

# Central banking in an open economy: Rist and Hawtrey on the Banque de France's policy in the 1920's-1930's

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I regard the Credit Cycle as having been the form in which the evils of monetary instability made themselves felt under the pre-war international gold standard" (Hawtrey, 1932, p.384)

The absorption of gold by one country alone was of such magnitude as to precipitate a world-wide deflation" (Hawtrey, 1946, p.16)

## Abstract:

In the twenties-thirties, the difficult return to the gold standard is often considered as a source of intensification of the great depression. During those years, an interesting way of thinking national and international monetary mechanisms has emerged from the debates between French and British economists, more narrowly, between the diverging views of Ralph G. Hawtrey, Director of Financial Enquiries at the British Treasury, and Charles Rist, second-deputy-governor of the Bank of France (1926-1928). Those two leading economists questioned the responsibility of the Bank of France in the worldwide depression in the thirties considering its large conversion of sterling balances in gold in the late twenties. Hawtrey disproved the policy of the Bank of France, while Rist justified it. According to this last, the Bank of France followed the right policy because it followed "the rules of the game"; it converted these balances into gold as soon as the franc/sterling exchange rate reached the gold import point. Rist and Hawtrey's different view on how the gold standard should work enable to understand why central banks did not cooperate well, a key argument presented by economic historians to explain the great depression. Also, a recent literature assesses the responsibility of France in causing the depression. Hawtrey's writings confirm the results of this literature. France might have accumulated gold because French central bankers such as Rist had a specific theory of central banking in mind; a theory justifying the accumulation of gold.

## 1. Introduction

Charles Rist (1874-1955) considered *Currency and Credit* as the most important book written by Ralph George Hawtrey (Rist, 1938, p.314). He supervised the French translation of the third edition, which was realized by two young French economists, Georges Gaussel and Leonard Rist (one of the five sons of Charles Rist). The translation was published in 1935 in France, three years after Hawtrey's book *The Art of Central Banking* (1932). In the first chapter of this book, Hawtrey criticized the *French Monetary Policy*, and more precisely the responsibility of the Bank of France in the worldwide depression.

A debate was ongoing between economists concerning the relevance of the gold standard system. Hawtrey listed three kind of gold standard system in *Currency and Credit* (1919a, p.105). First, the gold specie standard (gold coins can be used to pay for domestic transactions, and the paper money can be convertible on demand into gold coin), the gold bullion standard (gold is only used to pay for international transactions, and each central

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banks can use gold in order to stabilize the exchange rate of the domestic currency), and at last the gold exchange standard (two chosen exchanges, such as sterling and dollars exchanges are kept at parity with gold, and countries can stabilize the exchange rate of their currency thanks to foreign exchange redeemable in gold). In France, Charles Rist believed in the necessity of adopting a gold specie standard. The creation of credit should be conditioned by the in and out-flows of gold within the country, and the central bank should vary its discount rate to protect its gold reserve. On the other side of the Channel, Hawtrey, the Director of Financial Enquiries at the British Treasury, encouraged the central bank to try to impact the level of investment, employment and to enable a stability of prices. He first developed this theory in *Currency and Credit* (1919a) and later in *The Art of Central Banking* (1932). *Currency and Credit* is considered as one of Hawtrey's major works in the sense that it outlines almost all of the essential elements of the theories developed in his subsequent publications. Hawtrey is known to have developed a theory of the lender of last resort (de Boyer des Roches and Solis, 2011, Diatkine, 2002). In 1932, when Hawtrey wrote *The Art of Central Banking* (1932), he targeted explicitly the Bank of France, whose bad monetary policy seemed to be partly responsible of the worldwide depression of the thirties. Hawtrey's critic of the Bank of France, and the difference in stance between Hawtrey and the French economists on how the Gold Standard should work, is the purpose of this paper.

Like Rist, Hawtrey was consulted for advice on international monetary policies after the First World War. During the Genoa conference in 1922, he advised countries to return to the gold standard (Howson, 1985, p.155). In order to return to this system, countries had to reduce deficits financed by credit creation and had to stabilize their currency in order to settle a new parity with gold. But, during the Genoa Conference (1922), Hawtrey advised countries to adopt a gold exchange standard in order to economize gold. A return to the pre-war gold standard system would encourage countries to accumulate gold, which would engender a shortage of gold. This would drive central banks to conduct restrictive monetary policies, and would therefore make difficult for countries to stay under this regime (Memoranda of Hawtrey, The Gold Standard and the 'Rules of the Game'", 17, October 1931, in Susan Howson, 1985, p.168-169). Hawtrey was in favour of a gold exchange standard, where only sterling and dollar can be convertible into gold, and the other currency would be redeemable in sterling or dollars (on this point, Rojas's paper is particularly highlighting, 2015).

Rist advocated all of his life the necessity of a return to a gold specie standard, where the discount rate is used to protect the gold reserves. Rist was not willing to adopt new monetary policies such as the ones Hawtrey advised (more active monetary policies and open market). Rist defended the position of France on several occasions: in his book written in 1933 (p.136); also, during a conference in February 1931 on the topic of "The International Function of Gold" (as noted by Mouré, p.192-193). In this conference, Rist condemned the open market practices and credit management conducted by the Bank of England and the Fed in the late twenties and thirties. According to him, these policies were disrupting the functioning of the gold standard, because it hampered the movement of gold within the world (Rist, 1938, p.440).

Philippe Schwob, one of Rist's young colleague at the Institut Scientifique de Recherches Economiques et sociales (ISRES) (Tournès, 2006, p.52)<sup>3</sup>, explained that Hawtrey's articles

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<sup>3</sup> Rist received funds from the Rockefeller Foundation in order to create the Institut Scientifique de Recherches Economiques et sociales (ISRES) in 1933. This Institute is considered as the first center of research specialized into the study of the economics with statistical observations. The wish of Rist was to create an Institute independent from the department of law, to which was traditionally join the economics department. Schwob became quickly a member of this young Institute and received a fellowship from the Rockefeller Foundation. Schwob did a Phd on "the Investment Trusts in the United-States" in 1934 and was enrolled into a report comparing the state of the French economy to the state of other European countries. Schwob went to Belgium where he met Paul Van Zeeland, and also to Scandinavian countries where he met Bertil Ohlin, Ragnar Frisch and

was representative of the critics from English economists towards French economists: “I daresay I have chosen Mr. Hawtrey’s articles as typical of the English attitude towards French policy, because he is considered, on this side of the Channel, as the strongest critic of this policy and one of the best champions of British economic thought.” (Schwob, 1936, p.72). Other authors noted the influence of Hawtrey on French economists during the inter war period: Nicolas Barbaroux (2013) relates the difficult acceptance of the use of the open market by Rist, and the conflict which opposed him against two economists influenced by Hawtrey’s, Emile Moreau and Pierre Quesnay in the thirties. Moreau and Quesnay were advocating the use of open market operations.

This paper supports the literature according to which the lack of cooperation between central banks intensified the great depression. The comparison we do here between Rist and Hawtrey’s thoughts enables to understand that the lack of cooperation between central banks was due to diverging views of economists on how the gold standard should have worked. They both encourage the adoption of a gold standard system, but of a different type, because their analysis of the factors leading to disequilibrium of the balance of payments is not the same. [2] The second part analyzes how Rist and Hawtrey’s definition of money is different. While Rist draw a sharp line between “money” and “credit”, Hawtrey included deposits and bills of exchange in the definition of “money”. However, as explained in the third and fourth parts, in spite of an apparent divergence Hawtrey and Rist gave a similar analysis of the foreign exchange markets, by adopting both the Thorntonian mechanism of the gold points. [3] The third part develops Rist’s vision of the working of adjustment; he saw international gold flows as the main feature of the adjustment mechanism between gold standard countries. Central banks should adjust the discount rate according to the level of gold reserves, itself depending on the state of the balance of payments. Rist considered that gold movements were symmetrical between countries; this is why he was in favor of a certain kind of monetary policies. He accepted to adopt provisionally the Gold Exchange Standard, until the definite return to the full-fledged gold standard prevailing before the First World War. [4] The part four is about Hawtrey’s deep insistence on the hierarchal structure of the international finance, centralized around the creditor position of Great Britain. He considered, unlike Rist, that the international gold standard was asymmetric, and that international transactions were mainly realized thanks to sterling bills, exchangeable into gold. Since British credit financed international trade, economic perturbations did not result from national price and costs maladjustments but from global economic cycles originated in the leading role of Great Britain as a financial center. As a matter of fact and contrary to Rist’s analysis, Hawtrey refuted that gold flows and price level changes were the main features of the adjustment mechanism of the balance of payments and focused more on the way that the Bank of England could manage the international finance, and so short-term capital flows, thanks to its discount rate. Hawtrey, unlike Rist again, wanted to replace the pre-war gold standard by the gold exchange standard. [5] The fifth part confronts Rist and Hawtrey’s view on the functions of central banks in an open economy. [6] The sixth part examines that, according to Hawtrey, the Bank of France accumulated gold because it was not allowed to practice open market operations. This is due to reluctance from some influential French economists such as Rist. [7] The seventh part develops the need for cooperation between the Fed and the Bank of England, who should according to Hawtrey index their credit policy on an index of world prices. [8] The eight part concludes the paper.

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Jörden Pederson (as explained by Tournès, 2006, p.61). The ISRES suffered a lot from the Second World War; it lost several of its members (Schwob notably “disappears” after the war according to Tournès, 2006, p.66), and Rist had to use his own private funds to finance the Institute, because the Rockefeller Foundation stopped its financial support.

## 2. On the nature of money

Following Rist, the essential function of money is to serve as a “reserve of value” (Rist, 1938, p.328). He argued that it is because money has an intrinsic value that people trust it, and that they use it as a means of exchange, as explained by Jérôme Blanc (2000, p.266). Only metallic money like gold can fulfill the function of a reserve of value, according to Rist. He did not consider paper money as money (Rist, 1938, p.329). In the same book, Rist reproached several authors, notably Hawtrey, for having forgotten the function of money as a reserve of value:

Money, we usually say since Michel Chevalier until Colson, is the intermediary of exchange and the instrument enabling assets to be exchanged... The same thought has to be found in more recent authors: Cassel, Hawtrey, Robertson and so on. To reduce money to these two functions raises some great inconveniences... However, metallic money fulfills a third function, above all of the others: the function of reserve of value... (Rist, 1938, p.328).

Schumpeter (1954, p.304fn) noticed that Rist’s monetary thought is similar to that of Cantillon, according to whom money enabled the circulation of goods, and credit enabled the circulation of money (as noted by de Boyer, 2013, p.9); money and credit are considered as two distinct notions. Furthermore, Hicks (1943, p.112) and also Schumpeter (1954, p.687), explained that Rist underlined the differences between money and credit in his book *History of Monetary and Credit Theory from John Law to the Present Day* (1938).

Hicks, in his review in 1943 of Rist’s book *History of Monetary and Credit Theory* (1940, translated in English by Jane Degras), tried to explain why French economists were so reluctant to the creation of new instruments of payment other than gold. It is due, according to Hicks, to the loss of confidence in the paper money in France because of several bad experiences where the French government defaulted on its debt (notably, the French Assignats). In the mind of French people, French government’s debt was not a reliable asset. According to Hicks, French economist like Rist was concerned with finding a sound currency in order to avoid errors made in the past, and this could explain the essential function of money should be to act as a store of value.

Hawtrey’s monetary theory differed from Rist’s. In Hawtrey’s thought, money is a means of paying debts, and debts permit goods to circulate:

It is used as a medium of exchange because a purchase creates a debt, and money provides the means of paying the debt.” (Hawtrey, 1919a, p.16).

Hawtrey made a theory of credit before making a theory of money. In the first chapter of “*Currency and Credit*”, he gave an account of a hypothetical economy based on credit only, in order to “find the logical origin of money” (Hawtrey, 1919a, p.2). In such an economy, credit is a medium of exchange. A credit/or debt is created when a delivery of goods is not immediately followed by a payment in monetary terms. Credit/or debt is a promise to deliver money at a future date other than that of the delivery of the good. For instance, if a retailer A delivers goods to wholesaler B and B promises to pay A in money at a later date then; a debt or credit is created from B to A:

If a man sells a ton of coals to another, this will create a *debt* from the buyer to the seller (Hawtrey, 1919a, p.2).

The practice which we have attributed to the dealers of setting off one debt against another may be describes as the use of credit as the means of payments. Debt and credit are different names for the same thing. (Hawtreys, 1919a, p.4).

When retailer A accepts the debt or credit of wholesaler B, goods are delivered to B. There is a flow of commodities when a credit or debt is created. Confidence is the necessary condition for debt or credit to be created, and for goods to circulate within the economy. If merchants do not trust instruments of payment they would not be used and no trades would occur.

From their different views on the nature on money, Hawtreys and Rist advised different currency standard on which should be denominated debts in closed economy. According to Rist, the gold convertibility rule of bank note in gold provides an effective mechanism to avoid price level instability and so government manipulation of money. For instance, if an inflation occurs because of an over emission, economic agents will be encouraged to change their deposits or paper money in gold at their banks, which leads to a reduction of the metallic reserves of the banking system. The banks, to protect their gold reserve, are then forced to raise their discount rate in order to restrict credit, and to limit the issue of notes which are redeemable into gold on demand. Because traders think that gold is a more reliable asset than paper money, they prefer to hold gold instead of paper money. The liquidity risk that banks face when they increase their issue of note permits to limit over-emissions. Hawtreys, like Rist, underlines the risk faced by banks when they over-issue bank notes, because they have to convert, on demand, bank notes against gold:

From this point of view a banker's business may be regarded as composed chiefly of dealings in "options" and "futures" in gold. A bank credit is an option to buy gold at any time; a loan or bill is an undertaking to deliver gold at some fixed future date. (Hawtreys, 1919, p.230)

In the same vein than Rist, Hawtreys acknowledged the importance of a currency standard (such as a metallic currency, even if Hawtreys thought that a currency debased from gold was better to serve this function) permitting to prevent undue variations in the value of money. A currency standard is necessary to reduce the instability of credit leading to variations in the value of money. However, Hawtreys did not consider that all demand for money from traders is inflationist. In this sense Hawtreys's analysis differs from Rist's one. Traders may need cash in the regular process of their transactions in order to settle their debts towards their employees for instance, and not to make new investments. The access to cash for cancelling debts is crucial for traders, because during the process of production, they have locked their cash into the investment project, and are therefore not liquid. The return on the investment would come at a future date, when the trading partner will have paid for her/his orders:

The process of production which follows gives rise to a chain of *debts*. The manufacturer or contractor becomes indebted day by day to his employees. The merchant becomes indebted to the manufacturer. But whereas the merchant's indebtedness is due at some future date, when the goods are to be delivered, the manufacturer's obligations are immediate; his employees want to use these obligations as purchasing power. (Hawtreys, 1919, p.453)

The activity of the banker, Hawtreys explains, is to purchase traders' bills (at a lower price than its market price, the difference being the discount rate charged by the banker) and sell cash to traders needing it. One of the important function of money is to serve to cancel debt in Hawtreys's thought. This function does not appear in Rist's analysis. The issue of bank note should be flexible according to Hawtreys in order to provide liquidity to traders:

Here intervenes the banker, who takes the immediate obligations upon his own shoulders, in exchange for a future obligation which the manufacturer, as the creditor of the merchant, is in

a position to give him. The banker's debts, unlike those of the manufacturer, can be conveniently used as the means of payment; or, where legal tender money is needed for the purpose, the banker makes it his business to supply money on demand (Hawtrey, 1919, p.453)

In short, a gold standard provides a mechanism to avoid undue fluctuations in the value of money for Rist. Hawtrey also thought that a currency standard was necessary to keep stable the value of money. However, this standard should be a currency other than gold, because the central bank should be able to extend the issue in times of distress. The very reason of the need of flexibility in the latent need for money from traders, who need to pay for their debt before receiving the return on their investments. A rigid system of money issue such as the gold specie standard, according to Hawtrey, is not ideal, because of the liquidity risk and confidence crisis it can generate (Hawtrey explained this in a clear way on the first page of the Chapter 3 of *Currency and Credit*, 1919).

### **3. Rist on the gold standard and the classical adjustment mechanism**

The gold standard is a way of limiting the quantity of credit within the economy since monetary authorities commit to change on demand bank deposits and paper money in gold. Thus the level of credit should depend on the gold reserves level held by central bank. According to Rist, the central bank should not follow a discretionary policy since the only criteria to take into consideration for the discount rate setting is the behavior of its gold reserve ratio. How is determined the level of gold reserves under the international gold standard? Following balance of payments disequilibrium, gold movements between countries operated as an equilibrating force through their effects on nominal wages and commodity prices. Rist referred there to the classical theory of foreign exchange, first developed by Thornton (1802), whereby real and monetary factors, being the source of demand and supply for foreign exchanges, caused balance of payments disequilibrium and triggered gold flows when the exchange rate reaches the gold points<sup>4</sup>. This theory, known as the gold points mechanism, gives a rule that central banks could follow under the gold standard<sup>5</sup>.

Indeed, domestic traders, whether paying for imports or making investments abroad, sell domestic currency on the exchange market and buy the currency of foreigners. In the case where there is a higher demand for foreign currency than for domestic currency, the domestic currency depreciates. In other words, a greater quantity of domestic currency would be needed to obtain a given amount of foreign currency. The more that domestic currency depreciates, the more it becomes profitable for the English trader to buy gold at the bank instead of buying foreign exchange by selling domestic currency. In this situation, gold would be drained from the country. The only way the central bank could protect its gold reserves would be by raising its discount rate, the rate at which bills are rediscounted. A rise in the bank Rate would have two effects: in one way, it would increase the cost of short-term borrowing, and would make it profitable to invest money in English bank deposits, as a consequence the excess in sales over purchases of the domestic currency would diminish; in a second way, it would impact internal prices like commodity prices and wages. The depletion of gold would limit the extent to which banks could create credit and would discourage investment and employment.

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<sup>4</sup> Given that gold standard countries fix the values of their currencies in terms of gold, the exchange rates fluctuate in a range around the par of exchange, which means the relative amounts of pure metal contained in two units of value, plus the cost of transferring gold from one location to another.

<sup>5</sup> Rist thought that Ricardo developed the gold points mechanism (1931 [1933], p.141) while Ricardo strongly rejected Thornton' theory during the 1811 Bullion Controversy, reversing the causal effect between balance of payments disequilibrium and gold flows. According to Ricardo, inflation resulting from redundancy in the currency caused gold export and balance of payments disequilibrium. For this controversy, see de Boyer des Roches (2007).

Demand for goods and new workers would decrease. Then, low prices would make domestic goods more attractive to foreign buyers, so exports would rise, and gold would flow into the country. The discount rate policy of the central bank should aim at stabilizing the value of money to its parity with gold. In a 1928 article, Rist reminded in those terms this classical theory of the foreign exchanges and the automatism of the adjustment mechanism:

When the exchange rate is favorable in Paris and that the gold import point is reached, gold, leaving London or New York through arbitragers' actions, decreases the credit base in London and widens it in Paris. It follows a rise in the discount rate in London with the decrease of the same rate in Paris. A higher remuneration in London attracts Parisian short-term capital and tends then to reverse capital flows from one place to another" (Rist, 1928 [1933], p.100-101)<sup>6</sup>.

In Mouré's words, the central bank had a "passive" role in Rist's theory (Mouré, 2002, p.254), because the discount rate depends on the level of gold held in reserves. Rist referred to these automatic adjustments in a conversation with Benjamin Strong and George L. Harrison held on the 29-30<sup>th</sup> June 1927. It appears that Rist believed that, if all central bank respected the "rule of the game", the gold standard would be a self-regulating system.

All of the efforts of the French monetary policy have been to return to normal conditions, which has lead them towards having an automatic mechanism of interest rates and of gold movements. (Rist, 1927, underlined as such in the text)<sup>7</sup>.

The central banks should index their discount rates according to the state of their gold reserves. Discount rate policies were supposed to speed up the adjustment of the balance of payments and give the impetus to gold movements. Gold should flow freely where its value is the higher. After the demise of the gold standard in 1931, Rist was again clearly in favour to the re-adoption of the gold specie standard by all countries, as shown in this quote:

If we want the gold standard to operate again, it suffices to create all of the normal conditions under which this system was working in the 19<sup>e</sup> century. Let us employ discount rates again; let us renounce the practices of « managed currency » whose bad effects stick out like a sore thumb [...] – let us establish international trade again as it has been almost deleted [...] The gold standard would function again, for the satisfaction of everyone, because we will have settled the normal routes by which gold should be distributed in the world (Rist, 1932 [1933], p.174)<sup>8</sup>

Rist was critical of discretionary policies, because he feared the disruption of the automatic adjustments operating under the gold standard. According to Rist, if the central bank reduces its discount rate while the balance of payment is in a deficit, it would be a

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<sup>6</sup> Originally written in French in the text : « Quand les changes sont favorables à Paris et que le point d'importation de l'or est atteint, l'or en quittant Londres ou New-York sous l'action des arbitragistes réduit la base du crédit à Londres et l'élargit à Paris. De là une hausse de l'intérêt à court terme à Londres, accompagnée d'une baisse de ce même taux à Paris. La rémunération supérieure de Londres exerce une attraction énergique sur les capitaux à court terme parisiens et tend par la suite à renverser le courant des capitaux d'une de ces places vers l'autre »

<sup>7</sup> « Tout l'effort de la politique monétaire française est de revenir vers des conditions normales qui permettant de revenir au jeu automatique des taux d'intérêt et des mouvements d'or. »

<sup>8</sup> « Si l'on veut faire fonctionner de nouveau normalement l'étalon-or, il suffit de créer l'ensemble des conditions également normales au milieu desquelles il fonctionnait régulièrement au cours du 19<sup>e</sup> siècle. Que l'on fasse jouer à nouveau les taux de l'escompte ; que l'on renonce aux pratiques d'une « managed currency », dont les fâcheux effets crèvent les yeux ... - que l'on rétablisse le commerce international aujourd'hui à peu près supprimé... L'étalon-or fonctionnera alors de nouveau, à la satisfaction de tout le monde, parce qu'on aura établi les routes normales par lesquelles l'or doit se répartir dans le monde... »

“falsification of the real policy of the gold standard” (ibid, p.173)<sup>9</sup>. By itself, the gold convertibility rule of means of payments under the gold standard avoids the overexpansion of deposits and paper money; if central banks would follow a gold to bank note ratio rule, the gold standard would be self-regulating system, providing price level stability.

#### **4. Hawtrey’s asymmetrical view of the gold standard**

Hawtrey shared with Rist the analysis of the foreign exchange market, by adopting both the Thorntonian mechanism of the gold points. Considering that goods and capital circulate by means of bills of exchange that affect the demand and supply of foreign currency, Hawtrey stated that, in theory, gold flows between countries are a safeguard against the instability of credit:

The banking community in any highly-developed country is afraid of a loss of gold, and any seriously unfavorable movement of the exchanges (...) is the signal for a prompt contraction of credit. (Hawtrey, 1919a, p.88)

In the classical view – the one supported by Rist – the world is supposed to be made up of homogeneous countries and economic perturbations are seen as domestic and not worldwide. Indeed, each country is supposed to lead a monetary policy following the state of the balance of payments. In Hawtrey’s words, gold flows between countries operate as an impediment to the instability of credit. This theoretical framework assumes that the gold standard operation is symmetrical. Let us take the example of a French trader who want to import Indian goods. To finance the shipment of goods from India to France, the Indian exporter issues a bill of exchange against the French importer payable at some future date. The transaction is made through the banking system of both parties. The bank of the French importer accepts the bill and the French trader remits the sum to the Indian producer through his bank in maturity. In other words, the trade between India and France gives rise to a demand of rupees against a supply of francs on the foreign exchange market. In that framework, the depreciation of the exchange rate, and then gold export, compels central banks to follow the rules of the game, that is to say to raise their discount rate. In this framework, Hawtrey shares Rist’s analysis.

Actually, Hawtrey objects the fundamental hypothesis that is rooting Rist’s view of the functioning of the gold standard. Unlike Rist, Hawtrey believed that the structure of capital market was asymmetric because countries were not independent in their credit policy. Most of them had to follow the credit policy of the Bank of England, that Hawtrey considered as a leading authority. Indeed, the Bank of England had a direct control on the financial market of London, which was the most powerful financial place in the world. According to Hawtrey:

The nineteenth century credit system is not to be interpreted as consisting of a number countries each exercising independent control over credit within its own limits, and being led by the influence of gold movements to accommodate its credit policy to that of the others. It is rather to be regarded as a centralized system responding to a leader. The center was London and the leader the Bank of England. (Hawtrey, 1929, p.70)

Because trade and finance played an important role in the British economy since its first industrial revolution, a highly developed system of centralized banking institutions has grown in London to deal with international transactions. International contracts were denominated in sterling, and payments occurred through the British banking system even though the

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<sup>9</sup> In Rist’s own words : “falsification de la vraie politique de l’étalon-or”

international goods were not directed towards Great Britain. Before 1914, foreign banks owned subsidiaries in London that made the country the center of the world's stock of gold, commodities and capital markets. The international gold standard was structurally asymmetric resulting from the domination of the sterling as the medium of international exchange. Contrary to the symmetric case which supposes that each domestic financial and banking system finance its traders for international trade, the asymmetric case supposed that international traders finance their stocks by credit balances in sterling accounts. Let us take the same example previously developed, ie. the trade between India and France. In the asymmetric case, the French trader pays for the Indian goods with a bill of exchange drawn on a bank in London. The bulk of trade between foreign countries is financed by the bills of exchange in sterling, which are discounted in London and at maturity payable in British currency. According to Hawtrey:

The essential characteristic is that even though the bills may be drawn by foreigners on foreigners, yet they are drawn on the center [here London] and payables in its currency. (Hawtrey, 1919a, p.106)

In the asymmetric case, the exchange rate is not determined by demand for and supply of currencies reflecting the international trade. Since sterling denominated assets finance international trade, there is a sustained demand for sterling on the foreign exchange market for the need of international trade. According to Hawtrey, the asymmetric structure of the international payments system makes London the world clearing house:

As traders in the more circumscribed area of a single country pay one another in cheques which are passed through a single clearing-house, so international traders pay one another in bills which are drawn on a single financial centre. Thus London is often called the clearing-house of the world's trade. (Hawtrey, 1919a, p.106)

Because the system of international payment had one center (London), the system of international payment was asymmetric. Therefore, any credit disturbance originated by a variation of the discount rate of the Bank of England was engendering credit disturbance in peripheral countries. If the Bank of England restricts credit in London, it engenders a contraction of activity in peripheral countries. In the third edition of *Currency and Credit* (1928), Hawtrey reminded the decisive influence of British credit conditions on foreign countries. The Bank of England, by influencing both the liquidity of the British money market and its price with the discount rate policy, impulse global cycles. A rise in its discount rate deprived world demand for goods. In other words, world prices and economic activity hinge upon the policy of the financial center before 1914:

When it [the country that is the financial center] inflicts contraction of credit on the international merchants, it not only makes the restraint on its own producers more complete, but it extends the restraint in some degree to producers in other countries. The contraction of credit depresses world markets: producers everywhere finds that demand flags and competing sales are hastened. World prices fall, or, in other words, foreign currencies appreciate. (Hawtrey, 1928, p.139)

As well as depriving world demand, an increase in the Bank of England's discount rate results in a capital inflow and influences foreign monetary policies: domestic lenders repatriate their assets, and foreign lenders seek to obtain sterling-denominated assets rather than holding dollar or franc assets. According to Hawtrey:

It is for this reason that a rise in the London Bank rate is quickly accompanied by a rise in all other bank rates. Any money market which maintained too low a rate would quickly find the exchanges growing adverse owing to the desire of lenders to remit abroad. (Hawtrey, 1919a, p.117)

The rise in the British discount rate compels foreign central banks to do the same in order to avoid large gold outflows. Understanding that in the asymmetric case, a currency – here the sterling – is used both to finance international trade and to invest short-term funds sheds light on how monetary policies are linked under the international gold standard. Contrary to the symmetric case, the British expansion of credit resulted in “a universal expansion of credit, common to the entire gold-using world” (Hawtrey, 1919a, p.89).

## 5. Monetary Policy and Gold Exchange Standard: Rist Vs. Hawtrey

Hawtrey and Rist’s disagreement on how the gold standard should operate becomes obvious after the World War I, at a time when the bases of the classical gold standard were shattered. Except in the US, all European countries suspended the gold standard during the war (1914-1918). Countries went through economic troubles because of war expenditures, foreign loans and monetization of public debt, tending to provoke inflationary pressures. Moreover, the suspension of gold payments led to foreign exchange instability. Both in France and Great Britain, authorities launched a debate to return to the gold standard. In 1918, the Cunliffe Committee supported the return to the gold standard in Great Britain at the old parity, accepting that “the process of deflation would be difficult” (Donald E. Moggridge, 1972, p.18). In 1924, the Bradbury-Chamberlain Committee reiterated these recommendations. In France, the burden of inflation and franc depreciation on the foreign exchange market make difficult the return to the gold standard at the pre-war parity. The franc stabilization will be effective only in 1928 after two-years of stabilization policy led by Poincaré. In Great Britain, the return to gold will be effective in 1925 under Churchill’s guidance.

In their respective countries, Hawtrey and Rist advised the political sphere to support the return to the gold standard system. From 1919a, Hawtrey supported the return to the gold bullion standard in Great Britain so as to stabilize foreign exchange rates and support the resurgence of international trade<sup>10</sup>. However, Hawtrey looked for other use of discount rates policies. Under the pre-war gold standard system, the use of discount rates policies aiming at protecting the gold reserve was creating credit cycles according to Hawtrey:

I regard the Credit Cycle as having been the form in which the evils of monetary instability made themselves felt under the pre-war international gold standard. (Hawtrey, 1932, p.384)

Hawtrey wrote a long chapter, in *Currency and Credit* (1928) about the danger of credit contractions which occurred under the pre-war gold standard, when central banks were following the ‘rule of the game’ policies. For example, a deficit of the balance of payment, followed by an outflow of gold, compels the central bank to raise its discount rate and restrict its advance to commercial banks. This credit restriction reduces the consumer outlay, and after a certain lag wages and domestic prices decrease too. Then, domestic goods become more competitive, and exports could increase. If exports exceed imports, gold flows again within the territory. Credit contraction is therefore “the weapon for the defense of the gold reserve” (Hawtrey, 1928, p.107). However, Hawtrey worried about the liquidity crisis

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<sup>10</sup> Since the convertibility rule of means of payments into gold, main feature of the gold specie standard, is not a safeguard against price level instability in his theory, Hawtrey did not support the return to such a system.

engendered by credit contractions, which occurred recurrently under the pre-war gold standard (Hawtrey, 1928, p.28).

Given the asymmetry of the international monetary system and so, the lack of automatism in its operation, Hawtrey advocates a more flexible international monetary system in the provision of international liquidity. Indeed, under the gold exchange standard, countries held foreign currencies redeemable in gold to stabilize their exchange rates without gold reserves. It was a way, according to Hawtrey, to avoid central banks to replenish their gold reserves in the 1920s that would lead to world deflation. In Hawtrey's words: "If an undue demand for gold is to be avoided, we must have some method of economizing the use of gold as currency" (1922, p.293). Very influential on Basil P. Blackett and Sir Otto Niemeyer – respectively British Controller of Finance between 1917-1922 and 1922-1927 – and on Montagu Norman – the Governor of the Bank of England in the 1920s – Hawtrey prepared the drafts about the currency resolutions for the 1922 Genoa conference. Hawtrey's proposition for the establishment of the gold exchange standard was a way to restore the power of the Bank of England. This aim was important in Hawtrey's eyes because the Bank of England is the best institution which should drive the (asymmetric) international system of payments<sup>11</sup>. On the one hand, the core countries issued the international currencies used for the settlement of international payments. The monetary authorities' commitment to fix the price of gold in their own currency was a guarantee of credibility and security. On the other hand, the peripheral countries had to adhere to the gold exchange standard: gold was withdrawn from the internal monetary circulation and the central banks held reserves partly in foreign currencies redeemable in gold, and partly in gold. In case of balance of payments deficit, the gold exchange standard country sells its foreign exchange reserve and buys national money which is in excess on the foreign exchange market. In that way, it stabilizes its exchange rate. For instance, a depreciation of the foreign exchange could be corrected by sales of foreign currencies (sterling or dollars) and purchases of domestic currencies, instead of waiting the exchange rate to reach the gold point, and exports of gold. A market for foreign currencies would be the place where central banks could sell bills in exchange of sterling and dollars, convertible against gold. This generalization of the gold exchange standard system is based on the discretionary policy of the central banks: gold flows do not work as a force restoring the balance of payments equilibrium.

When the exchanges become adverse the central bank can come into the foreign exchange market and either offer the actual foreign bills for sale, or itself draw bills on the foreign center in favour of traders who want to remit thither. (Hawtrey, 1919a, p.148)

This system [the gold exchange standard] has the double advantage that it acts on the exchanges even more directly and quickly than the export of gold, and that the bills or other foreign assets, unlike gold, yield interest. (Hawtrey, 1923, p.149)

While Hawtrey saw the gold exchange standard coupled with monetary cooperation as a means to manage the international gold standard, Rist saw it as a temporary system: the gold exchange standard "is only an exceptional regime to which, for the health of the great money markets, it has to substitute as soon as possible the strong regime of gold standard. The Bank [of France] will issue as formerly francs, but against gold and not only against foreign currencies" (1928, p.102)<sup>12</sup>. In 1926, Rist was member of the board of experts that worked on

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<sup>11</sup> As we will show after, Hawtrey considered that the two financial centers – Great Britain and New York – had to manage the international monetary system by a common well defined monetary policy.

<sup>12</sup> « (L'étalon de change or) ne peut être qu'un régime exceptionnel auquel, pour la santé des grands marchés monétaire, il faut chercher à substituer le plus rapidement possible le régime solide de l'étalon or. La Banque

the stabilization of the French currency (Barbaroux, 2014, p.13), and between 1926 and 1928, he was second-deputy governor of the Bank of France. According to Rist, the stabilization of the franc requires balance in the budget which enables prices stabilization<sup>13</sup>. So in the short run, the Bank of France has to accept to buy and sell foreign currencies in order to stabilize the exchange rate. On that point, Rist adheres to the gold exchange standard principle such as it was proposed in 1922:

Monetary stabilization involves the freedom for the Bank [of France] to issue notes to the extent that they are backed by stable foreign currencies or gold. Such an issue, which is not imply inflation since it is totally backed, is simply equal to an increase in the reserve. (Rist, 1925, p.20)<sup>14</sup>

But the accumulation of foreign currencies has to be limited in time since the Bank of France will have to replenish its metallic reserve and respect the automatic and symmetric operation of the international gold standard. In the line of Rist' vision of the gold standard operation, an outflow of gold, following the fall in the exchange rate, provokes a credit restriction in the country that raises all of market rates. Under the gold exchange standard, if the Bank of France sells francs and buys sterling on the foreign exchange market to limit the rise in the exchange rate, its foreign exchange reserve increases. But without any gold movements between the two countries, the Bank of England is not compelled to raise its discount rate as it should have done if a gold outflow would have occurred from Great Britain to France. Under the gold exchange standard, central banks have too much room for leading discretionary policies. According to Rist:

Gold does not move automatically from London to Paris. If the exchange rate is unfavorable in Paris, it only results in an inflow of foreign currency to the central bank. The amount of available capital of which depends the credit base remains unchanged in London. What is called "import of foreign currency" is in reality a credit provision in a foreign bank from the exporter to the importer. None rise in the interest rate occurs in the financial place where the foreign exchange is unfavorable. (Rist, 1928, p.101)<sup>15</sup>

Under the gold exchange standard, the absence of gold flows and of automatic rules threatened all the international gold standard architecture. In Rist's mind, the economy of gold and the creation of an international inverted pyramidal credit structure based on the gold reserves of the core countries contradict the classical operation of the gold standard. The principle which consisted in economize gold to avoid world deflation was violated by the Bank of France. Hawtrey claims that "it was the Bank of France that brought the state of equilibrium to an end, by selling off some seven milliards of foreign exchange in the early months of 1929 and acquiring gold instead" (1934, p.662). Hawtrey directly objects the policy

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alors émettra comme autrefois des francs, mais ce sera contre de l'or et non plus simplement contre des devises ».

<sup>13</sup> Rist considered that the bond-financed policy by central bank is inflationist. In other words, the practice, which consists to issue money against public bonds, has to end in order to restore confidence in the economy (Rist, 1925).

<sup>14</sup> « La stabilisation monétaire implique la liberté pour la Banque d'émettre des billets dans toute la mesure où ils sont couverts par des devises stables ou de l'or. Une telle émission, qui n'est à aucun degré de l'inflation, puisqu'elle est entièrement couverte, équivaut simplement à un accroissement d'encaisse ».

<sup>15</sup> « (...) l'or ne se déplace pas spontanément de Londres à Paris. Si le change devient très favorable à Paris, la faveur du change ne se manifeste que par l'afflux des devises à la Banque d'émission. La masse de capitaux disponibles et la base du crédit d'où cette masse dépend reste inchangée à Londres. Ce qu'on appelle « importation de devises » n'est en réalité que la mise à disposition de l' « importateur » d'un crédit dans une banque étrangère, crédit que lui cède l' « exportateur ». Aucune hausse de taux d'intérêt ne se produit donc sur la place dont le change est devenu défavorable »

of the Bank of France while Rist defended it because it played according to him the rules of the game. Indeed, from 1928, the restoration of confidence in French currency results in a repatriation of French capital from Great Britain to France. According to Philippe Schwob:

The owners of capital and entrepreneurs in general had no further interest in exporting their money abroad. (...) Not only did the clandestine export of capital cease, but people even hastened to bring back the capital that had already been placed there, for fear of making losses or increasing those they had already incurred. To this was added an inflow of foreign capital. (...) The normal operation of the gold standard should tend to restore equilibrium in the balance of payments, through a movement of gold into France, and this, indeed, is what happened. (Schwob, 1935, p.292)

Moreover, gold inflows in France does not only hinges upon market forces but also on the necessity for the Bank of France to replenish its gold reserves to respect its commitment to convert money into gold. According to Rist:

The Bank [of France] has proceeded to the repatriation of a part of its foreign assets in as much as it was necessary to increase gold reserve to the level of legal requirements and with the idea to let gold flow out if circumstances required, without the legal provision was threatened and the public opinion got worried. (Rist, 1930, p.115)<sup>16</sup>

To conclude, Rist and Hawtrey cannot agree on the policy of the Bank of France since the two authors differ on the gold standard operation and so, on the role of the monetary policy in open economy. According to Rist, monetary policy depends of the behavior of the gold reserve ratio and explains why the Bank of France converted its sterling assets into gold in the late 1920s. On the contrary, Hawtrey supports the intervention of the central bank on the foreign exchange market. The flexibility permitted by the gold exchange standard enable countries to have access to international liquidity – rather than gold – to stabilize their exchange rate without any gold reserves and to avoid world deflation. In Hawtrey's mind, the gold exchange standard is no more than the institutionalization of the pre-war asymmetry: the financial centers issue the key currencies and have the responsibility to cooperate by leading a common monetary policy. While Hawtrey considers that major central banks play a role in the operation of the international gold standard, Rist refutes it and supports yet a passive monetary policy.

## **6. Hawtrey's stance on the urging need to implement open market practices in France**

Now we have settled, in the previous parts, the two different way of thinking the role of the central bank in an open economy in Rist's and Hawtrey's thoughts, we can better understand Hawtrey's critic of the accumulation of gold of the Bank of France. Rist, and other French economist such as Schwob, justified the accumulation of gold because the point of import of gold was reached in the late twenties.

Hawtrey discounted the too simplistic argument according to which the accumulation of gold of the Bank of France was due to the German reparations payment (1927, p.119). A first explanation given by Hawtrey is that a specific feature of the French population was to hold cash resources in the form of currency instead of keeping it within a current account at the

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<sup>16</sup> « La Banque a procédé au rapatriement d'une partie de ses avoirs étrangers dans la seule mesure où ces rapatriements étaient nécessaires pour élever l'encaisse-or au niveau des exigences légales et avec la seule arrière-pensée de pouvoir plus tard laisser librement sortir l'or si les circonstances l'exigeaient, sans que sa couverture légale fut menacée, et sans que l'opinion publique s'alarmât ».

bank (Hawtrey, 1932, p.198). A second argument deals with a specific institutional failure in France. According to Hawtrey, the Bank of France increased its demand for gold from 1928 to 1932 in order to extend its note issue. The Bank of France had to accumulate gold in order to make additional loans to the banking system, because the Government's debt "tied the Bank hands" (Hawtrey, 1932, p.289, and see also p.444). If the Bank of France would have been allowed to purchase French Government securities, it could have responded to the need of currency of the banking system:

If the Bank had been enabled to acquire some other form of backing (for example, French Government securities), its need for gold would have been correspondingly diminished. By such means the absorption of gold could have been diminished to an indefinite extent. It was the absence of such power that must be regarded as the real cause of the absorption of gold on so colossal a scale. (Hawtrey, 1927, p.119)<sup>17</sup>

The type of assets that the Bank of France could hold was limited. The economic historian Edward Nevin (1955, p.19) explains that it could only hold gold or bills of exchange of very high quality. Between 1926 and 1928, the Bank of France was given "exceptional powers" (in Hawtrey's words, 1927, p.117) to purchase foreign exchange. In 1929, it converted its balance sterling in gold, and it contributed to the drain of the world stock of gold. The stock of gold of the Bank of France increased by 230% from 1920 to mid-1932. This analyze is supported by Nicolas Barbaroux (2013, p.106). The Bank of France had a minimum reserve ratio of 35% between the level of the stock of gold and the notes issues plus bank deposits. Barbaroux explains that at the end of 1928, the Bank of France was lacking of gold in order to extend its note issuing. As a consequence, it sold its dollar and sterling balance against gold. This massive conversion created tensions with England and the United-States.

Philippe Schwob disapproved Hawtrey's critics toward the Bank of France in a review of *The Art of Central Banking* published in 1935. Schwob defended the position of the Bank of France. He discussed the first chapter of Hawtrey's book in *The Art of Central Banking* (1932). He took Hawtrey's works as representative of the critics from English economists toward French economists: "I daresay I have chosen Mr. Hawtrey's articles as typical of the English attitude towards French policy, because he is considered, on this side of the Channel, as the strongest critic of this policy and one of the best champions of British economic thought." (Schwob, 1936, p.72). According to Schwob, the needs of trade were managed efficiently by the four main French commercial banks (*Crédit Lyonnais*, *Société Générale*, *Comptoir National d'Escompte*, and *Crédit Industriel et Commercial*). Hawtrey replied to Schwob that the French clearing banks did not increase their clearings to respond to the needs of trade, they did it in order to supply liquidity to financial markets:

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<sup>17</sup> Hawtrey presented the same argument in *The Art of Central Banking*: "... the Bank [of France] was narrowly circumscribed in regard to its investments. Apart from certain statutory reserves which were required to be invested in Rentes, it had no power to buy Government securities. It could discount bills which fulfilled the prescribed conditions (two French signatures, and either a third signature or in certain cases suitable collateral), and it could make advances on gilt-edged securities with a margin. But it could not *take the initiative* in these operations. It could not buy bills in the open market" (Hawtrey, 1932, p.197, Hawtrey's italics)

...There seems good reason to suppose that the increase in clearings in France is to be taken as evidence not of a general increase in velocity, such as would enable a given volume of commercial and productive activity to be carried on with a relatively smaller supply of currency, but of a relative increase in the volume of financial transactions. (Hawtrey, 1936, p.66)

Hawtrey was in favour of the use of open market operations. He considered that it was a key tool to reinforce discount rate policies. The central bank could reinforce its Bank rate policy with open-market operations<sup>18</sup>: “It is the function of the sales of securities to make Bank rate effective” (Hawtrey, 1932, p.151). Asset purchases increase the central bank liability, and also the total of bankers’ deposits. Although a rise of the discount rate is an efficient policy to check an excessive expansion of credit, a reduction of the discount rate does not always prevent from an excessive contraction of credit. Hawtrey underlined some limits to discount rate policies. If the lending rate charged by banks does not follow a decrease of the discount rate of the central bank, open market purchases can be necessary<sup>19</sup>. The purchase of securities engenders a rise of the price of securities. Because commercial banks and businesses hold these securities in their balance sheet, banks are thus encouraged to make more loans:

If the Central Bank wishes to expand credit, it lowers Bank rate. That enables the other banks to lower the market rates. If traders do not respond as quickly or thoroughly to this stimulus as desired, the Central Bank can start buying securities or bills in the market; its liabilities increase along with its assets. The banks find themselves with more money in hand than they need, and in their efforts to escape from the loss of holding it idle, they will try to induce traders to borrow. (Hawtrey, 1919a, p.56)

If the bank fails to stimulate short-term borrowing, they can create credit by themselves buying securities in the investment market. The market will seek to use the resources thus placed in it, and it will become more favourable to new flotations and sales of securities. (Hawtrey, 1950 edition, p.75, as noted by Sandilands, 2010, p.334)

Open market operations reinforce discount rate policies. By purchasing bills on the open market, the central bank increases banks’ deposits. It makes banks more willing to extend their advances and discounts (Hawtrey, 1932, p.447).

France was confined to a passive part in the regulation of credit. Changes of Bank rate by the Bank of France had some effect upon the discount market, but only within narrow limits, because they could not be reinforced by an open market policy. (Hawtrey, 1932, p.199)

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<sup>18</sup> “The remedy is to be found in what in America is called an ‘open market’ policy, the purchase of securities by the Central Bank in the open market. Every asset creates a liability, and the liabilities of a Central Bank are money. When the Bank of England buys securities, the total of bankers’ deposits is increased. The joint-stock banks, holding more cash, become ready to increase their advances and discount. Thus when the stimulus of cheap money offered to the *borrower* is insufficient, the stimulus of redundant cash reserves can be applied to the *lender*.” (Hawtrey, 1932, p.447)

<sup>19</sup> In *The Art of Central Banking*, Hawtrey explained that the operation of “borrowing on Consols” can be considered as the first attempt to conduct open market operations in England. Horsley Palmer, Governor of the Bank of England from 1830 to 1833, presented the advantage of “borrowing on Consols”. The practice was subtle. The Bank of England was not merely selling Consols at a fixed price against Bank notes, it also hedged itself from the risk of a capital loss. At the same time, it was selling Consols (for a limited time), the Bank of England was buying an equal amount forward. “The net result was that the Bank borrowed from the Stock Exchange for a fortnight or less at a rate of interest equal to the contango rate.” (Hawtrey, 1932, p.151). These operations, rarely practiced by the Bank of England, were conducted for the first time in 1848 according to Hawtrey. By “borrowing on Consols”, the Bank of England succeeded in borrowing “to hundred millions”. Such operations aimed at increasing loans to the Government.

## **7. On the path of central banks cooperation: Hawtrey against the ‘rule of the game’ but for the ‘index numbers’ rule**

Hawtrey presented some risk inherent from the system of the gold exchange standard. As any systems where money creation is debased from gold, there is a risk of over issue, which would generate “undue fluctuations in the purchasing power of wealth-value of the money unit” (Hawtrey, 1946, p.15). An over emission of money can be detected as soon as it causes “the flow of money to exceed the value of the community’s production under conditions of full employment” (Hawtrey, 1946, p.15). Hawtrey constantly writes that monetary policy should be discretionary, that is to say, should not follow a rule. Nevertheless, while Hawtrey rejects the ‘rules of the game’ policies followed by central banks before the First World War, he encourages central banks should follow an index number including wages and commodity prices. Wages, according to Hawtrey, determine “the purchasing power of wealth-value of the money unit” (Hawtrey, 1946, p.15). Monetary policies seem therefore to be less discretionary than what Hawtrey seems to pretend.

Monetary authorities have both to limit an excessive demand for gold and avoid “an almost indefinite expansion of paper money with a fixed substructure of gold reserves” (Hawtrey 1919b: 437). To avoid the overexpansion of foreign bills upon which gold exchange standard countries could issue national paper money, Hawtrey supported the cooperation between the financial centers, Great Britain and the US. In that way, a common monetary policy led by the Bank of England and the Fed avoid the overexpansion of world liquidity, stabilize world monetary cycles and the purchasing power of gold – understood as world prices. Therefore, the discount rate and open market policies should aim at keeping gold at a constant value.

The central bank provides liquidity to the banking system, which can supply and/or withdraw the means of payment to agents of good markets. In this way, banks have a central role in the economy: they induce and/or deter traders from borrowing. Therefore, the central bank is able to manage the level of credit in the economy, and it is also able to smooth the business cycle:

The banking system has a dual function. It provides the means of payment in the forms of bank credit and currency, and it also comes into the capital market as a source of short-term lending. It is with the former function that the art of central banking is primarily concerned. The provision of the means of payment for the community is essentially a public responsibility, upon the proper discharge of which depends the smooth working of the entire economic system. (Hawtrey, 1932, p.290)

In Hawtrey’s thought, monetary policy should not follow ‘the rule of the game’ of the former gold standard system; it should rather follow “discretion” in order to suppress the variations of the cycle generated by money disturbances:

The Central banks must exercise discretion; they must be ready to detect and forestall any monetary disturbance even before it has affected prices. (Hawtrey, 1923, p.143)

The Fed and the Bank of England should cooperate on their monetary policy and follow an index number reflecting the evolution of world wages and commodity prices (Hawtrey, 1946, p.15). By following this rule, the inherent instability of credit which leads to prices instability could be corrected (Hawtrey, 1919a, p.57, and Hawtrey, 1932, p.168-169). The discount rate of the central banks is the last window where liquidity can be obtained. It can be considered as the price of liquidity, the rate at which bills are exchanged against cash (either gold or the

legal tender note). By varying the discount rate, central banks can impact the level of credit issued by the banking system, and thus it could manage the level of the unspent margin which is “the aggregate of the money and bank deposits in the community” (Hawtrey, 1927, p.11, as noted in de Boyer and Solis, 2011, p.179):

In reality, therefore, we can arrive at a fairly satisfactory practical solution of our currency problems as soon as we can reach an arrangement between England and America, with a view to maintaining their aggregate uncovered paper issues as nearly as possible at a fixed amount, to providing for remittances between them on a gold exchange basis, and to controlling credit with a view to keeping the gold value of commodities, as measured by an index number, approximately constant (Hawtrey, 1923, p.61)

Hawtrey distinguishes monetary from real factors affecting the evolution of commodity prices and wages. The indicator of the evolution of prices should be constructed by excluding non-monetary factors such as crop failure.

To sum up, in Hawtrey thought, main central banks such as the Bank of England and the Fed should agree on the direction of the monetary policy – by using similar monetary instruments such as the discount rate and open market policies – by following an index number of commodity prices and wages. Those policies enable central banks to influence the level of credit issued by the banking system nationally, but also internationally. Internationally, because the commercial operations of foreign firms (belonging to peripheral countries) rest upon the access to liquidity available at the financial places of New York and/or of London. By agreeing on the direction of their monetary policy, the Bank of England and the Fed could have an impact on the demand for credit from foreign traders, and thus, on the world demand for goods and, at last, on the world purchasing power of gold. This last could be stabilize if the Bank of England and the Fed manage to smooth the business cycle.

## **8. Conclusion**

During the inter-war period, Hawtrey’s monetary ideas were well-known in France both by economists of the Bank of France (Moreau, Quesnay) and by academics (Nogaro, Pirou, Schwob). The opening pages Rist wrote to the French translation of *Currency and Credit* can be understood as an opportunity for Rist to position himself against Hawtrey’s monetary theory while countries were abandoning the gold specie standard. As seen in the first section, Hawtrey’s and Rist’s disagreements are rooted in their respective views on the nature of money. Hawtrey considered that an essential function of money is to cancel debts; whereas Rist emphasized the fundamental role of money as a reserve of value. Paper money, for Rist, was not a sound monetary instrument because it fails to act as a store of value. Gold is the most dependable currency on which a monetary system should rely on according to Rist, because people trust the stability of its value. The monetary system that Rist advised was the gold specie standard - as developed it in the second section of this essay. Rist believed that the gold standard, if adopted by all countries, was an efficient way to stabilize internal and external prices, and also, a sound system to avoid over-inflation. The “automatic adjustments” of central banks’ discount rates, if countries play “the rule of the game”, was beneficial to international trades. For instance, when the balance of payments was in deficit, the gold flew out of the country, and as a consequence the central bank had to raise its discount rate in order to protect its gold reserves. This policy forced banks to reduce their loans and businesses to borrow less. When wages and prices have decreased sufficiently, export increases and gold flows into the country. The gold standard was a way to chasten excessive credit creation, and also to limit over-production. This is one of the reasons why Rist considered such a system as

a sound monetary system limiting monetary disorders within countries. On the other side of the channel, Hawtrey considered that countries would be too much constraint if adopting the pre-war gold standard. This monetary system obliged countries to hold large stock of gold and so to conduct restrictive monetary policies. These restrictions were even more difficult in debtors' countries which did not possess large stocks of gold, which was the predicament of almost every country except France and the United-States, who, in 1931, respectively held 60 per cent of the world's monetary gold (Mouré, 1999, p.2). The gold exchange standard was according to Hawtrey a better system, because central banks could directly intervene on exchange markets without using gold. French economists such as Rist, reluctant to the use of open market operations, and for the adoption of the pre-war gold standard, are in some way responsible of the aggravation of the great depression in the thirties. Especially, in his *Art of Central Banking* (1932) Hawtrey blamed the monetary policy followed by the Bank of France. Because of its lack of power on open market operations, the Bank of France was constrained in its monetary policy; the only right it has was to vary its discount rate (which had remained relatively stable during the first quarter of the twentieth century, as Barbaroux explains in 2013). Such cooperation was necessary to stabilize the world purchasing power of gold. Those two central banks should control the credit issue by following an index of prices built on the evolution of world commodity prices and wages.

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