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PART I

GENERAL

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Interwar Central Banks

A Tour d' Horizon

Barry Eichengreen and Andreas Kakridis

1.1 INTRODUCTION

Central banks are ubiquitous. Of the 195 sovereign states in the world today, 185 have delegated money issuance, monetary policy, oversight of the payment system, and lender-of-last-resort functions to specialized institutions known as central banks.[1] Their pronouncements make headlines. These send tremors through money and asset markets, whose reaction central banks seek to channel using forward guidance and other communication. Ever-growing lists of their functions have entered college textbooks, as have tales of their exploits in helping countries navigate global financial shoals.

Such has not always been the case. A century ago, nearly two-thirds of the world's sovereign states lacked a central bank (Figure 1.1). Central banking institutions then in existence commanded less authority. Their functions were circumscribed, their mandates ambiguous, their allegiances divided between multiple roles as commercial banks and appendages to the Treasury.

The key period of transition was the 1920s and 1930s. Between 1919 and 1939, twenty-eight new central banks were set up, most in what are now called emerging markets and developing economies. The studies collected in this volume examine the origins and early operation of these banks.[2]

[1] The definition implicit in this formulation is functional and cannot be applied uniformly or historically; many of today's central banks started with a subset of these functions. Capie et al. (1994: 5) bypass this hurdle by arguing that 'in one sense, we recognise [central banking] when we see it'.

[2] Of twenty-eight central banks established between 1919 and 1939, twenty-two are covered by the various country-specific case studies and comparative chapters in this volume.

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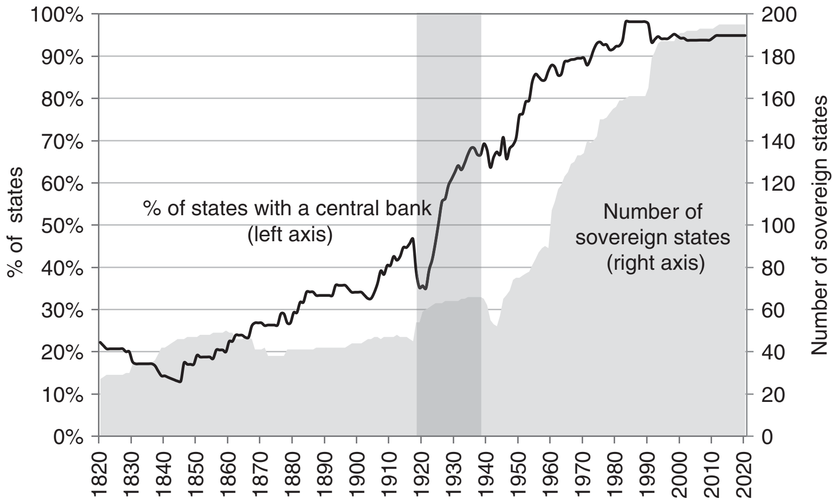

FIGURE 1.1 Sovereign states and central banks, 1820–2020
Source: See Appendix.

While an extensive literature documents the historical development of central banking in the now-advanced economies, the historical literature on central banking in emerging and developing countries, then and now, is more limited.[3] This imbalance deserves correction. Creating a central bank was seen as a key step in the process of modernization in late-developing economies. It was a step toward putting economic policy on a sound and stable footing and integrating emerging economies into the global system.

The list includes the Reserve Bank of India, even though India did not become a free nation until 1947 or adopt a constitution until 1950 (and thus is excluded from the interwar data underlying Figure 1.1). Countries not considered in this volume are Estonia, Yugoslavia, Latvia, Lithuania, Albania, and Ethiopia; for recent literature in English, see Troitiño et al. (2019) on Estonia, Jeftic (2021) for Yugoslavia, Puriņš (2012) on Latvia, Ahmetaj (2017) on Albania, and Mauri (2011) on Ethiopia.

[3] Limited should not be misunderstood to mean non-existent. Holtfrerich et al. (1999) offer two chapters on central banks in emerging and developing countries. Contributions to Cottrell (1997) focus on Central and Eastern Europe. Maxfield (1998) covers the post-Second World War period, when central banks were set up differently in newly independent countries (also evident in our Figure 1.1). Earlier work includes Kirsch and Elkin (1932) and de Kock (1954), while very recent contributions include Jacome (2015) and Caldentey and Vernengo (2019). Distinct but related is scholarship on monetary management before the emergence of central banks (de Cecco, 1975; della Paolera and Taylor, 2001), and on so-called money doctors advising on the design of monetary institutions (Drake, 1989; Flandreau, 2003).

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No sooner had the ink of newly drafted central bank statutes dried than the Great Depression swept across economies and political systems, putting new institutions to the test. Few interwar central banks successfully met the challenge. As a result of the political reaction to this failure, central banks became key agents in the Polanyian transition from the unfettered market system of the nineteenth century to the managed economy of the twentieth. In 1944, Karl Polanyi argued that the nineteenth-century combination of laissez-faire capitalism, unregulated labour markets, and the gold standard contained within it the seeds of this reaction, as popular opinion turned against the instability and inhumanity of market mechanisms (Polanyi, 1944). New central banks had been established in the 1920s in an effort to temper the operation of this system. When they fell short (Schenk and Straumann, 2016), the economic and political crisis of the 1930s brought a Polanyian reaction. Private banks of issue were nationalized. Central banks were enlisted in managing the economy in cooperation with other branches of government. This set the stage for their role in supporting import substitution in Latin America and central planning in Eastern Europe during and after the Second World War. The newly established central banks of the 1920s and 1930s thus were integrally involved in the pivotal economic developments of the mid-twentieth century.

The ideas underpinning both the spread of central banking and the subsequent reaction are introduced in Chapter 2. Chapters 3 and 4 then focus on the role of the League of Nations and the Bank of International Settlements. These two organizations promulgated international standards for the structure and conduct of central banking (best practice, if you will) and sought to foster international cooperation amongst these newly created monetary institutions. Part II of the volume turns to eight country studies and two chapters of greater geographical ambition, one on Latin America and one on the British Dominions. All chapters nevertheless provide readers with the necessary political and economic background before tackling the key questions that run through the entire volume. Under what circumstances was each new bank established? What was the role of domestic and international players and how did they impact the structure, mandate, and powers of the resulting institutions? The authors are careful to distinguish de facto and de jure independence, as well as compliance (or otherwise) with the so-called rules of the game, which extended beyond the rules and regulations associated with the operation of the gold standard. All country studies discuss the impact of the Great Depression: the specific challenges to each economy,

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the monetary policy response, the extent to which policy was conditioned by each bank's recent past, but also how it affected its future, not least by influencing the speed of economic recovery.

1.2 THE INTERWAR WAVE OF NEW CENTRAL BANKS

If not the father of *all* things, war was certainly the father of many of the new central banks of the 1920s. This was true of new states that emerged from the dissolution of the Habsburg, Ottoman, and Russian empires. It was equally true elsewhere, however, as old monetary arrangements were swept away and new banks were established.[4]

Table 1.1 lists, in chronological order, the twenty-eight new central banks established between 1919 and 1939. Most of these institutions received statutory independence and a mandate to defend the value of the currency in terms of gold or gold-convertible foreign exchange.[5] As Harold James explains in Chapter 2, with extensive references to German experience, independence was designed to mitigate risks of fiscal and financial dominance that had become apparent with wartime and post-war inflation.[6] This, in a nutshell, was the argument behind the interwar drive to establish new central banks, and why most were established with the primary objective of averting inflation and maintaining the gold standard.

This mantra gained broad international currency, not least through the efforts of a network of central bankers, financiers, civil servants, and

[4] Other well-known aspects of the war's financial legacy, such as the structural imbalances emanating from wartime shifts in producers, markets, and borders, the complications arising from reparations and inter-allied debt, the 1920–1 recession and countries' diverse roads to stabilization are not discussed in this introduction, which has a narrower focus. Needless to say, these developments influenced the new institutions. Feinstein et al. (1995) offer a succinct summary.

[5] This was the gold-exchange standard, which was meant to economize on scarce gold supplies; limits on the purchase of gold bullion to large quantities and the withdrawal of all gold coin from circulation were other aspects of the post-war gold standard (Eichengreen, 2019: 59).

[6] Insulated from political interference and operating at arm's length from business, central banks were designed to resist pressures to finance budget deficits and provide inflationary credits to the private sector. In modern parlance, central bank independence was expected to solve the problem of time-inconsistency by requiring commitment to monetary rules (Kydland and Prescott, 1977; Barro and Gordon, 1983). Despite its 'rediscovery' in the context of rational expectations, the underlying idea was hardly new, especially in post-war years. Historical parallels date back at least as far to the central banks of Norway, Denmark, and Austria-Hungary, which were established after the end of the Napoleonic wars (Capie et al. 1994: 5). For a discussion of the German experience with central bank independence since the nineteenth century, see Holtfrerich (1988).

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TABLE 1.1 *Central banks established in the interwar years (in chronologi*

	Country	Central bank	Year[1]	Interwar money doctors/fore
1	Yugoslavia	National Bank of the Kingdom of Serbs, Croats, and Slovenes	1920 [1884]	Harry Arthur Siepmann, 192 Banque de France, 1931
2	South Africa	South African Reserve Bank	1920	Henry Strakosch, 1920* Edwin Kemmerer and Gerha
3	Latvia	Bank of Latvia	1922	–
4	Lithuania	Bank of Lithuania	1922	–
5	Peru	Central Reserve Bank of Peru	1922 [1913]	W. W. Cumberland (gov't fi Edwin Kemmerer, 1931
6	Austria	Austrian National Bank	1923 [1816]	LoN/Drummond Fraser, 192 Albert Janssen, 1923*; Fra 1931; LoN/Carel Eliza ter Advisers: Charles Schnyder v Gijn (1924–6); Robert Ch (1931–2), and Maurice P.
7	Colombia	Central Bank of Colombia	1923 [1905]	Edwin Kemmerer, 1923* an
8	Australia	Commonwealth Bank	1924 [1920]	Ernest Harvey (BoE), 1927 Otto Niemeyer (BoE) and T.
9	Hungary	Hungarian National Bank	1924 [1878]	LoN/Arthur Salter and Josep LoN/Henry Strakosch, 1924 Advisers: Harry Arthur Siepr (1931–6)

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TABLE 1.1 (*continued*)

	Country	Central bank	Year[1]	Interwar money doctors/fore
10	Poland	Bank of Poland	1924 [1918]	Edward Hilton Young, 1923 Edwin Kemmerer, 1925 and Adviser: Charles Dewey (19
11	Albania	National Bank of Albania	1925	LoN/Albert Calmès, 1922 LoN (indirectly)/ Mario Alb Adviser: Jan Doekes Hunger
12	Chile	Central Bank of Chile	1925	Edwin Kemmerer, 1922, 19 Adviser: Walter M. Van Deu
13	Mexico	Bank of Mexico	1925	Edwin Kemmerer, 1917*
14	Estonia	Bank of Estonia	1926 [1919]	LoN/Joseph Avenol and Ale LoN/Albert-Édouard Jansse Adviser: Walter James Frank
15	Czechoslovakia	National Bank of Czechoslovakia	1926	–
16	Guatemala	Bank of Guatemala	1926	Edwin Kemmerer, 1919 and
17	Ecuador	Central Bank of Ecuador	1927	John Hord (gov't financial a Edwin Kemmerer, 1926–7* Adviser: Earl B. Schwulst (1
18	Bulgaria	Bulgarian National Bank	1928 [1885]	LoN/René Charron, 1926* LoN/Otto Niemeyer, 1927* Advisers: René Charron (19 las Koestner (1932–40)
19	Greece	Bank of Greece	1928 [1920]	LoN/Joseph Avenol, 1927* Adviser: Horace G. F. Finlay

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	Country	Central bank	Year[1]	Interwar money doctors/fore
20	Bolivia	Central Bank of Bolivia	1929 [1924]	Edwin Kemmerer, 1927* Adviser: Abraham F. Lindbe
21	Turkey	Central Bank of the Republic of Turkey	1930	Mr. Friedleb, 1927; Gerard Hjalmar Schacht, 1929*; Kemmerer, 1934
22	Ethiopia	Bank of Ethiopia	1931 [1906]	Everett Colson (adviser to H
23	New Zealand	Reserve Bank of New Zealand	1933	Otto Niemeyer (BoE), 1930
24	Canada	Bank of Canada	1934	Lord Macmillan and Charles
25	El Salvador	Central Reserve Bank of El Salvador	1934	Frederick Francis Joseph Pov
26	Argentina	Central Bank of Argentina	1935	Otto Niemeyer (BoE), 1934
27	India	Reserve Bank of India	1935	Hilton Young Commission/I
28	Venezuela	Central Bank of Venezuela	1939	Hermann Max (Central Ban

1. Years in [brackets] refer to the year a predecessor bank acquired de jure monopoly of issue in the cou central bank was the first one to exercise such monopoly.
2. Missions comprising several experts are identified solely by the official who headed them, with addition or notes; institutional affiliations are also noted, when relevant. LoN stands for League of Nations, Bo International Settlements. Missions with an * are considered important for the establishment of the ce

Sources and notes on individual countries in the Appendix.

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academics (Meyer, 1970; Schuker, 2003; Marcussen, 2005). With missionary zeal the Bank of England encouraged the establishment of overseas clones of itself (Sayers, 1976: 201). Otto Niemeyer, senior Treasury official turned Bank adviser, was dispatched as money doctor to administer the appropriate medicine. Eager to check this British imperialism, the Banque de France launched missions to Romania and Poland.[7] The governor of the Federal Reserve Bank of New York, Benjamin Strong, shared Norman's suspicion of politicians and his vision of a global network of cooperating central banks (Chandler, 1958: 281–285) and for his part encouraged American money doctors to spread the gospel. The most prominent American money doctor, Edwin Kemmerer, advanced this vision of central banking in Latin America and elsewhere on behalf of New York financial circles (Seidel, 1972; Drake, 1989; Eichengreen, 1989; Helleiner, 2009).

Multilateral institutions such as the League of Nations also helped to disseminate new monetary ideology. Patricia Clavin (Chapter 3) explains how new ideas about central banking dovetailed with the League's desire to limit state agency and relegate policy decisions to an international, rules-based depoliticized sphere. Intergovernmental conferences in Brussels in 1920 (under the League's auspices) and Genoa in 1922 called on governments to return to the gold standard and establish central banks free of political control and open to cooperation. An Economic and Financial Organization (EFO) was set up within the League to gather intelligence and provide advice on economic and financial matters, including those related to central banking. Its representatives emphasized fiscal prudence, currency reform, and central bank independence, where the latter would be guaranteed by a statutory commitment to gold convertibility, limits on lending to the public sector, and a cap on state ownership.[8]

Although the EFO projected itself as impartial and multilateral, it was close to London and the Bank of England in practice (Péteri, 1992). Its head, Arthur Salter, was British and had a collegial relationship with Norman. The US decision not to join the League tilted its scales toward London – much to the chagrin of the French, who remained suspicious of the League's activities. These political tensions pushed central bankers away from the League and towards the Bank for International

[7] Pierre Quesnay and Charles Rist played important roles in the stabilization of the leu, while the latter also became an adviser to the Bank of Romania. Romania is excluded from Table 1.1 because the National Bank of Romania had been established in 1880, and the reforms carried out in 1929 did not produce a stark discontinuity – see Cottrell (2003), Mouré (2003), and Chiappini et al. (2019).

[8] New institutions would be set up as private joint stock companies.

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