–38*	
	Open market rale	Central bank discount	Open market rale	Central bank discount
	Arilhmetic Mean			
New York[a]	4.85		2.69	2.76
New York[b]	3.73		2.79	
London	2.64	3.36	2.43	3.39
Paris	2.45	2.92	3.09	3.68
Berlin	3.16	4.17	4.81	5.53
	Coefficient of variation			
New York[a]	0.23		0.68	0.47
New York[b]	0.67	0.80		
London	0.43	0.29	0.76	0.41
Paris	0.27	0.19	0.48	0.41
Berlin	0.33	0.21	0.36	0.35

[a] Commercial paper.
[b] Call money.

Source: Morgenstern, 1959, lable 85, p. 377.

Continent that they were important as an international reserve currency.[16] This implies that at least by the end of the period, there had been some evolution of the international gold standard towards a gold-exchange standard.

In terms of the structure of international finance, there is additional evidence that other financial centres provided some competition for London. Short-term interest rates in Paris were consistently below those of London or any other centre in the pre-1914 era (see table 4.1). This indicates that Paris was a more 'liquid' market than London, supported by France's much more plentiful gold reserves and the Bank of France's lesser dependence than its British counterpart on discount rate changes in monetary management.[17] On the other hand, London's long-term interest rates were consistently lower than those in other financial centres, an indication of both the efficiency and the attractiveness of London as a source of long-term capital. At contemporary exchange rates, the book value of UK foreign investments has been estimated at $19,500 million in 1914, and that of the next largest investing countries, France and Germany, estimated at $8,600 and $6,700 millions respectively (tables 4.1 and 4.5).

The bulk of Britain's foreign investment was in the Americas, the

Dominions and the Indian subcontinent, while on the European continent and in Russia, German and French finance dominated.[18] This led to steadily growing investment income which in Britain's case was sufficient to offset a deteriorating trade balance and to produce a positive current account balance over the century before 1914 (table 5.2 – see page 118). These trends were connected with the increasing share of services in the British economy and the possibility that high rates of foreign investment contributed to lower rates of capital formation at home than in the US and Germany.[19] In terms of the broad picture suggested by raw data, Britain's international financial dominance, while indisputable, needs to be qualified. Before turning to the operation of the gold standard, we will discuss the role which Britain played in its establishment.

4.3 Britain and the emergence of the gold standard

Was British hegemonic power instrumental in the establishment of the ground rules for international trade and capital accumulation in the second half of the nineteenth century? Its naval power undoubtedly did help maintain freedom of navigation, but Britain's lack of military presence except on the periphery of the European continent meant that its ability to link economic and military issues was very limited when it came to relations with the other great powers. Britain could hardly hope to have much influence over the domestic economic policies of these other major countries, nor is there any convincing evidence that it attempted to exercise such influence.

It has been argued that 'Britain used its influence to usher in the age of free trade'.[20] Whether this had much effect, however, is debatable. Britain's adoption of a programme of free trade, whilst a great boon to primary producing and some newly industrialising countries, did not lead immediately to a marked shift to similar practices abroad, though it certainly provided an incentive for foreign manufacturers to export to this large market. Industrialisation in the other major countries and increasing levels of world trade had the effect of creating lobbies representing domestic agricultural and manufacturing interests, but these were by no means always in favour of free trade.

The shift to freer trade in the major European countries that occurred in the middle of the century came about because of the existence of strong state structures which often overrode the demands of protectionist lobbies. In Germany and France, the most important continental trading nations, the level of dependence on external trade

in the first case and a strong state committed to free trade in the latter prevented the adoption of the extreme protectionism of Russia and the US.[21] Kindleberger claims that British influence was greatest at the doctrinal level:

> [T]he countries of Europe in this period should not be considered as independent economies whose reactions to various phenomena can properly be compared, but rather as a single entity that moved to free trade for ideological or perhaps better doctrinal reasons. Manchester and the English political economists persuaded Britain, which persuaded Europe – by precept and example.[22]

If hegemonic 'power' in this case amounted largely to the ideological importance of the British model, it was of a fairly flimsy kind. Britain was unable to arrest the general tendency towards a resurgence of protectionism from the time of the generalised economic downturn of the early 1870s. It is sometimes argued that part of the reason why British influence was not great was because it refrained from employing the weapon of retaliatory protectionism until the development of Imperial Preference in 1932. Whether such retaliatory action could have provided much benefit to the British economy is very difficult to say, though the admirable doctrinal attachment to the principle of free trade was probably beneficial to the stability of the world economy. Most other countries had a pragmatic attitude and found no difficulty in discarding the ideological baggage when they felt that British exports threatened their domestic industries.

The relatively uninhibited flow of capital established in this period was also due to a natural self-interest on the part of other countries to develop their industry and extend their economic presence in their particular sphere of influence. The bulk of Britain's overseas investment in the second half of the nineteenth century were in the major projects of railways and other public utilities in the Americas and the Dominions, while German and French financiers organised similar loans to Russia and the Ottoman Empire.[23]

It is often claimed that orthodox economic ideas were most important when it came to monetary issues. These took a long while to catch on elsewhere: Britain restored the link with gold in 1819 after a highly charged debate, but the other major countries of Europe did not move to the gold standard until the 1870s. Even from this time, bimetallism (the use of a gold and silver monetary standard) continued to have its supporters in Germany and especially the United States. The practice of bimetallism was becoming increasingly difficult, however, and it seems likely that the basic reason for the shift to the gold standard in the 1870s, beginning with Germany in 1871, was the rapid increase in

the supply of silver and its consequent depreciation in value from the 1860s.[24] In this sense, British power had little to do with the emergence of the international gold standard in the 1870s. As Nurkse observed in 1944:

> The nineteenth-century gold standard system did not emerge as the result of an international convention or agreement imposing a set of formal obligations on the member countries. It sprang up spontaneously through the recognition by various individual nations of certain common objectives, chief among them being exchange stability.[25]

Perhaps the model of industrial and financial success which Britain represented played some role in encouraging other states to move to the adoption of the gold standard. There was also the argument for Paris and Berlin that going onto gold was necessary in order to capture some of the lucrative international financial business from London. For those countries who wished to attract capital from the major financial centres, considerations of creditworthiness may have played an important role in the decision to adopt gold as the standard. The older British colonies (except South Africa) had been linked to gold following Britain, though the remainder were on an effective silver standard until the depreciation of silver led them to link their currencies to sterling in the later nineteenth century.[26]

For the Austro-Hungarians, Russians and Italians, arguably the most important factor in their decision was one of prestige. In the gold standard debate of 1892, a deputy of the Austrian parliament claimed that: 'We cannot have a separate, an insular, currency continue: if we want to take part in the competition of civilized nations, we too must accept the international means of payment, and the international measure of value is just nowadays gold.'[27]

It is difficult to argue that British power played a very direct role in the emergence of the international gold standard in the last quarter of the nineteenth century, though it may have served as a model which other states saw as desirable to emulate. Metallic monetary standards were seen in most countries as the only viable long-term solution to the problem of monetary organisation, whilst, ironically enough, the countries of the British Empire tended to be amongst those most willing to adopt hybrid systems with a large fiduciary element.[28] Having discussed the role of hegemonic power in the establishment of the international gold standard before 1914, we may now turn to consider its role in the operation of this system.

4.4 Britain and the operation of the pre-1914 gold standard

The stability of the world economy 1870–1913

The idea that the few decades before World War I represented a Golden Age for the international economy is widespread. Despite the enormous structural changes going on in the major countries during this period, the growth in trade interdependence between the principal economies of Europe was considerable. Over the period 1870–1913, Maddison has estimated that world real GDP grew by an average of 2.5 per cent per annum, while world exports grew at an average rate of 3.9 per cent.[29] The absence of devaluations or even major currency crises for the most important of the international currencies during these years also testifies to considerable stability in the international monetary system. Relative stability compared with the interwar period is also apparent in evidence relating to the levels and volatility of interest rates in both periods. In his historical study of international financial relations since the late nineteenth century, Morgenstern found that central bank discount rates were generally lower in the pre-war period than after 1918, particularly for the Reichsbank. The variability of discount rates and short-term market rates was also less before 1914 (table 4.1 – see page 89). The picture for the US is somewhat muddied because of the creation of the Federal Reserve in 1913, though even here there is greater variability in short-term market rates in the later period, albeit at a lower average level.

Even before 1914, there were occasions on which the degree of strain in the international financial and monetary system was severe. Morgenstern found that all major currencies violated a generally accepted principle of the gold standard, that the maximum range of fluctuation of currencies should be within the so-called 'gold points'. That such violations were not only frequent but often also persistent (especially for Berlin and New York) indicated both periodic international financial stress and deviation of practice from gold standard theory.[30]

The fact that devaluations were largely resisted was not due to an *absence* of instability, but a willingness on the part of monetary authorities to tolerate (or an inability to prevent) substantial real economic fluctuations. Examining tables 4.2 and 4.3 (taken from Maddison's study of growth and fluctuations in the world economy), it is apparent that the general performance and stability of the world economy in this period is superior compared with the interwar years. The evidence also suggests, on the other hand, that in terms of both

Table 4.2 Growth characteristics of different periods in the world economy,* 1820–1979.

	(Annual average compound growth rates)			
	Real GDP	Real GDP per head of population	Tangible reproducible fixed capital stock**	Volume of exports
1820–70	2.2[a]	1.0[a]	(n.a.)	4.0[b]
1870–1913	2.5	1.4	2.9	3.9
1913–50	1.9	1.2	1.7	1.0
1950–73	4.9	3.8	5.5	8.6
1973–9	2.5	2.0	4.4[c]	4.8

Notes: * Arithmetic averages of figures for the 16 major economies.
** Excludes residential capital stock.
[a] Average for 13 countries.
[b] Average for 10 countries.
[c] 1973–8.

Source: Maddison, 1982, table 4.9, p. 91.

Table 4.3 Cyclical characteristics of different periods in the world economy,* 1820–1979.

	Maximum peak-to-trough fall in real GDP (or smallest rise)**	Maximum peak-to-trough fall in export volume	Average unemployment rate (% of labour force)	Average annual rise in consumer prices
1820–70	−6.7[a]	−21.7	(n.a.)	0.2[b]
1870–1913	−6.1	−18.2	4.5[c]	0.4
1920–38	−11.9	−36.5	7.3	−0.7[d]
1950–73	+0.4	−7.0	3.0	4.1
1973–9	−1.3	−6.4	4.1	9.5

Notes: *Arithmetic averages of figures for the 16 major economies, annual data.
[a] Denmark, France and UK only.
[b] France, Germany, Sweden, UK and US only.
[c] UK and US 1900–13.
[d] 1924–38 for Austria and Germany, 1921–38 for Belgium.

Source: Maddison, 1982, table 4.10, p. 91.

real economic performance and stability, the world economy under the classical gold standard was considerably worse off than in 1950–73 and even as compared to the 1973–9 period.

It would be dubious to attribute this difference in real performance solely to changes in the international monetary regime as there are a host of other important factors involved, such as the considerably heightened role of the state in the domestic economy after World War II. Despite the difficulties of comparison, it should be emphasised that the 'stability' often associated with the classical gold standard was of a very limited kind, and that in terms of modern experience, the real fluctuations which the world economy underwent in this period demonstrate considerable instability.

Considering the rapid rate of structural change in the domestic and world economies of this era, what stability there was might be seen as remarkable. This may have been due more to the relative openness of the major export markets during this period than to the gold standard itself. Open and expanding markets facilitated long-term adjustment to changes which might otherwise have resulted in unmanageable disturbances to the structure of international payments.[31] The contrast with the interwar period is this respect is great.

Even Britain experienced cyclical fluctuations in real national output which (by more recent standards) could be seen as exhibiting considerable instability, and the British economy was more stable than the average of the major countries. Such stability as there was probably accrued mainly to the large, industrialising countries of Europe, rather than to the 'peripheral countries' in the international economy.[32] Currency instability was most apparent in South America and those countries highly dependent upon external supplies of capital and prone to great surges of development, such as Australia, Canada and the US.[33] The dependence of many peripheral economies upon commodity exports to the centre countries, the demand and (short run) supply of which tended to be price-inelastic, meant that their balances of trade were very sensitive to fluctuations in demand emanating from the centre.[34]

Not only were their export receipts likely to fluctuate in a more volatile fashion, but the amplitude of recessions in real output and in the *volume* of exports was also greater in the peripheral countries. Of the sixteen economies studied by Maddison, the largest peak-to-trough falls of export volume during this period were recorded by Australia, Italy, Denmark and Japan, while the smallest were in Norway, Sweden, the UK and France (in that order). The average maximum peak-to-trough falls in real GDP for Australia, Canada, the US and Japan was 12.7 per cent (by any measure a large figure), while for the Low

Countries, Scandinavia, Germany, France and Britain the figure was a comparatively low 3.0 per cent.[35] It is difficult to reach strong conclusions from this data because the higher growth rates experienced in countries like Australia, Canada, South Africa and the US, as well as the stage of development of their economies, would lead one to expect greater instability of their economies than those of the 'core' countries. During this period, the white British Dominions and some countries such as Argentina became some of the richest in the world on an income per capita basis, which precludes too rigid an interpretation of the 'structural asymmetries' in the international gold standard.

The case is often made that because the direction of long-term capital flows was from centre to periphery, the major creditor states determined the stringency of financial conditions in the rest of the world. Britain, it is argued, could raise the discount rate in order to slow the rate of capital export, thereby improving its own balance of payments at relatively minimal cost to itself in the short run, whereas the peripheral countries were more or less at the mercy of monetary management in the creditor countries.[36] In many cases, the bulk of net capital imports were very concentrated in a few years, such as for Australia in the 1880s, Canada in the decade before World War I, Argentina in the second half of the 1880s and South Africa in 1902–5, only to fall dramatically when fears of creditworthiness began to take hold in the capital exporting countries. Although it may be wrong to see foreign capital imports as having played an overwhelmingly dominant role in these countries' capital formation, in peak periods the ratio of net capital imports to gross domestic capital formation probably approached 50–60 per cent in the cases of Australia, New Zealand and Canada, though this ratio was subject to considerable instability.[37]

Triffin also argued that London's role in the financing of peripheral countries' exports meant that Bank Rate increases had a favourable effect on Britain's terms of trade in a downturn. By forcing a quicker liquidation of commodity stocks, this would exert downward pressure on the prices of Britain's major imports, to the detriment of commodity exporters in the periphery.[38] The empirical evidence for this hypothesis is scanty. Studies of factors affecting terms of trade have shown that there was a broad inverse relationship between British terms of trade and the business cycle, or that British export prices fell more rapidly in recessions than did import prices, but this is not the effect Triffin suggested. Much more important than interest rate changes were the fluctuations in demand which bore no simple relation to British discount rates. More competitive British export prices may have been a factor leading to the subsequent recovery of the cycle, since Britain was generally led into the boom phase by rapid export growth. The UK trade balance tended to improve with the business cycle, with exports being further promoted by generalised growth and British capital exports.[39]

The greater instability of the capital-importing economies does nonetheless imply that the benefits of the pre-1914 international monetary system were to some extent concentrated in the core economies. This challenges not only the classical theory of the operation of the gold standard system, but also the idea that the international gold standard constituted an international public good, the benefits of which were equally available to all. It may not be inconsistent with the coercive view of hegemonic power, that the hegemon will use its power to construct and maintain an international economic order in its own particular interest. As Cohen has written, 'the stability insured by British monetary management was confined largely to the core of advanced nations in Europe and the regions of recent settlement'.[40]

The adjustment mechanism and the rules of the game

Most of those who have examined the operation of the international gold standard have concluded that there is a major discrepancy between the predictions of classical theory and the empirical evidence. For example, contrary to the predictions of the price-specie flow mechanism, price changes in different countries were positively rather than negatively correlated in the short run, suggesting that the relative price mechanism was weak or even inoperative between countries.[41] Parallelism can also be witnessed in international business cycles and in the growth of international trade, with exports and imports growing together for a good deal of the period rather than moving in opposite directions.[42] In general, the classical view that adjustment proceeded through equilibrating changes in countries' balances of trade has been seriously disputed; a number of countries were able to finance persistent current account deficits (North America, the Dominions) or sustain surpluses (Britain, France and Germany). This attests to the growth of trade and financial interdependence in the pre-1914 years.

The inadequacy of actual flows of gold to explain the balance of payments adjustments that did take place led Friedman and Schwartz to argue that it was the money supply which determined domestic prices and incomes in the short run, with gold reserves being part of the monetary base. A loss of gold reserves, given the concentration by central banks upon reserve to liability ratios, would signal a shift in monetary policy which would create domestic price and income effects sufficient to restore balance between countries.[43] This argument

assumes that the rules of the game of the gold standard were by and large observed by central banks, in the positive sense that reserve losses would signal a tightening of monetary policy sufficient to effect the adjustment without a further running down of gold reserves.

Problems arise with this explanation because it appears that in practice, interest rates between countries moved in parallel rather than in opposite directions.[44] There is also little evidence to suggest that central banks *did* observe the rules of the game during the pre-1914 period in the sense of reinforcing changes in gold reserves with monetary policy adjustments. As Bloomfield found in his study of this question, central banks consistently violated the rules of the game in this positive sense, both before and after 1914.[45] By and large, Bloomfield felt that in the purely passive sense of allowing changes in gold reserves to have their effect upon commercial bank reserves, central banks did observe the rules, and that this was a major reason for the rough stability of the international monetary system during these years. This, he believed, was largely due to a consensus between major states on the usefulness of maintaining the gold parity and a related willingness in the end to accept the consequences for domestic economic activity.[46] Goodhart's conclusion to an empirical study of the British banking system of the period goes even further to argue that in periods of domestic expansion, the Bank of England:

> did not reinforce the liquidity pressures on the banking system . . . by deflationary open-market operations. Instead the Bank seems to have generally followed the practice of passively granting the discount market the accommodation required, at that level of Bank rate chosen by itself.[47]

The flexibility provided by the lender of last resort role of the Bank of England *vis-à-vis* the British banking system was, Goodhart argued, a major reason for the absence of major financial and economic crises in Britain during the period. Strict observance of the rules of the game, allowing the monetary base to reflect gold flows, would have led to considerable financial and real economic instability, both in Britain and abroad. By downplaying the importance of the rules of the game in the operation of the British and international monetary systems, these findings conflict with the common claim in the literature that the British hegemon played an important rule-establishment and enforcement role. Ironically, that Britain provided a bad example by *not* observing the rules may have been an important explanation of the relative stability of the British economy (and to some extent the world economy).

An alternative explanation could be provided by the Monetary

Approach, which denies the relevance of adherence to the rules of the game to the operation of the gold standard adjustment mechanism. Its supporters argue that the parallelism of international price and interest rate movements is explained by arbitrage in international goods and financial markets.[48] The related idea that central banks had no influence over domestic interest rates, however, would appear to be incorrect. It is generally accepted that the Bank of England at least had considerable influence over domestic interest rates through manipulation of its discount rate.

Morgenstern and others found significant imperfections in the international financial markets of the period, with large differentials in interest rates on similar assets across countries persisting over time. There is also much evidence of imperfection in the currency markets of the period.[49] In addition, while the monetary approach assumes that income effects of changing credit conditions will be negligible due to a permanent state of full employment equilibrium in the real economy, the evidence suggests that changes in credit conditions did affect real income both in Britain and abroad.[50] In general, the monetary approach exaggerates the level of financial integration which existed in the pre-1914 period and underestimates the financial asymmetries which favoured the most important countries.

The 'management' of the international gold standard

If it is doubtful that hegemonic rule enforcement was of importance in the operation of the international gold standard, did the Bank of England, at the centre of the British and international banking systems, manage the gold standard for itself and the world as a whole? At least in the British case, there is evidence that discretionary central bank policy helped stabilise the British monetary system. Did it consciously or by default stabilise the world monetary system as well? Kindleberger suggests that this explanation best accounts for the operation of the system:

> [T]he Bank of England set the level of world interest rates, which accounts for the fact that national interest rates moved up and down together, while other countries had power only over a narrow differential between the domestic level and the world rate. With sterling bills traded worldwide, serving as a close substitute for money in foreign countries, and their interest rate manipulated in London, the gold standard was a sterling system.[51]

This highly asymmetrical system, with London at the apex and with the Bank of England able to determine domestic and world interest rates through its discount rate policy, stabilised the world's financial

structure and prevented major upheavals in the system of fixed exchange rates.[52]

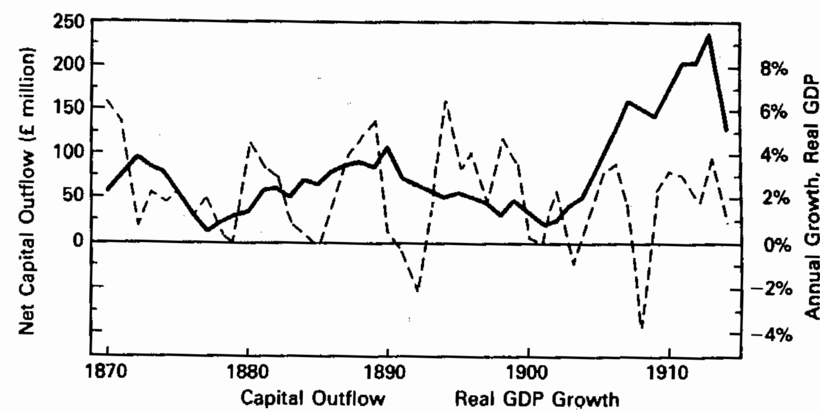
This view raises a number of issues about the operation and stability of the international financial system in this era. Most of the time, international financial markets operated within limits that were to some extent self-imposed. One of the most important of these limits may have been psychological: the acceptance by most central banks and financial markets of gold as the ultimate international measure of value. Sterling as private and official international credit money was acceptable because of the generally held assumption that it was convertible upon demand into gold on the London market. That the Bank of England's ratio of gold reserves to total short-term liabilities to foreigners could be as great as 1:4.5 or more without confidence problems arising implies that the market believed that convertibility would in the end be assured. This seems to be supported by the general presence of 'stabilising' short-term capital movements during this period.[53]

It is important to note that while this certainly reflected confidence in Britain's ability and willingness to maintain the external gold convertibility of sterling, this must also have been the case for other important countries like France and Germany and in fact most gold standard countries. As Bloomfield found, 'only a trifling number of countries were forced off the gold standard, once adopted, and devaluations of gold currencies were highly exceptional.'[54] The major countries were on the whole willing to accept the costs of domestic economic adjustment so as to maintain the gold convertibility of their currencies, though there were a number of instances in which countries had to undertake emergency borrowing from abroad. As a result:

> relatively excessive (from an international point of view) internal expansions tended to have effects similar to balance of payments pressures, as far as the managing Authorities were concerned, and to result in situations where rates of domestic expansion were moderated in the short run. The obverse was true in periods of recession.'[55]

The acceptance of a fairly strong external constraint upon domestic economic expansion was sufficient to produce a reasonable degree of stability in the international monetary system.

The persistently strong current account position of Britain during the gold standard era meant that the main avenue through which an external imbalance could emerge for that country was through the capital account. The financing of foreign companies, institutions and governments was necessarily constrained to some extent by the availability of credit for particular industries and countries in the major



Source: Feinstein, 1972, tables 6 and 15, appendix.

Figure 4.1 British net capital outflow vs. growth in real GDP, 1870–1913.

international financial centres. If a foreign borrower ran up against the limits of its existing borrowing capability, or if there were changes in its perceived creditworthiness, market reactions would be fairly rapid. Access to the wholesale debt markets for such borrowers or for the London branches of their domestic banks to credit in the discount market would be increasingly difficult.[56]

Although such self-regulating factors may have been important most of the time, overlending or overborrowing periodically occurred, creating international imbalances which required policy adjustments, often in the wake of crises. For example, the international cyclical upturn from 1910 led not only to a rapid growth in British trade, but also pushed vast funds from Britain (half national savings) to countries like America in particular (see figure 4.1). The financial panic which broke out on Wall Street and on the bourses of Europe when the likelihood of war in Europe became clear in July 1914 engendered a run on the City of London, America's and the world's largest creditor with a considerable stake in the New York market.[57] As Kindleberger has written: 'The 1914 British [lending] bubble would have shortly burst had the outbreak of war not halted its expansion and deflated it prematurely'. The result was that the Bank had to launch 'the most pervasive lender-of-last-resort operation of the time'.[58]

Part of the problem was that in the case of overlending, the deterioration in the lending country's payments position would not appear immediately, since foreigners might take some time to draw down bank balances held in London or Paris. Loans made in periods

of euphoria could easily look less viable when changing conditions led to a shock to expectations, as was the case with loans made to Argentina in the 1880s leading up to the Baring Crisis of 1890, after which loans dried up for the country. Still, a deteriorating balance of payments position would sooner or later be recognised as the exchanges fell towards the lower gold point (the exchange rate at which it would become profitable to export gold). The Bank of England, due to an inability or unwillingness to raise Bank Rate, would normally first try to protect its gold reserve by alteration of the gold points (through the so-called 'gold devices'),[59] but would ultimately need to increase Bank Rate if this did not improve the exchanges.

Since Britain's liquid liabilities to gold reserves ratio was relatively high compared to that of countries like France, the international confidence in sterling that prevailed throughout the period is usually attributed to the potential 'pulling power' of the Bank Rate. For example, Cohen argues that 'virtually any amount of money could be drawn into London, whenever it was necessary to maintain external liquidity, by raising interest rates.'[60] An increase in Bank Rate, made effective in the market through open market operations, would work to improve the capital account balance in a number of ways. The various mechanisms which operated also serve to illustrate most vividly the degree of asymmetry and hierarchy between different countries under the international gold standard.

First, higher interest rates in London would attract short-term capital from abroad, since the probability of exchange gains was high, whilst it would induce investors or banks to delay the transfer of funds abroad. Here, we encounter a problem, since if the Bank of England raised domestic interest rates, would this not force rates up in other countries (as Kindleberger seemed to be suggesting above), leading to a potentially destabilising deflationary process? Part of the reason why deflation was not widespread was that some major countries, France in particular, relied to a much lesser extent than Britain on discount rate changes in their monetary management. France's gold reserves were more than three times those of Britain's and gave it much more room to adopt an approach of waiting until the storm was over.

Peter Lindert argued that even in the absence of changes in international interest rate differentials, London had superior 'pulling power' not only over the shallower financial centres in Europe, but also over the other major centres of Paris and Berlin. When discount rates rose together, the tendency of the banking system to increase the liquidity of their portfolios would inevitably lead to a movement of short-term funds towards the largest financial centres. The operation of this international adjustment mechanism depended upon a hierarchy

of financial centres: London occupied the first tier, Berlin and Paris the second, while Amsterdam, Vienna, Zurich, Milan, Brussels and others occupied a third.[61] Britain did not simply export deflation to Berlin and Paris, because these two centres, especially Berlin, could in turn attract funds from the third tier of countries in central Europe, most of whom consistently ran payments surpluses in the years before 1914. Lindert concluded that the 'ability of the system to tap surplus-country funds in support of key currencies seems to have contributed to the stability of, and confidence in, the key currency system before 1914.'[62]

Another element in the adjustment response set in train by an increase in Bank Rate in London was the sensitivity of finance bills to variations in interest rates. Given the dominance of British finance bills in international trade, this would add to the Bank of England's ability to improve the exchanges in the short run. An increase in interest rates may have delayed the issuance of new long-term foreign bonds as well, temporarily reducing the rate at which long-term capital left the country.[63] Contrary to Triffin's argument about the terms of trade effects of discount rate changes, what evidence there is suggests that the most important factor in the adjustment mechanism was short-term capital movements rather than current account adjustment. This is not to argue that changes in discount rates did not have any real effects, but these are difficult to quantify.[64]

In summary, higher interest rates in Britain were an important factor in the international adjustment mechanism which was intimately connected with the hierarchical structure of the world financial system. Net capital inflows from Paris and Berlin were not necessarily deflationary for the rest of the world if surplus funds were transferred from the third tier of countries in Europe to the major financial centres. The ability of Paris in particular to resist discount rate rises in times of crisis may have been especially important in preventing a deflationary process spreading to other countries. In other words, although Britain may have been at the top of this financial structure, this does not support the view that the Bank of England could manage the system alone or that it was necessarily conscious of the international dimensions of its actions.

Two particular aspects of the claim made for Britain's active role as world monetary manager require additional attention. First, the idea that Britain provided lender of last resort finance to the rest of the world in periods of financial distress is crucial to the concept of management. Second, there is the oft-made claim that Britain also (presumably unconsciously) stabilised the world economy by engaging in long-term countercyclical lending.

Turning to the issue of the provision of short-term finance, it is necessary to point out from the beginning that the evidence pertaining to the question is very sparse. One thing that can be said with relative certainty is that the slenderness of the Bank of England's gold reserves and capital meant that often it could not hope to play any direct role in offering short-term credits abroad in periods of distress. In fact, the very limited reserves of the Bank of England tended to necessitate that it did the opposite (by raising discount rates and attracting gold in times of difficulty), which would hardly indicate stabilising behaviour.[65] Most economists have therefore concentrated upon Britain's position as the world's largest gross short-term creditor before 1914 in trying to demonstrate that its net creditor position fluctuated in a stabilising manner. The idea that Britain managed the international gold standard amounts to the proposition that its liquidity position *vis-à-vis* the rest of the world fluctuated in a way conducive to the stability of the system.

Given the almost complete lack of statistical evidence regarding the relationship between Britain's net liquidity position and the international business cycle, it is impossible to decide whether Britain expanded her short-term credits abroad in times of domestic recession and contracted them in times of ease. As Jacob Viner noted in 1945:

> It is a commonplace that England was during the nineteenth century the efficient manager of the international gold standard, and that the Bank of England was the agency through which this management was applied. It is extraordinary, however, how little systematic study of the workings of the pre-1914 gold standard has ever been engaged in, and how little concrete evidence has been available as to the extent or the quality of its management.[66]

The state of the empirical evidence, unfortunately, has little improved since then, though the view Viner referred to has continued to play a prominent role in the post-1945 literature. For example, E.S. Shaw believed that: 'Great Britain was the pre-1914 International Monetary Fund. Her loans to countries having temporary difficulties with their balances of payments saved the borrowers from gold exports, exchange depreciation, or internal deflation.'[67]

Although the period 1880–1914 experienced no severe, prolonged, depression comparable to that of 1929–33, there was considerable economic instability, some examples of exchange depreciation and exchange controls in both centre and periphery in these years. The pre-1914 era was by no means the trouble-free golden age that some suggest. More specifically, there is little evidence that Britain acted as a lender of last resort on the Continent of Europe or in North America.

Even within the Empire itself, local financial crises in the nineteenth century were more often dealt with by local institutions and local funds, though such action was often insufficient to prevent considerable distress. There seem to be isolated instances in which colonial governments in the 1890s in Australia and India gained some aid in crises from the Bank of England and the British money market, though the evidence points more in the direction of a severely underdeveloped lender-of-last-resort facility even in the heart of the Empire.[68] Kindleberger himself has taken a fairly qualified view in recent years, arguing that 'the existence of an international lender of last resort made the financial crises of 1825, 1836, 1847, 1866 and 1907 more or less ephemeral, like summer storms, whereas its absence in 1873, 1890, and 1929 produced deep depressions'.[69]

Bloomfield, who examined extensively the role of short-term capital flows in the pre-1914 system, felt that while Britain managed its own gold standard, he was sceptical of the claim that Britain played a management role in the international system as a whole, especially of the idea that it did so consciously. The City of London was concerned with its own liquidity position and the profitability of its operations, but there was no firm evidence to suggest that it expanded its net foreign credits unless it was seen as profitable to do so.[70] The paradox here is that if the City of London had not operated on the basis of profitability, then the international confidence in sterling, upon which the internationalisation of the British banking system depended, might have been impaired. It seems likely that the London financial community sometimes acted to reduce its overseas commitments in times of difficulty, as was probably the case in the period following the world downturn of 1873 and after the severe crisis of 1890. Put differently, if we ought to regard the stability in the value of sterling as an international public good (something Kindleberger for one has often suggested), then there may have been a trade-off between a stable pound and the British financial system's ability or willingness to act in a manner conducive to anti-cyclical short-term capital flows.

In the absence of statistical evidence, the claim that Britain managed the international gold standard amounts to the belief which Hayek and others exhibited that banks' decisions based upon considerations of profitability would not conflict with the conditions for systemic stability. Acting as a 'bank' for the rest of the world, which Britain to some extent did, is not necessarily the same thing as acting as its proxy *central* bank. The doubtfulness of the claim that Britain performed the latter role in addition to the former means that international relations writers may simply be repeating an old claim of economists which has little basis in fact.

Table 4.4 Shares (per cent) of gold reserves of major countries.

Country	1889	1899	1910
UK	6	5	4
France	17	14	15
Germany	6	5	4
Austria-Hungary	2	8	6
Russia	4	7	1
United States	29	26	33
Other	36	35	37
Total	100	100	100

Source: de Cecco, 1974, table 13, p. 244.

The suspicion that this is so is heightened by the prominence in the literature of the idea that only hegemonic powers like Britain have provided international lender-of-last-resort facilities.[71] Historical practice was considerably more complex. There is little evidence to suggest, as we have seen, that the practice of granting emergency credits to foreigners was widespread in the period. When central banks did grant emergency loans to foreigners, it was by no means always a case of Britain lending to other countries. In fact, while the Bank of England lent money or gold on such a basis to the Bank of France in 1846 and 1860, in the classical era of the international gold standard, Britain tended to be on the receiving end because of its low level of reserves. In the Baring crisis of 1890 the Bank of England borrowed £3.8 million in gold from the French and Russian central banks, and during the 1907 crisis the Bank of France again came to the aid of the British with a shipment of 80 million francs in gold.[72]

As the international competition for gold reserves increased in the later years of the gold standard era, of which the 1907 crisis was a manifestation, Britain's slender gold reserve, coupled with the growing reserve role of sterling, made her potentially more dependent upon emergency assistance (or at the least, cooperation) from the strong gold centres like France and the US (see table 4.4).[73] As to the net short-term creditor positions of countries like Germany and France and their relationship to the international business cycle, again the almost complete lack of information allows no categorical answer, though what evidence there is (relating to France) suggests that there was no clear trend to a stabilising or destabilising pattern.[74]

This leads to a general point which deserves emphasis: it is unlikely that Britain provided the necessary conditions for the maintenance of the pre-1914 system alone, since at least in times of strain it relied upon cooperation from the central banks of other great powers, especially the Bank of France. When it is recalled that on the Continent, Berlin and Paris were the most important financial centres, and that the mark and franc were used as reserve currencies along with sterling, the picture of the pre-1914 international monetary system appears more pluralistic than the term hegemony conveys. The broad policy consistency which operated under the international gold standard was more the product of similar domestic monetary institutions and a commitment to the general observance of an external monetary constraint, rather than the 'policy cooperation' which was to become such an important issue in the twentieth century. The Bank of England was arguably foremost in its selfish management of Britain's gold standard. Viner's judgement was harsh in this respect:

> the Bank of England never showed any interest in developing connections with other central banks and in systematically planning in advance for collaboration in case of need . . . [It] was completely unenterprising and unimaginative. It contented itself with looking after convertibility of its notes, and left it to other countries to keep their monetary affairs in order in the same narrow sense . . . [Hence] as far as the international aspect of the gold standard was concerned, there is nothing . . . which gives any support to the claim that the Bank 'managed' the gold standard.[75]

It is easy to exaggerate the influence of the Bank of England or any other central bank in the international financial system of the time. The size of the capital flows that passed through London and the other financial centres dwarfed Bank of England reserves. The Bank also had increasing difficulties in making its discount rate effective in the market from the 1880s. The rise of the large joint-stock banks and their increasing dominance of the money market resulted in an erosion of Bank of England power because the former were not compelled to hold cash reserves or deposits with the central bank. Although in practice some such reserves were held by the banks, the absence of legal reserve requirements meant that the Bank of England lacked a key element of monetary policy. In the years before 1914, this loss of control over the domestic money market accelerated.[76]

What of the related claim that the flow of British long-term investment was countercyclical, increasing in times of domestic recession and decreasing during domestic booms? In the last quarter of the nineteenth century, foreign investment over the 'long swing' and domestic activity were in general negatively correlated, though in the shorter run, this was not always the case.[77] From what it is possible to tell from the statistical evidence, the first half of the 1870s, the end

Table 4.5 Growth of foreign investments of leading capital exporting countries, 1870–1914 ($ million).

Country	1870	1885	1900	1914
United Kingdom	4,900	7,800	12,100	19,500
France	2,500	3,300	5,200	8,600
Germany	n.a.	1,900	4,800	6,700
United States	n	n	500	2,500

n.a. = not available.
n = negligible.

Source: Woodruff, 1966, p. 150.

of the 1880s, and turning points in the domestic cycle are possible exceptions to the long swing pattern, when domestic boom coincided with large capital exports (see figure 4.1). From around 1905, with British foreign investment rising to new heights, there was a considerable period of pro-cyclical movement in net capital exports.[78] Britain may not have been the consistent countercyclical capital exporter that some believe it to have been.

Other countries such as Germany and France were important exporters of long-term capital before 1914 (see table 4.5). Both France and Germany were active investors on the Continent, and France in Africa and Latin America. There is evidence to suggest that French foreign investment and domestic activity were positively correlated at least some of the time. In addition, the gross flow of long-term investment capital from the major countries to the capital importing countries was subject to considerable instability.[79]

The pro-cyclical flow of international lending in many of the years 1870–1914 is understandable if the dependence of the British economy upon growth in international trade is taken into account. If developing countries were to maintain credit-worthiness and grow at the same time, then they had to export more goods to the centre countries (Britain included). The latter would join in the process of importing and exporting more goods, as well as making new investments in the periphery. This kind of sustainable, positive relationship between international trade and investment flows was made easier as the flow of savings from the advanced countries was going to finance investment in infrastructure and similar basic development in the periphery.[80] In conjunction with the rapid advances in sea transport over the nineteenth century, this dramatically increased the supply and made cheaper the food and raw materials which the advanced countries wished to import. Eventually, however, industrialisation outside Europe, above all in

North America, would have more ambiguous consequences for Europe's position because it led to the rise of import and ultimately export competitive industries in these countries.

Britain's rising trade deficits with Europe and North America in the decades before 1914 made it increasingly reliant upon less competitive export markets in the Empire. The Empire's trade surpluses with Europe and North America and its willingness to conduct its financing largely through the British banking system allowed Britain to clear its deficits with the other advanced countries and to pursue the global economic and political role to which it had become accustomed. As a result, the strength of the major creditor economy during this period derived in part from its commanding position within Empire trade and finance, but it would be an exaggeration to speak of its 'hegemony' over other large economies. As Saul points out, '[h]ad not British exports . . . found a wide-open market in India . . . it would have been impossible for her to have indulged so heavily in investment on the American continent and elsewhere.'[81]

Foreign investment and the financial services offered by the City of London were to provide the key to Britain's current surpluses over the period as the role of manufacturing in the economy declined. How long this could last was debatable, since the export of around 40 per cent of domestic savings in this period was possibly aggravating the problem of slower capital accumulation at home than in other major countries. The last years of the nineteenth century also saw the emergence of rival financial centres in Berlin, Paris and even New York, providing competition in the field of financial services and resulting in some degree of change in the international financial hierarchy in which Britain was at the top. Such trends would detract from Britain's ability in the long term to maintain such a strong current account position and at the same time preserve its pre-eminent role in much of the periphery and on the oceans. The growing dependence upon invisible trade if anything tied Britain to dependence upon the maintenance of international peace even more than the free-trade doctrines of the mid-nineteenth century.[82]

The breakdown of the Concert of Europe exposed this weakness, compelling Britain to allocate more of its limited resources to the defence of the homeland. As many have pointed out, the fact that it was able to operate and defend a global Empire on the cheap was largely due to its industrial lead and 'the fact that outside Europe Britain largely operated in a power-political vacuum.'[83] With a host of rival powers challenging Britain's industrial and imperial position by the late nineteenth century, in retrospect the rapidity of Britain's relative decline seems less surprising than it might otherwise.

This inevitably led to some erosion of Britain's financial preeminence, while on the domestic front, the Bank of England was having difficulty in managing the domestic money market, especially given the growing role of short-term capital movements. These problems came to a head by 1907, when a financial crisis in New York spread to London, forcing the Bank to resort to a large loan from the Bank of France. Bank Rate, due to both internal and external developments, was becoming less powerful as a means of managing Britain's own gold standard, let alone that of the world. By 1914, the position of the Bank of England had so deteriorated *vis-à-vis* the joint stock banks that in the financial crisis of July–August 1914, the government had to intermediate between the two parties, suspending the Bank Act and monetising the bill market.[84]

At the same time, pressures to focus more attention on the domestic economy were growing in all states. The beginnings of a fundamental shift in the domestic balance of power between state and market economy was under way, with reformist moves in Bismarck's Germany, in Britain and elsewhere resulting in a growing share of state expenditure in GDP.[85] This growing state role, soon to be dramatically enhanced as a result of World War I, was ultimately to clash with the demands of the external constraint represented by the international gold standard. While the dominant attitude in Britain remained one of *laissez-faire*, financial crises in 1890, 1907 and 1914 highlighted the growing vulnerability of the British economy to developments abroad.[86] The increasing importance of short-term capital movements and the growing competition for gold in the years after 1900 (the political implications of which were highlighted by Germany's creation of a 'war-reserve' of gold in Spandau in Berlin) left Britain particularly vulnerable.

For those who wished to retain the multilateral system of the pre-1914 world, there was, even as early as 1907–8, increasing recognition of the growing volatility of international financial movements, connected with calls for higher gold reserves to enable the maintenance of more stable interest rates and/or to create a war-chest. Less important but nevertheless telling was a 'growing sentiment in certain quarters in favour of some kind of systematic international monetary cooperation, the absence of which was a conspicuous feature of the pre-1914 arrangements.'[87] As we shall see, while the process of 'national economic integration' progressed during and after World War I, the failure to foster any new basis for international monetary cooperation eventually led to a complete breakdown of the old order.

4.5 Conclusion

In summary, the theory of hegemonic stability does not provide a satisfactory account of the relationship between the international balance of power in the pre-1914 era and operation of the international gold standard. Britain played a very limited role in the establishment of the gold standard in the 1870s; economic and political factors very indirectly connected with British power and influence provided a more important impetus. The idea of Britain fostering order by upholding the ground rules of the international economy and monetary system was also found to have little basis in reality. Even if it is useful to describe the international gold standard as a regime, given the lack of strong rules, it was a regime which owed its establishment more to perceived national interest than hegemonic power.

The stability of the exchange rate structure during this period was to some extent achieved at the expense of macroeconomic stability, both in Britain and the other major countries and more so in the periphery. In Britain's own case, stability relative to what was to come after the war was due in no small part to the Bank of England's growing role as a central bank which managed the British financial system given the constraint of a very slender gold reserve. Relative stability in Britain was probably important for stability in the rest of the world, given that country's pivotal international position. That Britain's own success was not usually at the expense of other countries appears to have owed less to any world monetary management role than to the ability of other major countries to maintain monetary stability when London was absorbing gold. In times of severe crisis, the strong financial position of Paris was especially useful in maintaining international stability.

It might be more true to argue that the pre-1914 structure rested less upon British hegemony than the general dominance of the European great powers over their own spheres of influence. This was reflected in their financial dominance over smaller states in the European area and abroad. Britain's own strong current account position and ability to invest abroad at a remarkable rate was very dependent upon its position within the trading and financial structure of the Empire. The collapse of the Concert of Europe in 1914 was as destabilising for Britain as it was for the rest of the world.

Also important for the operation of the international gold standard was the assumption that there was little alternative but for the monetary authorities to maintain their par-values in terms of gold. The reigning assumption of the pre-1914 period was that gold was an immutable standard, above all for sterling itself, and this probably

played an important role in stabilising financial markets. Once the experience of the Great War was to shatter this assumption along with many others, stability would be much more difficult to attain. Most countries were willing to accept before 1914 that a strong external constraint upon domestic economic expansion was unavoidable. To some extent this may have been due to the development of domestic and international banking, which allowed a degree of flexibility which could not otherwise have been provided by the inelastic supply of gold. The relative openness of the major countries' markets also helped facilitate adjustment to the rapid structural change which was occurring, preventing the emergence of imbalances which might have disrupted the international monetary system. British attachment to freedom of trade and capital flows was important and to that extent Britain exercised 'leadership'. When it came to international monetary affairs, however, British interests were limited to managing its own gold standard with little thought of promoting cooperation between the major countries, despite the difficulties posed by growing short-term capital movements.

Private financial markets, while innovative, exhibited considerable tendencies towards instability, and the ability of governments or central banks to offset this was not great (nor was this seen as surprising). Ultimately, the limited role of the state in the economy was inseparable from the domestic social structure of the major countries. To put it differently, relative stability was not only enjoyed by the dominant states of Europe to a much greater degree than those in the periphery, but also by some domestic social classes more than others. A consensus existed on the possibilities of state intervention which may in part have been related to an ability of the ruling élites to pass on the costs of economic instability to other groups in society. The breakdown of this domestic political 'consensus' was, it will be argued, a key factor in the international monetary instability of the interwar period. Any theory which attempts to provide an account of international monetary relations before 1914 largely in terms of the structure of the international states-system risks overlooking a number of important domestic and attitudinal factors unique to the pre-war world. 'Hegemony', as applied to Britain's position in the international system from 1870–1914, cannot bear the weight of explanatory power that some have tried to thrust upon it.

Notes

1. Gilpin, 1981, p.135.
2. *ibid.*, pp.138–9.
3. Gilpin, 1987, p.126.
4. Cohen, 1977, pp.81–2. Gilpin's latest position is also consistent with a Keynesian interpretation (1987, p.124).
5. Kindleberger, 1973, p.292, 1984, p.70. See also Minsky, 1979, pp.110–11.
6. Brett, 1983, pp.19, 29–30; Sandretto, 1983, pp.104–5; Mandel, 1980, pp. 30–6.
7. Many of the figures contained in table 5.3, and much of what follows on the relative size and importance of national economies should be treated with caution. Much of the literature in this area places excessive weight on what can only be described as very inadequate estimates of the relative international positions of major economies. Although the quality of the data for the post-1945 period is more reliable, as we shall see, such comparisons have been complicated enormously by large movements in exchange rates over the past two decades. With this caveat in mind, such estimates can be of use in giving an *indication* of relative economic weights of major countries.
8. Floud and McCloskey, 1981, pp.7–8.
9. Kennedy, 1988, p.151.
10. Rostow, 1978, pp.70–2.
11. Maizels, 1963, table 8.1, p.189.
12. *ibid.*, pp.191–4, and Rostow, 1978, pp.178–85.
13. Kennedy, 1988, pp.152–8.
14. Williams, 1968, p.268; Triffin, 1968, pp.10–11; de Cecco, 1974, pp.104–6.
15. Williams, 1968, pp.286–7.
16. Lindert, 1969, pp.17–25,37–40; Bloomfield, 1963, pp.13–14.
17. Kindleberger, 1984, pp.265–8.
18. Woodruff, 1966, pp.150–4.
19. Floud and McCloskey, 1981, ch.1; Maddison, 1982, p.38.
20. Gilpin, 1987, p.73.
21. See Kindleberger, 1978b, pp.39–65; Mathias, 1969, p.316; Checkland, 1964, p.67; Stein, 1984, pp.367–74.
22. Kindleberger, 1978b, p.65.
23. Stern, 1987, ch.8,15; Kindleberger, 1984, ch.12,14.
24. de Cecco, 1974, ch.3; Kindleberger, 1984, pp.64–7.
25. League of Nations, 1944, p.231.
26. Williams, 1968, pp.272–4.
27. For a discussion and the above quotations, see Yeager, 1984, pp.657–9.
28. Williams, 1968, pp.272–4.
29. Maddison, 1982, p.91. See also Maizels, 1963, pp.80,98.
30. Morgenstern, 1959, ch.5.
31. I am indebted to Sir Alec Cairncross for this point.
32. Triffin, 1968, pp.8–14; Lindert, 1969, pp.47–57; Moggridge, 1972, pp.6–7.
33. Bloomfield, 1963, pp.83–4; Williams, 1968, p.272.
34. Moggridge, 1972, p.6.
35. Calculated from Maddison, 1982, table 4.1, p.67. See also p.61.
36. Triffin, 1968, p.8.

37. For evidence, see Bloomfield, 1968a, charts 1 and 2, pp.8–9, and Appendix 3.
38. Triffin, 1968, p.9. Others have also emphasised this effect, e.g. Cohen, 1971, pp.62–3.
39. Rostow, 1978, pp.94,329; Kindleberger, 1956, ch.7; Cairncross, 1953, pp.189–92.
40. Cohen, 1977, p.82.
41. Triffin, 1968, pp.5–6. This makes Gilpin's assertion that 'Hume's price-specie flow mechanism continued to characterise international monetary relations into the twentieth century' (1987, p.121) difficult to support.
42. Between 1890 and 1913 'the value of exports and imports in Belgium, France, Germany, Britain and the US moved in the same direction in 72.9 and 73.9 per cent of the years observed. The trade balances of these countries moved in the same direction 68.7 per cent of the time.' (Moggridge, 1972, p.5.) Morgenstern (1959, pp.44–8) found that over 1878–1914, the three major European economies were in the same 'reference' phase of the business cycle 83 per cent of the time, though the US was the odd man out, being in the same phase only 53 per cent of the time. See also Maizels, 1963, table 4.4, p.89.
43. Friedman and Schwartz, 1982, pp.28ff.
44. Triffin, 1968, p.12; Bloomfield, 1959, pp.35–7.
45. Bloomfield, 1959, pp.48–51.
46. Ruggie, 1982, p.386, and van Buren Cleveland, 1976, p.57, make similar points.
47. Goodhart, 1972, pp.218–19. There is even some more recent evidence which suggests that some (probably limited) degree of sterilisation of the impact of gold flows upon bank reserves may have occurred in the short run, though it is doubtful whether this was due to any conscious anti-cyclical policy on the part of the Bank of England. See Dutton, 1984, and Dornbusch and Frenkel, 1984, pp.244–8.
48. McCloskey and Zecher, 1976, pp.371–9; Pippenger, 1984.
49. Morgenstern, 1959, pp.160–5,276; Bloomfield, 1963, p.45.
50. See Williams, 1968, p.276; Goodhart's comments on Pippenger, 1984, especially pp.229–30.
51. Kindleberger, 1984, p.70.
52. Cohen, 1977, p.82.
53. Bloomfield, 1963, pp.43–4; League of Nations, 1944, pp.15–16. Bloomfield notes, however, that destabilising movements of short-term capital were greater than has sometimes been assumed, and that in at least two important cases (the US and Russia) such movements led to the adoption of temporary exchange controls (1963, ch.5).
54. Bloomfield, 1968b, p.27, note 2.
55. Moggridge, 1972, p.6.
56. Williams, 1968, pp.276–7.
57. See de Cecco, 1974, ch.7, and 1984, p.18.
58. Kindleberger, 1984, pp.259,291.
59. Moggridge, 1972, p.8, note 4.
60. Cohen, 1971, p.59.
61. Lindert, 1969, pp.47–57.
62. *ibid.*, p.57.
63. Moggridge, 1972, p.9; Bloomfield, 1963, ch.3.

64. See the discussion in Moggridge, 1972, pp.10–13; Lindert, 1969, pp.44–6.
65. Viner, 1945, p.63.
66. *ibid.*
67. Quoted in Bloomfield, 1963, p.77.
68. See Pressnell, 1982, and comments by Bloomfield and Fischer, especially pp.151–60.
69. Kindleberger, 1986, p.9.
70. Bloomfield, 1963, p.77.
71. For example Cohen, 1977, pp.81–2; Krasner, 1976, p.336; Gilpin, 1987, p.309.
72. Kindleberger, 1984, p.281.
73. See Bloomfield, 1963, pp.30–3; Pressnell, 1968, especially pp.219–28; de Cecco, 1974, pp.115–26.
74. *ibid.*, pp.65–70.
75. Viner, 1945, p.64.
76. See de Cecco, 1974, pp.86–102.
77. Cairncross, 1953, ch.7.
78. Kindleberger, 1984, pp.256–9, and 1985, p.9; Bloomfield, 1968a, pp.22–4; Cairncross, 1953, pp.187ff.
79. Bloomfield, 1968a, pp.32–3, and Kindleberger, 1984, p.258.
80. Williams, 1968, pp.281–2.
81. Saul, 1960, p.88. See also pp.62–3, and de Cecco, 1974, pp.26–38.
82. See the good general discussion in Kennedy, 1981, pp.17–73.
83. *ibid.*, pp.32–3.
84. de Cecco, 1974, ch.7.
85. See Stone, 1983, part II.
86. Bloomfield, 1963, pp.88–9; Pressnell, 1968, pp.220–27.
87. Bloomfield, 1963, p.91.