Benjamin Strong, the Federal Reserve, and the Limits to Interwar American Nationalism

Part I: Intellectual Profile of a Central Banker

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This essay on Benjamin Strong, the first governor of the Federal Reserve Bank of New York (1914–1928), evolved from the author's research on the development of an American internationalist tradition during and largely in consequence of the First World War. Viewing Strong's activities in the broader context of the world view and diplomatic preferences of the educated East Coast establishment, a foreign policy elite to which Strong belonged and most of whose norms he accepted, greatly illuminates his broader motivations and the interwar relationship between finance and overall international diplomacy. Strong's work for international stabilization also provides revealing insight into the limits of American internationalism during the 1920s and the degree to which, in both finance and diplomacy, the interwar years represented a transitional period between the restricted pre-1914 American world role and the far more sophisticated assumptions which would guide United States policies in the aftermath of the Second World War.

Strong's career as governor encompassed 15 years of rapid domestic and international change. The outbreak of the First World War just a few weeks

This article is based on a paper presented as part of the seminar series at the Federal Reserve Bank of Richmond. The author, Priscilla Roberts, is Lecturer in History and Director of the Centre of American Studies, University of Hong Kong. The article benefited greatly from the comments of Robert Hetzel, Marvin Goodfriend, and Roy H. Webb. Thanks are due to all for so generously sharing their time and expertise. The views expressed are the author's and not necessarily those of the Federal Reserve Bank of Richmond or the Federal Reserve System.

after he became governor in 1914 greatly enhanced the economic position of the United States. American manufacturers, financed by American bankers, provided much of the materiel essential to the Allied war effort, causing a flood of gold into the United States and tipping the international balance of trade and payments heavily in favor of the United States. When the war ended in 1918, European nations' ability to undertake postwar reconstruction depended upon the extent to which they could tap into the accumulated American capital reserves. During the war the U.S. economy boomed but American prices soared. Once fighting ended in late 1918, a short but intense recession occurred in 1920–1921, the product of a combination of the cessation of wartime orders and the Federal Reserve Board's efforts to end inflation by raising interest rates. After 1922, for most of the decade the American economy boomed, enjoying both real growth and price stability and generating the surplus funds necessary to enable Americans to invest heavily overseas. In the mid-1920s, private American loans financed both the return of most European countries to the gold standard and a wide array of European government and business enterprises. The American stock market slump of October 1929 marked the end of this prosperity. It precipitated a range of interlocking domestic and international economic difficulties whose constantly intensifying destructive synergy led to the worldwide Great Depression, the impact of which persisted until the late 1930s. The Federal Reserve System's inability to cope with the crisis led directly to the Banking Act of 1935, which greatly enhanced the powers of the Washington-based central Federal Reserve Board while diminishing those of the constituent regional Federal Reserve Banks.

1. THE CONTEXT OF STRONG'S IMPERIALISM

It is worth remembering that Strong was merely one individual in a group of prominent interwar American figures who were committed to what they termed "internationalist" policies and who often worked closely together to this end. This foreign policy elite generally favored expanding their country's international diplomatic and economic role. Its members usually supported American intervention against Germany in the First World War and U.S. participation in an international organization to maintain peace and in efforts to facilitate Europe's postwar economic recovery. Many also endorsed international arms limitation and some an American guarantee of France's security against a potential future German attack. There was a strong Anglophile element to their thinking: Most believed that an Anglo-American alliance, formal or informal, and Anglo-American diplomatic and economic cooperation would be fundamental to any acceptable postwar settlement.[1]

[1] On this outlook, see Priscilla Roberts, "The First World War and the Emergence of American Atlanticism 1914–20," *Diplomacy and Statecraft* 5:3 (November 1994), 569–619; idem, "The

Insights drawn from more traditional diplomatic history, as opposed to economic history, can help to illuminate some of Strong's policy choices, suggesting that his financial activities can only be fully understood when viewed in the overall context of contemporaneous broad internationalist developments within the United States. In particular, his profound sympathy for the Allies during the First World War, his support for American assistance to the Allied cause, and his belief that Anglo-American cooperation, economic and otherwise, must provide the foundation of the postwar international order, were far from unique. This outlook was shared not only by most in the New York financial community, the Morgan partners, for example, but also by the majority of the American East Coast elite, such as Theodore Roosevelt, his secretary of state, Elihu Root, Root's protege Henry L. Stimson, and numerous others.

The Anglo-American emphasis of the First World War and the 1920s seems to have derived, in large part, from the broadly Anglo-Saxonist views of the late-nineteenth- and early-twentieth-century U.S. upper crust. Roosevelt and the circle around him subscribed to Mahanist views that American security and the Monroe Doctrine had always depended upon Britain's goodwill and the consequent tacit protection that the British fleet afforded against the depredations of other European powers.[2] The Anglo-Saxonist movement reached its apogee in the years around the turn of the century. Throughout the nineteenth century, especially from the 1880s onwards, historians and political theorists, such as the British Edward August Freeman, John Mitchell Kemble, and John Richard Green, and their American counterparts, James K. Hosmer, Herbert Baxter Adams, John W. Burgess, and the even more influential Reverend Josiah Strong, John Fiske, and Mahan himself, disseminated and popularized the belief that the Anglo-Saxon race, in effect the British and Americans, was uniquely capable of self-government and had evolved the best and most democratic institutions to date.[3] In addition, many admired the British Empire as an

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Anglo-American Theme: American Visions of an Atlantic Alliance, 1914–1933," *Diplomatic History* 21:3 (Summer 1997), 333–64.

[2] See Alfred T. Mahan, *The Interest of America in Sea Power, Present and Future* (Boston: Little Brown, 1897), esp. 27, 49–51, 107–34, 189–90, 257–59; idem, *The Interest of America in International Conditions* (Boston: Little Brown, 1910), esp. 35–124, 155–85; idem, *Lessons of the War With Spain* (Boston: Little Brown, 1899), 289–98; Robert Seager, *Alfred Thayer Mahan: The Man and His Letters* (Annapolis: Naval Institute Press, 1977), 148–49, 225–26, 268–69, 522–25; Howard K. Beale, *Theodore Roosevelt and the Rise of America to World Power* (Baltimore: Johns Hopkins University Press, 1956), 144–45; William C. Widenor, *Henry Cabot Lodge and the Search for an American Foreign Policy* (Berkeley: University of California Press, 1980), 87–91, 149, 158–59; Kenton J. Clymer, *John Hay: The Gentleman in Politics* (Ann Arbor: University of Michigan Press, 1975), 125–29.

[3] The origins of this tradition are covered in Reginald Horsman, *Race and Manifest Destiny: The Origins of American Racial Anglo-Saxonism* (Cambridge, MA: Harvard University Press, 1981). For its later development, see Stuart Anderson, *Race and Rapprochement: Anglo-Saxonism and Anglo-American Relations, 1895–1904* (Rutherford, NJ: Fairleigh Dickinson University Press, 1981); Beale, *Theodore Roosevelt,* 41–47; David S. Healy, *US Expansionism: The Imperialist*

example of enlightened government.[4] Prominent British statesmen, for their part, were eager to welcome the United States into the imperialist club as a fellow Anglo-Saxon power which would, they hoped, be an ally. Conscious of their own isolation vis-à-vis the new European powers, especially the increasingly assertive Wilhelmine Germany, they hoped that the United States and Britain might establish at least a de facto alliance.[5]

This viewpoint informed Strong's own Manichaean interpretation of the war as a global struggle between the forces of good and evil. It was reinforced by Strong's personal ties with Britain, and given added ideological underpinning by the belief that Britain and the United States shared a common Anglo-Saxon heritage, one incomparably superior to that of any other nation. On the outbreak of the First World War, every indication is that Strong's sympathies were automatically and unhesitatingly pro-Ally, and that he was determined to do all in his power to assist the Allies. This sentiment was entirely typical of the social circles in which he moved.[6] It also had a major impact upon his conduct of wartime and postwar Federal Reserve business, predisposing him to close cooperation with Britain and to a world view to which intimate Anglo-American collaboration was fundamental.

The prominence of international considerations in Strong's policymaking should also be perceived as part of the broad outlook of the New York financial community, and as one aspect of the development since the late nineteenth century of a sense that the United States was a world power, which should both behave and be treated as one. One important goal of the Federal Reserve System's founders, particularly those New York bankers who were among its most prominent architects, was to provide the United States with a central banking system which would enable their country to fulfill its potential as an international financial power. Throughout the First World War and the 1920s,

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Urge in the 1890s (Madison: University of Wisconsin Press, 1970), 13–16, 29–33, 123–24, l38–42; Richard Hofstadter, *Social Darwinism in American Thought,* rev. ed. (Boston: Beacon Press, 1955), 170–84; Michael H. Hunt, *Ideology and US Foreign Policy* (New Haven: Yale University Press, 1986); Bradford Perkins, *The Great Rapprochement: England and the United States, 1895–1914* (New York: Atheneum, 1968), 74–83.

[4] See Roberts, "The First World War," 592. See also Robert E. Osgood, *Ideals and Self-Interest in America's Foreign Relations: The Great Transformation of the Twentieth Century* (Chicago: Chicago University Press, 1953), 66–70; Hofstadter, *Social Darwinism,* 179–84; Beale, *Theodore Roosevelt,* chs. 1–2; Healy, *US Expansionism,* 33, 38–39, 114, 122–25, 129–37; Hunt, *Ideology and US Foreign Policy,* 79–81.

[5] See Anderson, *Race and Rapprochement,* 86–94, 112–29; Beale, *Theodore Roosevelt,* 96–96, 139–40; David Dimbleby and David Reynolds, *An Ocean Apart: The Relationship Between Britain and America in the Twentieth Century* (London: Hodder and Stoughton, 1988), 40–41; Osgood, *Ideals and Self-Interest,* 58–59; Perkins, *Great Rapprochement,* 51–53, 65–67; D. C. Watt, *Personalities and Policies: Studies in the Formulation of British Foreign Policy in the Twentieth Century* (London: Longmans, 1965), 28–30.

[6] For a broader exploration of this outlook, see Roberts, "The Anglo-American Theme," 333–64.

Strong and other leading New York bankers perceived the System primarily in this light, as part of America's mechanisms for dealing with the outside world. Although their numbers were relatively small, they were highly influential. They included some of the brightest up-and-coming young men from the top East Coast banks. Among them were Henry P. Davison of J. P. Morgan and Company, the intellectual Paul M. Warburg of Kuhn, Loeb and Company, and Frank A. Vanderlip of the National City Bank of New York, not to mention Strong himself and his colleague Fred I. Kent of the Morgan-associated Bankers Trust Company. In the early twentieth century all these institutions had substantial international interests and plans to enhance them. For the U.S. finance system, which until late in the nineteenth century had looked to Europe to provide capital, their activities represented a new departure.[7]

From this perspective, the creation and operation of the Federal Reserve System were an integral part of the increasingly assertive U.S. policies which characterized the early part of the century. The United States flexed its military muscles in the Venezuela crisis and the Spanish-American War, as it sent the Great White Fleet around the world, acquired the Philippines, administered the customs of several Latin American countries, participated in international arbitration conferences, helped to settle the Russo-Japanese War, intervened in Mexico, and ultimately developed the plans which would eventually result in the League of Nations. In this sense, it seems highly significant that as a young man Strong was one of a coterie of youthful diplomats, journalists, financiers, and military men, whose shared belief that the United States must assume a much greater world role than in the past brought them together in a small, exclusive private club, often termed "the Family," at 1718 H Street in Washington, D.C.[8]

It can also be argued that, as with a number of other American internationalists among his contemporaries, Strong's passionate devotion to internationalism and to European economic reconstruction fulfilled certain personal needs of his own. He was a man who needed a purpose, even a mission, in life. Shortly before his death, Strong wrote: "All of my experience of life (and sometimes it grips me hard) convinces me that nowhere can one get better guides than from the teachings of Christ and [Abraham] Lincoln. . . . Maybe it's this point of view which gives me more joy when salaries are raised than when the discount rate is."[9] Indeed, to some degree his internationalist activities served as a near-religious faith for him. In the United States, Strong was perhaps the

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[7] See Lawrence Broz, *The International Origins of the Federal Reserve System* (Ithaca: Cornell University Press, 1997).

[8] See A. J. Bacevich, "Family Matters: American Civilian and Military Elites in the Progressive Era," *Armed Forces and Society* 8 (Spring 1982), 405–18.

[9] Strong to Walter T. Stewart, July 6, 1928, File 1117.2, Benjamin Strong Papers, Federal Reserve Bank of New York, New York.

most dedicated advocate of Europe's recovery, and it became a cause to which he literally devoted his life. Perhaps for personal reasons, Strong virtually drove himself to death in the service of the Federal Reserve System and European reconstruction. After the suicide of his first wife and his divorce from her successor in 1916, by all appearances Strong's only interest in life became his work. Shortly after his second marriage ended, Strong suffered the first of a recurrent series of bouts of tuberculosis brought on by overwork, a malady whose associated complications ultimately killed him. Even when confined to a Colorado or Arizona sanatorium, supposedly recuperating, he habitually wrote lengthy letters to associates on every aspect of Federal Reserve policy. The "determination" to finish the "job" of European reconstruction was perhaps the only thing keeping him alive. In 1928 Strong recounted his doctor's reaction when he learned of his patient's decision to retire as governor, a choice which seems to have been precipitated by his relationship with a much younger opera singer, whom he intended to marry:

> His advice was to quit as soon as possible and do it with as little effort as possible. But he was not satisfied with that advice until he knew my plans, as he feared that after a few months, inactivity might be worse than the work would be after a long rest. He feels I need an anchor and naturally thought of an occupation. . . . He feels that for five years past and longer I have been kept alive only by my determination to keep alive until a job was finished, once I let go that idea I would crack.[10]

It was perhaps not entirely surprising that shortly afterwards Strong died, still supposing that the task of European economic reconstruction had been successfully completed.

2. STRONG AS INTERNATIONALIST

Strong was unquestionably a major force in the post-World War I economic reconstruction of Europe. During the 1920s, credits extended by the New York Federal Reserve Bank to the Bank of England, the Banque de France, the Reichsbank, and other central banks, underpinned the restoration of the gold standard throughout most of Western Europe. This was an endeavor in which Strong worked closely with the New York financial community, especially the preeminent investment bank, J. P. Morgan and Company. Once a country had made the commitment to return to the gold standard and had undertaken the preparatory fiscal work of balancing budgets, cutting expenditures, and, in general, observing orthodox economic principles, the Morgan banking firm generally handled the American portion of loans to European governments,

[10] Strong to Stewart, July 26, 1928, ibid.; on Strong's temperament, see also Lester V. Chandler, *Benjamin Strong: Central Banker* (Washington, DC: Brookings Institution, 1958), 1–2, 47–53.

facilities intended to finance stabilization and thereby, it was hoped, promote economic recovery from the ravages of war. On occasion the New York Federal Reserve Bank also furnished credits to central banks in countries undertaking stabilization measures. These undertakings were by no means purely American in character, though the war had so diminished the ability of Europe's central bankers to orchestrate such endeavors and of private bankers to float the associated loans that the Europeans required American assistance to do so. The 1920s return to the gold standard was choreographed by a concert of central bankers, an enterprise in which Strong and the Morgan partners were closely associated with the Bank of England, the Banque de France, the Reichsbank, and the central banks of Austria, the Netherlands, Italy, and Belgium, as well as with those countries' leading private bankers. Biographies of Montagu Norman have also drawn attention to the close friendship that existed between him and Strong and their joint commitment to restore the gold standard in Europe and so implement a return to the international financial normalcy of the prewar years.[11] Norman was very conscious that Britain's loss of financial stature because of the war meant that, to accomplish postwar economic reconstruction, Europe "need[ed] the active cooperation of our friends in the United States," the Federal Reserve and private bankers whose financial participation and assistance was a sine qua non for the success of all such schemes.[12]

During the First World War, disputes among New York bankers over the impact which Federal Reserve policies might have upon the outcome of the European war led to fierce debates within the System. In the 1920s, by contrast, much of the New York financial community essentially shared a common outlook as to the desirability of accomplishing Europe's financial rehabilitation. While those investment bankers with German ties found the Morgan firm and its allies moved too slowly for their liking in providing loans to finance German recovery, they differed over timing rather than over fundamentals.[13] At least

[11] On these endeavors, see Richard Hemmig Meyer, *Bankers' Diplomacy: Monetary Stabilization in the Twenties* (New York: Columbia University Press, 1970); Stephen V. O. Clarke, *Central Bank Cooperation 1924–31* (New York: Federal Reserve Bank of New York, 1967); Chandler, *Benjamin Strong*, chs. 6–11; R. S. Sayer, *The Bank of England, 1891–1944*, 3 vols. (Cambridge: Cambridge University Press, 1976), Vol. 1, chs. 7, 8, 15; Sir Henry Clay, *Lord Norman* (London: Macmillan, 1957), chs. 5, 6; Andrew Boyle, *Montagu Norman* (New York: Weybright and Talley, 1967), chs. 7, 8; Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression 1919–1939* (New York: Oxford University Press, 1992), chs. 4–7.

[12] Quotation from Norman to G. Vissering, November 16, 1921, File G3/177, Bank of England Archives, London; see also, for example, Norman to W. H. Clegg, October 13, 25, December 17, 1921, ibid.; Norman to V. Moll, February 6, 1922, ibid.; Norman to Baron Havenstein, June 23, 1922, File G3/178, ibid.

[13] See Roberts, "The American 'Eastern Establishment' and World War I: The Emergence of a Foreign Policy Tradition" (Ph.D. diss., Cambridge University, 1981), 530–36. Initially the National City Bank of New York, the largest United States commercial bank, was far less wedded to European recovery and currency stabilization than the investment banks, declining to participate in the Austrian stabilization loan of 1923 and querying the 1925 Federal Reserve line of

in part, Strong's dominance of the Federal Reserve System during the 1920s reflected the fact that the New York financial constituency was firmly united behind him, another indication of the manner in which, despite the attempts of the System's founders to prevent any one region attaining such influence, New York was able to prevail on most important issues.

The roots of Strong's policies during the 1920s can be traced back at least to the First World War. Strong became governor of the Federal Reserve Bank of New York almost concurrently with the outbreak of war in Europe. Like other New York bankers, Strong perceived the war as providing an opportunity to expand America's international financial role, to allow New York to become a center which could aspire to rival London's preeminent position. One field of opportunity for the United States was the development of a market in commercial paper, or bankers' acceptances, previously a London monopoly. The new Federal Reserve Act permitted the Federal Reserve Banks to buy, or rediscount, such paper.[14] A second was the potential for U.S. banks to play a far greater role in international finance than ever before, floating loans which would likewise once have been left to the London market. Strong eagerly promoted the development of American acceptance financing, welcoming the manner in which the war facilitated the growth of a U.S. acceptance market.[15]

On several wartime trips to London, Strong developed far closer ties than before with British bankers—including those in the Bank of England—and explored the possibilities of obtaining for the United States a decidedly more substantial share of international financing. Even before the United States intervened in the First World War, Strong perceived that after the war Europe would desperately require capital for reconstruction, and that his country would possess the only substantial reservoir thereof.[16] Some American bankers,

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credit which the Bank of England negotiated to support Britain's return to gold. Later in the decade, however, the National City overinvested in foreign loans, particularly German bonds, and suffered severe losses in the subsequent European financial crash. Ibid., 537–39; Silvano A. Wueschner, *Charting Twentieth-Century Monetary Policy: Herbert Hoover and Benjamin Strong, 1917–1927* (Westport, CT: Greenwood Press, 1999), 65–67, 72, 88–89; Harold van B. Cleveland and Thomas F. Huertas, *Citibank 1812–1970* (Cambridge, MA: Harvard University Press, 1985), 145–50, 167–68.

[14] See James Livingston, *Origins of the Federal Reserve System: Money, Class, and Corporate Capitalism, 1890–1913* (Ithaca: Cornell University Press, 1986), 202–03; Burton I. Kaufman, *Efficiency and Expansion: Foreign Trade Organization in the Wilson Administration, 1913–1921* (Westport, CT: Greenwood, 1974), 30, 76; Carl P. Parrini, *Heir to Empire: United States Economic Diplomacy, 1916–1923* (Pittsburgh: University of Pittsburgh Press, 1969) 103–04; Broz, *International Origins,* 142–159; Clyde William Phelps, *The Foreign Expansion of American Banks: American Branch Banking Abroad* (New York: Ronald Press Company, 1927), 104–11.

[15] Strong to Paul M. Warburg, August 5, September 10, 1915, Box 12, Paul M. Warburg Papers, Yale University Library, New Haven, CT; Chandler, Benjamin Strong, 83–96; Priscilla Roberts, "'Quis Custodiet Ipsos Custodes?': The Federal Reserve System's Founding Fathers and Allied Finance in the First World War," *Business History Review* 73:4 (Winter 1998), 585–620.

[16] Strong to Fred I. Kent, July 10, 1915, U. S. Senate, 74 Cong., 2d Sess., *Hearings Before the Committee Investigating the Munitions Industry,* 40 vols. (Washington, DC: Government Printing

particularly the Morgan partners, consciously discountenanced predictions of postwar American commercial and financial predominance.[17] Strong carefully emphasized that his country's financiers hoped not to shoulder aside their British counterparts, but to enter into a partnership with them. He told Norman: "I do hope that you and other sensible and friendly people in London do not attach too much importance to the vain-glorious boasting of the American press about these financial developments."[18] Even so, in a speech in March 1916, Strong—though sweetening the pill by emphasizing his own complete support for the Allied cause—told prominent London bankers:

> [T]his war might entail tremendous sacrifices upon the English people, including the bankers, and if it involved the surrender of some part of the world[']s banking to New York, at least we believed that it would be surrendered upon fair terms, on fair competitions [sic], and that some of us felt that if this great sacrifice had to be made, England, which had established the standard of commercial honor and integrity throughout the world, would rather relinquish this great trust into the hands of those who spoke their own language and who believed in the same institutions, and had, I hoped, the same high ideals of honor and integrity.[19]

While some British financiers, including the officials of the Bank of England, Sir Felix Schuster of the Union of London and Smith's Bank, the partners of Morgan Grenfell and Company, J. P. Morgan and Company's sister firm, and Sir Charles Addis of the Hong Kong and Shanghai Banking Corporation, were prepared to welcome or at least—in return for access to U.S. funds—tolerate American cooperation, others were less sanguine.[20] Yet few British bankers were likely to welcome wholeheartedly any diminution of their own country's financial predominance. Not unsympathetically, Strong recounted that, when he visited Britain in 1916, Sir Edward Holden, chairman of the London City and Midland Bank, "made an address at the Manchester Chamber of Commerce in which he referred to efforts of American bankers to undermine Lombard Street's

Office, 1934–36), 30:9527; Strong, diary, March 28, 1916, File 1000.2, Benjamin Strong Papers, Federal Reserve Bank of New York.

[17] See, for example, Thomas W. Lamont, address before Cosmopolitan Club, March 31, 1915, 29–30, File 144-20, Thomas W. Lamont Papers, Baker Library, Harvard Business School, Boston, MA; Lamont, "Financial Illusions of the War," 209–11, ibid.; Dwight W. Morrow, "Address delivered at New York State Bankers Association Dinner," January 7, 1916, "Speech to Commercial Club," November 9, 1916, Speeches File, Dwight W. Morrow Papers, Robert Frost Library, Amherst College, Amherst, MA. Strong congratulated Morrow on the first of these speeches. See Strong to Morrow, January 16, 1916, File Bankers Association, New York State, ibid.

[18] Strong to Norman, March 22, 1917, File 1116.1, Strong Papers.

[19] Strong, diary, March 10, 1916, reporting speech at London Clearing Banks dinner, File 1000.2, ibid.; cf. Strong to Alexander Mackenzie, July 1, September 17, 1915, File 1112.5, ibid.; Strong to Sir Edward Holden, April 19, 1917, File 1112.3, ibid.

[20] Strong, diary, March 6–8, 10, 13, 21, 22, 23, 1916, File 1000.2, ibid.

supremacy and he was so overcome by the mere thought that the old man broke down and wept."[21] Strong's policies towards Britain rather neatly exemplify the Anglo-American relationship of "competitive cooperation," which the historian David Reynolds perceives as characterizing the immediate pre-World War II period.[22]

Yet, even as Strong pursued an enhanced financial position for his country, he also implemented policies that might be perceived as assisting Britain and the other Allies at the expense of the United States. It is hard to exaggerate the depth of Strong's commitment to the Allies. Like many others of the East Coast upper-crust elite, those Anglophiles whom Henry F. May has termed the "custodians of culture," Strong perceived the First World War as a global struggle between the forces of good and evil, Prussianism, Kaiserism, and autocracy against democracy, freedom, civilization, and Christianity.[23] Even before American intervention, he identified himself almost completely with the Allied cause. Publicly explaining the meaning of the war in 1917, Strong stated:

> Four hundred years ago [sic] the Anglo-Saxon race received the first great bill of rights upon which their personal liberties are founded, when King John of England signed the great Magna Charta at Runnymede. For two hundred and fifty years that race in England has been engaged in building up constitutional government. It was the beginning, the foundation of our personal liberties; the foundation of the liberties of the English-speaking peoples throughout the world. It was bequeathed to us one hundred and fifty years ago by Great Britain, and for substantially four hundred years we English-speaking people, and those from other countries whom we have adopted, have been developing our institutions based upon that foundation of constitutional law. For forty years, since the war between Prussia and France, a military autocracy in Germany, filled with lust for power, has been building up a great military structure, on an entirely different theory of personal or autocratic government, and now they have come into conflict—so the question is, which is going to win? That is the greatest problem the human race has ever faced—constitutional government against personally organized military government, with the Kaiser at its head.[24]

Strong's support for the Allied cause was slightly less fervent than that of many of his associates, for example the members of the Morgan firm. The Morgan

[21] Strong to James Brown, September 4, 1916, *Munitions Hearings,* 31:9937.

[22] See David Reynolds, *The Creation of the Anglo-American Alliance, 1937–1941* (Chapel Hill: University of North Carolina Press, 1981).

[23] See Henry F. May, *The End of American Innocence: A Study of the First Years of Our Own Time, 1912–1917* (New York: Oxford University Press, 1959), 363–37; Roberts, "The First World War," 575–56; idem, "The Anglo-American Theme," 338–30.

[24] See Strong, "The Sale of Liberty Bonds," address to the Four-Minute Men, New York City, October 1, 1917, in Strong, *Interpretations of Federal Reserve Policy in the Speeches and Writings of Benjamin Strong,* ed. W. Randolph Burgess (New York: Harper & Row, 1930), 41.

partners, to whom he had always been extremely close, and whom he would probably have joined had they not persuaded him to take the Federal Reserve position instead, financed and handled most of the Allied war purchases in the United States.[25] Like the Morgan partners, well before American intervention Strong was determined to do all he could to help the Allies. To this end, he pushed for interpretations of the new Federal Reserve System's regulations that would assist the Allies in their increasingly desperate quest to obtain American financing for the war purchases which were vital to their ability to continue fighting the war. In doing so, Strong at least temporarily undercut the development of a New York acceptance market. By permitting repeated extensions of commercial credits against Allied war purchases, he effectively converted these securities into medium-term unsecured loans to the Allied powers, which absorbed most of the capital that would otherwise have been available to finance genuine acceptances.[26] Strong was also one of those bankers who supported the extension of American loans and credits to the Allies. In addition, in 1916 he negotiated correspondent relationships for the New York Federal Reserve Bank with the Bank of England and the Banque de France, one purpose of which was to facilitate the Allies' American fund-raising.[27]

Strong's efforts to assist the Allies involved him in lengthy and fiercely contested battles with another major figure in the Federal Reserve System, the New York banker Paul M. Warburg. The intellectual Warburg was perhaps Strong's closest friend; the two men had been allies in the struggle to create the Federal Reserve System, and Warburg was one of those who persuaded him to accept the position of governor. The German-born Warburg himself became a vice-governor of the Federal Reserve Board, and probably its strongest voice.

[25] On the Morgan firm's wartime role, see "Memorandum Relative to Financing by J. P. Morgan & Co. during the World War," no date, File 213-7, Lamont Papers; Kathleen Burk, *Britain, America, and the Sinews of War, 1914–1918* (Boston: Allen Unwin, 1985), chs. 1–5; idem, *Morgan Grenfell 1838–1988: The Biography of a Merchant Bank* (Oxford: Oxford University Press, 1989), 103–34; Vincent P. Carosso, *Investment Banking in America: A History* (Cambridge, MA: Harvard University Press 1970), 204–07; Ron Chernow, *The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance* (New York: Atlantic Monthly Press, 1990), ch. 10; Edward M. Lamont, *Ambassador from Wall Street: The Story of Thomas W. Lamont, J. P. Morgan's Chief Executive* (Lanham, MD: Madison Books, 1994), 67–85; Harold Nicolson, *Dwight Morrow* (New York: Harcourt Brace, 1935), 172–93; Roberts, "The American 'Eastern Establishment' and World War I," 247–61.

[26] See Roberts, "'Quis Custodiet Ipsos Custodes?,'" 592–617.

[27] See Roberts, "'Quis Custodiet Ipsos Custodes?,'" 605–06; Chandler, *Benjamin Strong,* 93–98; Paul P. Abrahams, "The Foreign Expansion of American Finance and Its Relationship to the Foreign Economic Policies of the United States" (Ph.D. diss., University of Wisconsin, 1967), 82–83; Sayers, *Bank of England,* 1:93. For details of these negotiations, see Strong diary and letters during European trip of 1916, File 1000.2, Strong Papers; *Munitions Hearings,* 27:8239–8252; exhibits 2354–2395, ibid., 8428–8455; File Federal Reserve Board–Bank of England 1915–1918, Box 329, 74 Cong., 2nd Sess., U.S. Sen., Papers of the Special Committee Investigating the Munitions Industry, Record Group 46, National Archives, Washington, DC.

Until American intervention in April 1917, he and Strong waged a persistent battle as to whether Federal Reserve regulations should be framed and interpreted in such a way as to facilitate the Allies' ability to finance their war purchases in the American market. Perhaps not surprisingly, while both men couched their arguments in terms of the best interests of the United States, Strong invariably favored courses which would assist the Allies while Warburg, though more neutral and pacifist than pro-German, supported measures which would encourage the Allies to consider a negotiated peace settlement. Initially, Strong was victorious; then, in late 1916 it seemed that Warburg and his allies on the Federal Reserve Board, W. P. G. Harding, its chairman, and Adolph C. Miller, a fellow governor, had finally triumphed, thanks to assistance from President Woodrow Wilson. Shortly afterwards German determination to wage unlimited submarine warfare on the United States impelled an American declaration of war, and the whole issue became moot. Even so, it demonstrated the manner in which noneconomic considerations, particularly sympathies for one or another European country, could affect the judgment of figures within the Federal Reserve System.[28]

To some degree this long-running debate prefigured Strong's continuing pattern of behavior during most of the 1920s, when he habitually gave international considerations a high priority. As early as 1916, Strong supported postwar "disarmament" and "a formal, definite understanding between all the great nations, including the United States, that differences between nations will be settled without force and that settlement, if necessary, will be imposed upon parties to disputes by a combination of the neutrals."[29] Moreover, he hoped that this would rest upon a foundation of Anglo-Franco-American cooperation and understanding, though he feared that for political reasons any such alliance would have to remain informal.[30] In negotiating the correspondent relationship with the Bank of England, he told Lord Cunliffe, its governor, that he favored such an arrangement not simply for commercial reasons, but also because he "believed . . . that the world's future very largely depends upon the character of the understandings between your people and ours."[31]

Whereas many pro-Ally Americans tended to believe that any lasting peace settlement must be contingent on a conclusive Allied victory, in late 1916 Strong endorsed Woodrow Wilson's attempts to bring about a negotiated peace

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[28] See Roberts, "'Quis Custodiet Ipsos Custodes?,"' 585–620.

[29] Strong to Warburg, December 15, 1916, File 211.3, Strong Papers; see also Strong to Warburg, November 17, 1916, ibid., Strong, diary, March 28, 1916, File 1000.2, ibid.; Strong to James Bryce, October 23, 1916, File 1111.3, ibid.

[30] Strong, diary, March 28, 1916, File 1000.2, ibid.; Strong to Bryce, October 23, 1916, File 1111.3, ibid.

[31] Strong to Cunliffe, December 3, 1918, File 1115.1, ibid.

settlement, provided that American influence was employed to win peace terms favorable to the Allies.[32] Even before this, he had opposed a punitive peace settlement, arguing that "when the war stops—it should actually STOP," whereas the imposition of harsh economic terms upon Germany would effectively continue hostilities through nonmilitary channels and "lead to a renewal of the very conditions which gave rise to the present war."[33] He warned his British friend Lord Bryce, a former ambassador to the United States, that his country, while willing in principle to participate in the postwar international settlement, might well refuse to guarantee "peace arrangements in which was consciously planted the germ of later strife." In addition, he told Bryce, British attempts to subjugate Germany economically might lend added force to the contentions of those Americans who advocated commercial competition with Britain, and that such policies would in any case be unworthy of England's distinguished and honorable diplomatic record.[34]

Strong was indeed concerned by proposals that the British and French developed at the Paris Economic Conference of June 1916, which appeared to envisage a protectionist trading bloc of the Allied nations. The meeting's recommendations included the postwar prohibition of trade with former enemy states, the elimination of enemy firms in Allied countries, the common pooling of the Allies' natural resources, their cooperative purchase of raw materials not otherwise available, restrictions on former enemy powers' shipping, and measures to encourage mutual trade among the former Allies.[35] Although the British contended that such an Allied economic bloc would be aimed only at their quondam enemies, not at the United States, Strong warned British friends that such commercially discriminatory measures would severely impede the achievement of any type of postwar Anglo-American entente or cooperation. He believed that if the United States "avoided trouble with Germany and kept out of the war" such measures, although supposedly intended merely as anti-German, "would inevitably be directed to some extent against us." A free trader, he also feared that proposals such as those advanced at the Paris Economic Conference gave added weight to the arguments of those Americans who supported protective tariffs, export trade combinations, "and other similar projects, all possibly proper enough as weapons of defence, but which will, I hope, not be required in order to face a world which has armed itself with

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[32] Strong to Bryce, January 12, 1917, File 1111.3, ibid.; see also Strong to J. H. Treman, December 21, 1916, File 333.221, ibid. Somewhat erroneously, Strong believed that the German leaders were willing, even eager, to make peace. Strong to W. P. G. Harding, November 20, 1916, *Munitions Hearings*, 31:9674.

[33] Strong, diary, March 9, 1916, File 1000.2, Strong Papers.

[34] Strong to Bryce, October 23, 1916, File 1111.3, ibid.

[35] See Parrini, *Heir to Empire*, 15–17; Gerd Hardach, *The First World War, 1914–1918* (London: Penguin, 1977), 237–41; Kaufman, *Efficiency and Expansion*, 166–75.

every political contrivance for a commercial strife to be carried to the point of extermination."[36]

Strong's attitude towards European reconstruction was thus moderate and pragmatic, but he never doubted that the United States should participate in this enterprise. From before American intervention until his death, Strong remained dedicated to the cause of facilitating European recovery. Inevitably, one consequence of this would be a great increase in U.S. international financial activities, a development consonant with Strong's long-time interest in building up the United States as a world economic power. After American intervention, he stated publicly, repeating his utterances while his country was still neutral, that the United States would possess the only large resources of postwar capital available to finance Europe's economic recovery.[37]

When the war ended, Strong continued to state the case for the provision of American capital to finance European recovery, both as immediate long-dated credit for food and raw materials to tide Europe over the impending winter of 1919–1920, and longer-term loans and investment capital to facilitate economic redevelopment. Like many leading American bankers, at the end of the war Strong believed that economic reconstruction was far more vital to the restoration of European stability than the settlement of political questions. As he had earlier, Strong opposed a Carthaginian peace, supporting the imposition of a relatively moderate, rather than harshly retributive, reparations settlement on Germany. He also supported the reduction or even cancellation of the war debts that the Allies owed the United States.[38] He called for speedy ratification of the Treaty of Versailles, even if some of its terms were imperfect, on the grounds that until this took place the maintenance of a technical state of war with Germany would reinforce American businessmen's prevailing uncertainty as to European conditions, discouraging private American investment in Europe. He also hoped that after ratification the League of Nations machinery would provide some of the administrative infrastructure needed to accomplish economic reconstruction and solve such problems as German reparations and Allied war debts.

In the long term, Strong hoped for extensive American private investment in Europe, which he believed should be predicated upon European governments' return to strict financial discipline, balanced budgets, governmental economy, currency stabilization, minimal state intervention, and the removal

[36] Strong, "Interview with Lord Kitchener," March 24, 1916, File 1000.2, Strong Papers; Strong, diary, March 28, 1916, ibid.; Strong to Bryce, October 23, 1916, File 1111.3, ibid.

[37] Strong, "An Appeal to Buy Bonds," address at mass meeting at the Metropolitan Opera House, New York City, September 27, 1918, in *Interpretations*, 53.

[38] See Strong, "Memoranda," on inter-Allied debts and reparations, Strong to Leffingwell, July 31, 1919, Strong, "Memorandum," August 30, 1919, Strong, diary, September 13, 1919, all in File 1000.3, Strong Papers.

of preferential tariff barriers. In the short term, Strong argued, the American government should be prepared to extend some credits to European businessmen and governments, to tide them over their immediate difficulties.[39] Strong even expected the U.S. government to write off some such assistance, telling Russell C. Leffingwell, the Under Secretary of the Treasury who later became a leading Morgan partner, that "a part of the problem can be dealt with on a business basis and a part of it must be dealt with on an eleemosynary basis."[40]

In 1919 several American bankers to whom Strong was close, including his old friend Paul Warburg and Fred I. Kent, the president of the Bankers Trust Company, together with leading British and Dutch financiers, were instrumental in drafting the Amsterdam Memorial, signed by J. P. Morgan, Jr., as well as many leading European and American statesmen, bankers, and industrialists. This international petition called for the extension of large-scale American credits and loans to European governments and businesses, lenient intergovernmental debt settlements, a reparations assessment relatively generous to Germany, and a readiness on the part of both Americans and Europeans to make sacrifices for these ends. Strong firmly approved of the Memorial's prescriptions, although he declined to sign it, on the grounds that "my relations with our treasury department [are] of such an intimate character that I feared the possibility of its being misunderstood and causing embarrassment which would, of course, have done harm rather than help the effort."[41] The Amsterdam Memorial led the League of Nations in December 1920 to endorse the ter Meulen plan, named after a Dutch banker, which called for European governments to issue bonds that could be used to guarantee private credits to finance Europe's recovery. Although he had some reservations as to the degree of statism this undertaking involved, Strong suggested that American bankers might participate if their own government was prepared to take "an active and official part in the plans for European reconstruction."[42]

As early as 1921 Strong was eager to cooperate with other central banks to devise schemes to facilitate Europe's economic recovery, probably through a variety of private credits guaranteed by European governments. At this time Charles Evans Hughes, the Secretary of State, refused to permit him to

[39] Strong to Leffingwell, July 31, August 21, 30, 1919, Strong, "Memorandum," August 30, 1919, Strong to Harding, September 11, 1919, File 1000.3, Strong Papers; Strong to Norman, March 20, 1920, File 1116.1, ibid.

[40] Strong to Leffingwell, July 31, 1919, File 1000.3, ibid.

[41] Strong to G. Vissering, March 29, 1920, File 1150.0, ibid.; for the drafts and text of the memorial and much correspondence among its supporters, see the materials in Box 17, Warburg Papers; the Warburg Memorial Collection, Boxes 18 and 19, Record Group 56, Records of the Department of the Treasury, National Archives II, College Park, MD; and Boxes 20 and 22, Robert H. Brand Papers, Bodleian Library, Oxford, England.

[42] Strong to Hoover, June 9, 1921, quoted in Wueschner, *Charting Twentieth-Century Monetary Policy*, 27.

undertake such activities.[43] Strong also continued to urge Anglo-American financial and economic cooperation in promoting European economic recovery.[44] He remained anxious that financial and commercial rivalries should not disrupt Anglo-American harmony. Noting Britain's eagerness to attract American credit and investment capital, Strong suggested to Lord Cunliffe, Montagu Norman's predecessor as governor of the Bank of England, that "if this problem is approached in a friendly and cooperative spirit they [the British] are the one nation in the world to which credit will be freely given here, because, after all, it is the English businessman and banker that we trust."[45] Writing to Norman the same day, Strong stated: "I believe the greatest difficulty comes from a fear on the part of your London bankers of the [Sir Edward] Holden [chairman of the London City and Midland Bank] type that we are going to encroach upon the English banking preserves. Frankly, I don't see how it can be avoided for a time because when the period of unsettlement is over we are going to have the reserve of banking in this country and it is bound to find an outlet."[46] Writing in 1920 to an official of the New York Federal Reserve Bank, Strong stated that their institution "should always have it in mind" that its policies could adversely affect the British. "By this I do not mean to suggest that our policy should be shaped with regard to their interests, but rather that when our policy does appear to impose hardship upon them, the least we can do with such an intimate association is to keep them advised and give them some explanation of the reasons for our course."[47]

As Strong's words suggest, and as the 1920s would demonstrate, however fervent his personal commitment to internationalism, the parameters within which he and the Federal Reserve System operated imposed distinct restrictions upon the degree to which he could make European recovery and stabilization his first priority. He could not ignore political pressures, internecine sectional disputes among American bankers and within the Federal Reserve System, and the domestic demands of the U.S. economy. Strong was also firmly wedded to orthodox, pre-Keynesian economic tenets rooted in the thinking of the prewar era. His policies in the decade after the war would demonstrate both the ambitious scope of internationalist central banking objectives in the United States and the de facto obstacles to their attainment.

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[43] See Wueschner, *Charting Twentieth-Century Monetary Policy,* 27–32.

[44] Strong to Russell C. Leffingwell, July 31, 1919, File 1000.3, Strong Papers; Strong to Montagu Norman, November 22, 1918, February 5, May 21, 1919, File 1116.1, ibid., Strong to Lord Cokayne, May 23, 1919, File 1115.2, ibid.

[45] Strong to Cunliffe, February 5, 1919, File 1115.1, ibid.

[46] Strong to Norman, February 1919, File 1116.1, ibid.; cf. Strong to Norman, November 22, 1918, May 2, 1919, ibid.; Strong to Cunliffe, December 3, 1918, Cunliffe to Strong, January 5, 1919, File 1115.1, ibid.; Strong to Leffingwell, July 25, 31, 1919, Strong, diary, July 28, 1919, File 1000.3, ibid.

[47] Strong to Pierre Jay, March 30, 1920, File 320.113, ibid.

Benjamin Strong, the Federal Reserve, and the Limits to Interwar American Nationalism

Part II: Strong and the Federal Reserve System in the 1920s

Priscilla Roberts

1. BENJAMIN STRONG: CONTEMPORARY VIEWS

Controversial in life, the dominating figure of Benjamin Strong, first governor of the Federal Reserve Bank of New York, continues to precipitate debate long after his death in 1928. "There are," intoned former President Herbert Hoover, "crimes far worse than murder for which men should be reviled and punished."[1] Perhaps slightly biased by the fact that the Great Depression had ruined his presidency, he was referring to what he perceived as deficiencies in Federal Reserve policy during the 1920s. In particular, Hoover believed that the United States Federal Reserve System, most of whose members he unkindly characterized as "mediocrities," had been overly influenced by the priorities of its dominant figure, Benjamin Strong. Describing Strong as "a mental annex to

This article is based on a paper presented as part of the seminar series at the Federal Reserve Bank of Richmond. The author, Priscilla Roberts, is Lecturer in History and Director of the Centre of American Studies, University of Hong Kong. The article benefited greatly from the comments of Robert Hetzel, Marvin Goodfriend, and Roy H. Webb. Thanks are due to all for so generously sharing their time and expertise. The views expressed are the author's and not necessarily those of the Federal Reserve Bank of Richmond or the Federal Reserve System.

[1] See Herbert Hoover, *The Memoirs of Herbert Hoover,* Volume III: *The Great Depression 1929–1941* (New York: Macmillan, 1941), 14.

Europe," Hoover laid much of the blame for the stock market crash of 1929 and the subsequent Great Depression on the governor's deep commitment to facilitating Europe's economic recovery from the damage done by the First World War. During the 1920s, the majority of Europe's governments, led by Great Britain, returned to the gold standard. Britain's insistence on doing so at what Hoover termed a "fictitious rate" of $4.86 to the pound sterling, in his opinion far too high, and Strong's acquiescence in these policies, in turn led Strong to expand American credit by keeping American discount rates relatively low and manipulating the Reserve System's open market operations. The rationale for this was that keeping interest rates lower in the United States than in Britain eased pressures on sterling and enabled the Bank of England, whose governor, Montagu Norman, was Strong's closest friend, to maintain an overvalued pound. Hoover ascribed Strong's policies to what he viewed as the malign persuasions of Norman and other central bankers, especially Hjalmar Schacht of the Reichsbank and Charles Rist of the Bank of France. He believed that due to Strong's unwise predilections, from the mid-1920s onward the United States experienced credit inflation, which fuelled the stock market bubble that collapsed in the Great Crash of 1929. Although Hoover suggested that other economic weaknesses, including a "weak banking system" and the low purchasing power of farmers and white-collar employees, contributed to this, he argued that imprudent Federal Reserve policies bore the primary responsibility for the crash and the Depression.[2]

Hoover was not alone among Strong's contemporaries in expressing the view that Strong's efforts to aid Britain's return to the gold standard laid the foundation for the Depression by triggering stock market speculation. At the onset of the Great Depression, Russell C. Leffingwell, a leading partner in the investment bank J. P. Morgan and Company, agreed with those who condemned Strong's policies and ascribed to them at least some responsibility for the boom and final crash of that decade's second half. Leffingwell did so even though Strong had close ties to the Morgan banking firm, which had provided much of the financing for European nations' stabilization efforts.[3]

Within the Federal Reserve System, Strong's rate policies of the mid-1920s also provoked substantial regional opposition, particularly from midwestern and agricultural elements, who generally endorsed Hoover's subsequent analysis.[4] It is generally accepted that in 1924 Strong engineered low interest rates in the United States, which by making the dollar and sterling respectively less and more attractive to investors drove up the foreign exchange value of the British

[2] Ibid., 2–15, quotations from 8 and 9.

[3] Leffingwell to Lamont, August 29, 1931, File 102-15, Thomas W. Lamont Papers, Baker Library, Harvard Business School, Boston, MA; cf. Leffingwell to Lamont, March 8, 1929, File 102-13, ibid.; Leffingwell to Lamont, May 29, 1929, File 103-14, ibid.

[4] See note 10, below.

currency and facilitated Britain's return to the gold standard.[5] The records not only of Strong's correspondence with Montagu Norman, but also the Bank of England's files on relations with the Federal Reserve Bank of New York, reveal how closely British and American bankers kept in touch on their respective discount rates.[6] Throughout the 1920s, two of the Federal Reserve Board's directors, Adolph C. Miller, a professional economist, and Charles S. Hamlin, perennially disapproved of the degree to which they believed Strong subordinated domestic to international considerations; indeed, they and Strong had generally disagreed over Federal Reserve policies ever since all three men joined the System in 1914.[7] In 1925 Hoover, then Secretary of Commerce and in the early 1920s an ally of Strong's in the quest to bring about European economic recovery, also demonstrated great reservations toward Strong's policy of reducing United States rates in order to facilitate Britain's return to gold at its prewar parity, and worked behind the scenes to precipitate congressional questioning of its wisdom.[8]

The issue of government control over foreign loans also brought Strong—and other New York bankers—into direct conflict with the Secretary of Commerce, clashes which probably contributed to Hoover's later antagonism towards Strong. Indeed, one consequence of their disputes was that after mid-1922 the two men, once fairly close collaborators, ended their formerly extensive correspondence, generally communicated through intermediaries, and only met on one subsequent occasion, in November 1923.[9] Hoover believed that the U.S. government should have the final say as to whether a foreign loan was in the national interest, and demanded that American bankers obtain preapproval of

[5] Strong to Andrew Mellon, May 27, 1924, File Gold (Miscellaneous), 1922–1925, Box 86, Record Group 56, Records of the Department of the Treasury, National Archives II, College Park, MD; Lester V. Chandler, *Benjamin Strong: Central Banker* (Washington, DC: Brookings Institution, 1958), 241–46, 300–07; Stephen V. O. Clarke, *Central Bank Cooperation 1924–1931* (New York: Federal Reserve Bank of New York, 1967), 85–96; Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States 1867–1960* (Princeton: Princeton University Press, 1963), 282–284, 288; Elmus R. Wicker, *Federal Reserve Monetary Policy 1917–1933* (New York: Random House, 1966), 80, 89–90; R. S. Sayers, *The Bank of England, 1891–1944,* 3 vols. (Cambridge: Cambridge University Press, 1976), I:139–40; Sir Henry Clay, *Lord Norman* (London: Macmillan, 1967), 140–44; Boyle, *Montagu Norman* (New York: Weybright and Talley, 1967), 183–84; Silvano A. Wueschner, *Charting Twentieth-Century Monetary Policy: Herbert Hoover and Benjamin Strong, 1917–1927* (Westport, CT: Greenwood Press, 1999), 57, 75–85; Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression 1919–1939* (New York: Oxford University Press, 1992), 191–92.

[6] See correspondence in Series OV31 and OV32, Bank of England Archives, London; Strong's extensive correspondence with Norman, Files 1116.1–1116.8, Benjamin Strong Papers, Federal Reserve Bank of New York, New York.

[7] See Chandler, *Benjamin Strong,* 44–45 and pass.; Donald F. Kettl, *Leadership at the Fed* (New Haven: Yale University Press, 1986), 24–25, 33–35; Wueschner, *Charting Twentieth-Century Monetary Policy,* esp. 71, note 99, and chs. 4 ff.

[8] See Wueschner, *Charting Twentieth-Century Monetary Policy,* 77, 84, 90–104.

[9] Ibid., 42, 104.

all such loans from the Department of Commerce. He was also eager to demand that the proceeds of American loans should be spent on American products. Like most of his fellow bankers, Strong opposed all such restrictions, viewing them as an undesirable extension of government supervision over aspects of the economy that should be left to the free market. In correspondence with Hoover and others, Strong expressed his views at length. The outcome was that American bankers found themselves obliged to notify the State Department of all foreign issues; the department could and sometimes did object to them on grounds of the national interest, but Hoover's attempts to force borrowers to spend the proceeds in the United States failed.[10]

The most notorious episode of monetary ease, however, occurred in July and August 1927, when Strong, though alarmed by the American market's speculative and inflationary tendencies, nonetheless forced through the Federal Reserve System a decrease in the discount rate from 4 to 3 percent. This move relieved the excessive pressures to which the initial level of American interest rates was subjecting the dangerously shaky pound. In July 1927 the central bankers of Great Britain, the United States, France, and Germany had met on Long Island in the United States to discuss means of strengthening Britain's gold reserves and the general European currency situation. Strong's reduction of discount rates and purchase of £12 million of sterling, for which he paid the Bank of England in gold, appear to have been the direct result of this conference. Indeed, according to Charles Rist, one of the French bankers who attended, Strong said that the American authorities would reduce discount rates as "un petit coup de whisky for the stock exchange."[11] Strong pushed this reduction through the Federal Reserve System despite strong opposition not just from Miller, but also from James McDougal, the governor of the Chicago Federal Reserve Bank, who represented Midwestern bankers who generally

[10] Strong, diary, August 6, 1919, File 1000.3, Strong Papers; Strong to S. Parker Gilbert, May 23, 1921, File 012.5, ibid.; Strong to Gilbert, June 2, 1921, File Federal Reserve Board 1921, Box 70, Record Group 56, National Archives II; Strong to Charles Evans Hughes, April 14, 1922, File 800.51/312, Record Group 59, Records of the Department of State, National Archives II, College Park, MD; memorandum by Strong, attached to Hoover to Hughes, April 29, 1922, 800.51/316, ibid.; Gilbert to Strong, October 18, 1925, enclosing Gilbert to Secretary of State, October 16, 1925, and Gilbert to Garrard B. Winston, October 18, 1925, Strong to Gilbert, November 7, 1925, File 1012.1, Strong Papers; Chandler, *Benjamin Strong,* 265–66; Carl P. Parrini, *Heir to Empire: United States Economic Diplomacy, 1916–1923* (Pittsburgh: University of Pittsburgh Press, 1969), 188–94; Michael J. Hogan, *Informal Entente: The Private Structure of Cooperation in Anglo-American Economic Diplomacy 1918–1928* (Columbia, MO: University of Missouri Press, 1977), 98, 100; Herbert Hoover, *The Hoover Memoirs,* Vol. 2 *The Cabinet and the Presidency 1920–1933* (London: Hollis and Carter, 1952), 85–91; Wueschner, *Charting Twentieth-Century Monetary Policy,* 33–35, 38–42.

[11] See Chandler, *Benjamin Strong,* 375–77; Clarke, *Central Bank Cooperation,* 123–24; Sayers, *Bank of England,* 1:336–345; Clay, *Lord Norman,* 236–37; Boyle, *Montagu Norman,* 231; Eichengreen, *Golden Fetters,* 212–13; Wueschner, *Charting Twentieth-Century Monetary Policy,* 137–39. Rist's recollection of Strong's remark is quoted in Sayers, *Bank of England,* 1:340.

did not share New York's preoccupation with international financial markets. Indeed, the Chicago Bank only reduced its rates when the Federal Reserve Board ordered it to do so.[12]

In a confidential memorandum written shortly afterwards for use at a meeting of the Federal Advisory Council, Strong specifically denied that his close relationship with the Bank of England had affected his policy choice on this issue. The rate reduction had, he claimed, facilitated European purchases of America's "marginal production of export goods," the market for which would disappear should European currencies collapse. He also cited, as he had on numerous earlier occasions since the First World War, the menace of domestic American inflation were Europe to ship over excessive amounts of gold.[13] Yet Frank Altschul, a leading partner in the New York branch of the multinational investment bank Lazard Freres, told Emile Moreau, the governor of the Bank of France, "that the reasons given by Mr. Strong as justification for the reduction in the discount rate are being taken seriously by no one, and that everyone in the United States is convinced that Mr. Strong wanted to aid Mr. Norman by supporting the pound."[14] Other correspondence in Strong's own files suggests that he was giving priority to international conditions rather than to American exporters' needs. Writing to Norman, who praised his handling of the affair as "masterly," Strong described the rate reduction as "our year[']s contribution to reconstruction."[15]

2. STRONG AND THE GREAT DEPRESSION: THE CURRENT DEBATE

Since the 1930s, economic historians have focused on Strong's central role in setting early Federal Reserve policies; the likely relationship between these policies to the Great Depression; the possibility that, had he lived, Strong might have averted the slump; and Strong's involvement in international economic

[12] Strong's own version is given in Strong, "The Chicago Rate Controversy," September 11, 1927, File 320.121, Strong Papers. Accounts may also be found in Chandler, *Benjamin Strong,* 438–55; Clarke, *Central Bank Cooperation,* 124–34; Wicker, *Federal Reserve Monetary Policy,* 106–16; Wicker, "Federal Reserve Monetary Policy," 336–37; Friedman and Schwartz, *Monetary History,* 288–89; Sayers, *Bank of England,* 1:340–341; Clay, *Lord Norman,* 237; Boyle, *Montagu Norman,* 231; John Kenneth Galbraith, *The Great Crash 1929,* reprint ed. (Boston: Houghton Mifflin, 1997), 55; Eichengreen, *Golden Fetters,* 211–14; Wueschner, *Charting Twentieth-Century Monetary Policy,* 136–37, 140–45.

[13] Strong, "The Chicago Rate Controversy," September 11, 1927, File 321.121, Strong Papers.

[14] See Emile Moreau, *The Golden Franc: Memoirs of a Governor of the Bank of France: The Stabilization of the Franc (1926–1928)* (Boulder, CO: Westview Press, 1991), 343, diary entry for August 24, 1927.

[15] Strong to Norman, August 9, 1927, Norman to Strong, August 11, 1927, File 1116.7, Strong Papers.

affairs, especially central banks' efforts during the 1920s to restore international currency stability.

Several historians have suggested that Strong's economic policies during the 1920s were fundamentally sound and that, had he survived, he might well have taken more decisive action than did his successors in the Federal Reserve System to deal with the slump that developed into the Great Depression. In their *Monetary History of the United States,* Milton Friedman and Anna Schwartz argue that the root cause of the Great Depression was the Federal Reserve System's "great contraction" of money in the late 1920s and the early 1930s. Indeed, they even suggest that the term 'Great Contraction' should replace the traditional nomenclature of 'Great Depression.' Friedman and Schwartz undermine one of Hoover's major arguments when they point out that the 1920s were a period of minimal inflation when the monetary expansion failed even to match the growth in national income. They agree with Hoover, however, in ascribing to Strong a dominating position within the System, certainly that of first among equals. In their view, "foreign considerations were rarely important in determining the policies followed but were cited as additional justification for policies adopted primarily on domestic grounds whenever foreign and domestic considerations happened to coincide."[16] Moreover, one of the major problems affecting Federal Reserve monetary policy was that after Strong's death in 1928, the System suffered a year of stasis, since a "dispute [over raising the discount rate] between the [Federal Reserve] Board and the New York Bank largely paralyzed monetary policy during almost the whole of the important year 1929." While tensions between the Board and the member banks had always existed, "So long as Benjamin Strong was alive, his unquestioned preeminence kept the struggle submerged. . . . Strong's death in October 1928, preceded by a few months of inactivity, triggered a phase of overt conflict." Although Friedman and Schwartz attribute the onset of the Depression to the collapse of the banking system, they also believe that Strong's absence was a major reason for the inadequate Federal Reserve response.[17]

Lester V. Chandler largely agrees with Friedman and Schwartz, arguing as they do that by raising interest rates and contracting money and credit in the late 1920s, the Federal Reserve System initiated the deflationary monetary policy that led to the Great Depression. As the Depression developed, the System only half-heartedly relaxed its monetary stringency. As a result, between 1929 and 1932 the money supply effectively fell by almost 25 percent and thereby created a vicious spiral of continuous intensification of the Great Depression's effects. For most of 1929, inconclusive battle was joined within the Federal

[16] See Friedman and Schwartz, *Monetary History,* chs. 5, 6, 7, quotation from 269; Milton Friedman, "Real and Pseudo Gold Standards," *Journal of Law and Economics* 5:1 (October 1961), 68–70.

[17] Quotations from Friedman and Schwartz, *Monetary History,* 255.

Reserve System as to whether commercial paper resulting from the financing of "speculative" transactions should be eligible for discount, with several members of the Board, notably the two long-time directors Adolph Miller and Charles Hamlin, arguing that ruling it ineligible would discourage stock speculation. According to Chandler, then, in the early 1930s the Fed radically failed to meet the needs of the economy, thereby helping to precipitate the greatest contraction in United States history.[18] The popular historian John Brooks suggests that, had Strong "been given another year of life, his full attention would surely have focused on the American situation and his firm hand might have done much to set things to rights in time."[19] Although Chandler rather hedges his bets, the final pages of his biography of Strong seem to endorse this viewpoint, as does an article by the economist Robert L. Hetzel.[20]

Historical debate still continues as to whether Strong's concern to facilitate European economic recovery compromised the American economy and, in particular, led him to subordinate United States monetary policies to the demands of European reconstruction. Chandler, Strong's sole biographer to date, tends to favor this approach.[21] The economist John Kenneth Galbraith, by contrast, goes so far as to describe as "formidable nonsense" the view that Strong's 1927 determination to lower discount rates in the United States was "an act of generous but ill-advised internationalism" that ultimately caused the Great Depression.[22]

An assessment minimizing the impact of Strong's death is given in work by Meltzer and Karl Brunner, Silvano Wueschner, and Elmus R. Wicker. While stressing different economic factors, they alike tend to downplay the role of Strong. Wicker argues that consistent policies were followed throughout the 1920s, both before and after Strong's demise, and that changes in gold flows and international monetary relations were primarily responsible both for the Federal Reserve's successes during the greater part of the 1920s and for its failure to respond adequately to the Great Depression.[23] Brunner and Meltzer emphasize the Federal Reserve System's continuing reluctance to make substantial open market purchases, with the resulting constriction upon the money

[18] See Lester V. Chandler, *America's Greatest Depression 1929–1941* (New York: Harper & Row, 1970), chs. 5 and 7; cf. Friedman, "Real and Pseudo Gold Standards," 70–72.

[19] See John Brooks, *Once in Golconda: A True Drama of Wall Street 1920–1938* (New York: Harper & Row, 1969), 98–99.

[20] See Chandler, *Benjamin Strong,* 457 ff; Robert L. Hetzel, "The Rules versus Discretion Debate over Monetary Policy in the 1920s," Federal Reserve Bank of Richmond *Economic Review* 71 (November/December 1985), 3–14.

[21] See Chandler, *Benjamin Strong.*

[22] See Galbraith, *Great Crash,* 9, 11.

[23] See Elmus R. Wicker, "Federal Reserve Monetary Policy, 1922–33: A Reinterpretation," *Journal of Political Economy,* 73:4 (August 1965), 325–43; idem, *Federal Reserve Monetary Policy.*

supply, as the primary factor; again, they suggest that these policies were similar to those the Federal Reserve System had followed throughout the 1920s, and that it was their timing, not the inherent wisdom of the protagonists, that made their impact so disparate.[24]

Elmus R. Wicker and Silvano A. Wueschner defend Strong against charges that his policies neglected U.S. interests, yet question the thesis that he would have been successful in combating the Great Depression. Wicker suggests that Strong had a sophisticated appreciation of the importance of international factors to the U.S. economy, and that, far from being "quixotic," his policies were inspired by a prudent concern for his own country's interests. Wicker also argues that Strong's fundamental commitment to the gold standard precluded any likelihood that he would have done better than his successors in countering the Great Depression.[25]

Wueschner's recent study *Charting Twentieth-Century Monetary Policy* likewise portrays Strong as the representative of New York financial interests, and his support for European stabilization and Britain's return to gold as "required if the involvement of the American banking community in international finance and debt settlements was to yield the current and future returns that it gave promise of yielding." He also confesses himself skeptical that, had Strong not died, he would have provided vigorous and successful leadership in the subsequent financial crisis.[26] Wueschner not only draws attention to Strong's dominating personality but also illuminates those conflicts that arose between Strong and New York financial forces on the one hand and agricultural, interior interests within the United States, and those between Strong and Herbert Hoover, then Secretary of Commerce. Wueschner brings out the manner in which disputes among Board members, including Adolph C. Miller as well as Hoover and Strong, over the primacy of domestic or international considerations in the setting of Federal Reserve policy, continued from the time of the First World War throughout the 1920s and culminated in the famous 1927–1928 debates over Federal Reserve discount policy. He pays particular attention to the close relationship between Strong and Norman. He also makes it clear that the National City Bank, New York's largest commercial bank, did not ascribe the same primacy to international recovery as did Strong and the Morgan investment banking interests with whom he was closely associated. Wueschner argues that internecine Federal Reserve System policy disputes "contributed

[24] See Karl Brunner and Allan H. Meltzer, "What Did We Learn from the Monetary Experience of the United States in the Great Depression?" *Canadian Journal of Economics* 1 (1968), 334–48, reprinted in Allan H. Meltzer, *Money, Credit and Policy* (Aldershot: Edward Elgar Publishing, 1995), 104–18.

[25] See Wicker, "Federal Reserve Monetary Policy, 1922-33," 325–43; idem, *Federal Reserve Monetary Policy.*

[26] See Wueschner, *Charting Twentieth-Century Monetary Policy,* 161.

in some degree to the inability of the system to develop a coherent Federal Reserve policy that could provide the regulatory instrumentality that the nation needed."[27]

Yet another respected historian goes so far as to ascribe at least part of the responsibility for the Great Depression and Europe's financial collapse in the early 1930s to Strong's dominating figure. Barry Eichengreen's massive recent work *Golden Fetters* argues forcefully that the overall strategy of European interwar reconstruction was misguided and that its reliance on the restoration of the gold standard created an unduly rigid economic system which itself precipitated the Great Depression and was then unable to remedy the situation. Eichengreen, one of Strong's most severe critics, suggests that the deep commitment of Strong, Norman, and other international bankers to returning the pound, the mark, and European currencies to the gold standard at overly high parities, which they were then forced to maintain at all costs, including deflationary policies, had the effect of undercutting Europe's postwar recovery. Not only did Strong and his fellows help through their policies to precipitate the Great Depression, but their continuing attachment to gold acted as a straitjacket confining economic and fiscal policies within narrow bounds that effectively precluded expansionist options. Eichengreen draws attention to the inflexibility that was one result of the gold standard and to the manner in which bankers' desire to protect their national currencies' convertibility into gold at almost any cost drastically limited the options available to them when responding to the crisis. He argues that in 1927 Strong's narrow reliance on the gold standard, which emphasized the financial predominance of the United States—the possessor of by far the greatest holdings of gold in the world—as opposed to a broader-based gold-exchange standard, which would have permitted the use of both foreign exchange reserves and gold to back national currencies, exacerbated nascent international economic problems. Eichengreen also implies that in 1928 Strong might well have been more daring in reducing discount rates in the United States and that the Federal Reserve System's later reluctance to do so, its determination to force "liquidation" of all assets, greatly enhanced the Great Depression's severity and severely affected European countries. At the same time, Eichengreen points out that to adopt any other course might well have been more difficult for Strong in the post-1928 period, since whereas before that time there was relatively little conflict or incompatibility between the System's domestic and international objectives, at least where American interest rates were concerned, after 1928 this was no longer the case.[28]

Peter Temin lays much of the responsibility for the crisis upon the Great War and its impact on the international monetary system. Like Eichengreen,

[27] Ibid., quotation from 130.

[28] See Eichengreen, *Golden Fetters,* esp. chs. 4–10.

he suggests that the international gold standard itself was one of the major factors underlying and reinforcing the Great Depression, since "the conditions that had sustained it before the war no longer existed."[29] Temin agrees with Wicker that Strong's fundamental commitment to the gold standard precluded any likelihood that he would have done better than his successors in countering the Great Depression.[30] Charles P. Kindleberger even questions the image of Strong as a dominating figure who set a clear objective, referring to the "Hamlet-like indecision" of his policies toward stock market speculation in 1927 and 1928.[31]

3. STRONG AND THE LIMITS OF INTERNATIONALISM

Whatever historians' specific opinions of Strong's policies, he is clearly a figure whom students of pre-1930 Federal Reserve policies cannot ignore. This essay does not propose to answer the fundamentally irresoluble question of whether, had he lived, Strong might have prevented the Great Depression. It does, however, address the issue of the degree to which Strong's internationalist predilections influenced him in setting domestic monetary policy. Overall, it seems that while international considerations undoubtedly ranked high in Strong's order of priorities, clearly defined limitations restricted his commitment to assisting Europe, and these boundaries broadly reflected the nature of and constraints upon American internationalism in the interwar period.

For Strong, European reconstruction was not simply a policy but a cause, almost a religious faith. In 1927 he told Norman:

> Long ago I had reason to ponder the question whether I would allow discouragements to dissuade me from favoring a constructive attitude toward reconstruction abroad. There have been many and serious ones, at times, and many reasons, as well as temptations to quit and let the old world solve its own problems.
>
> Considering everything, (and that included personal satisfaction and the like) I decided to allow no discouragements to alter our position. It has at times involved serious risks to my own position and prestige in the System and the country.[32]

According to Hoover's bitter post-presidential charges, Strong recklessly placed the interests of the international financial system ahead of United States domestic concerns. In practice, the picture was more complex, reflecting the distinct

[29] See Peter Temin, *Lessons from the Great Depression* (Cambridge, MA: MIT Press, 1989), quotation from 25.

[30] Ibid., 34–35.

[31] See Charles P. Kindleberger, *Essays in History: Financial, Economic, Personal* (Ann Arbor: University of Michigan Press, 1999), 13.

[32] Strong to Norman, August 9, 1927, File 1116.7, Strong Papers.

boundaries of Strong's commitment to European recovery and the limitations that broadly characterized the outlook of most contemporary internationalists, bankers among them, as well as the influence of political constraints. These, in turn, illuminate the significant differences that generally distinguished interwar American internationalism from the variety that prevailed after the Second World War.

There is no reason to doubt that Strong believed his work for European currency stabilization also promoted the best interests of the United States. He argued frequently that uncertain exchange rates, especially when the dollar was at a premium against other currencies, made it difficult for American exporters to price their goods competitively.[33] As he had done during the war, on numerous later occasions Strong also stressed the importance of preventing an influx of gold into the United States and consequent domestic inflation; to avoid this, Strong argued, Americans should make loans to Europe, pursue lenient debt policies, and accept European imports.[34]

Neither Strong nor his friend Norman appears ever to have questioned the parities at which they stabilized first the mark and then sterling; rather, they accepted that returning the pound to gold at prewar exchange rates was likely to require British deflation and American efforts to use lower United States interest rates to alleviate pressures on sterling. In 1931 Leffingwell wrote to Thomas W. Lamont, a fellow Morgan partner:

> You will remember that when Monty [Norman] came over to discuss with us plans for the return to the gold standard, I asked him whether it was politically possible for the Bank of England to raise the bank rate from time to time to defend her gold and to complete the operation. He assured me that it was. He was mistaken about this. The general strike soon followed and instead of Monty's defending the gold standard and completing the deflation on classical lines by making money dearer in England, he called upon Ben to defend it

[33] Strong to Junnosuke Inouye, August 29, 1921, File 1330.1, ibid.; Strong to William Hailey, October 24, 1921, File 1112.5, ibid.; Strong to Herbert Hoover, April 22, 1922, File 013.1, ibid.; Strong to Mellon, May 27, 1924, File Gold (Miscellaneous) 1922–1925, Box 86, Record Group 56, National Archives II; Strong, "The Chicago Rate Controversy," September 11, 1927, File 320.121, Strong Papers; memorandum written by Strong, December 25, 1924, included in "Open Market Hearings," extract from Strong's testimony before a Hearing of the House Committee on Banking and Currency, April 1926, in Strong, *Interpretations of Federal Reserve Policy in the Speeches and Writings of Benjamin Strong,* ed. W. Randolph Burgess (New York: Harper & Row, 1930), 256–61; Strong, "Credit Arrangement with the Bank of England," extract from his testimony before the House Committee on Banking and Currency, April 1926, ibid., 275–90; Chandler, *Benjamin Strong,* 266–68.

[34] Strong to Hoover, April 22, 1922, File 013.1, Strong Papers; Strong to Mellon, May 27, 1924, File Gold (Miscellaneous) 1922–1925, Box 85, Record Group 56, National Archives II; Strong, "The Reconstruction of World Finance," address before executive council, American Bankers Association, October 3, 1922, in *Interpretations,* 146–47; Strong, "Prices and Price Control," unpublished article prepared by him in April 1923, ibid., 231–34.

> by making it cheaper in America. This Ben did for Monty consistently and persistently, and successfully until the return of France to the gold standard in 1927 and her adoption of a definite deflation policy. This seemed to make it necessary for Ben to adopt an active (instead of passive) inflation policy in the latter part of that year. Ben's long illness in 1928, and the stupidity and stubborness [sic] of the Washington Federal Reserve Board in 1929, left the inflation policy uncorrected until it was too late to correct it without the disaster of September and October 1929.[35]

It should be noted that, Leffingwell's ex post facto criticisms notwithstanding, in 1925 the Morgan firm had enthusiastically endorsed and provided a credit facility to back Britain's return to gold. Despite Leffingwell's effective condemnation of Strong's policies as inflationary, there is substantial evidence to suggest that, in practice, Strong was generally cautious in assisting with European recovery. Leffingwell's implicit suggestion that, had Strong survived, Federal Reserve discount rate policies in 1928 would have followed a different path can perhaps be viewed as a lefthanded tribute to Strong's predominating concern to protect his own country's interests.

Leffingwell's assertions as to Strong's easy money policy notwithstanding, Strong often seems to have placed American domestic interests above those of the international financial system. Most notably, he was never prepared to permit the vast quantities of gold that accrued in the United States during the First World War and for most of the 1920s to trigger domestic inflation within the United States, despite the fact that such policies would have greatly eased the burdens which European nations faced in resuming the gold standard. As early as July 1915, Strong went so far as to state that the enormous quantity of gold with which the Allies had paid for many of their war supplies was "deposited with us in trust until the tide turns when we probably will have to let some part of it go to Europe."[36] In the interim, Strong made every effort to ensure that the influx of gold did not encourage domestic inflation, even though the consequent price differential between the United States and Europe would have greatly facilitated the ability of European nations to export to the United States and hence would have hastened their economic recovery.

By preference, if no other considerations intervened, in the immediate postwar period Strong was largely wedded to economic orthodoxy, and tended to take a fairly hawkish and conservative line on raising the discount rate to damp down inflationary and speculative tendencies. His policies therefore reflected a delicate balancing act between international and domestic priorities. Just

[35] Leffingwell to Lamont, August 29, 1931, File 102-15, Lamont Papers; cf. Leffingwell to Lamont, March 8, 1929, File 102-13, ibid.; Leffingwell to Lamont, May 29, 1929, enclosing Leffingwell to Edward C. Grenfell, May 29, 1929, File 103-14, ibid.

[36] Strong to Fred I. Kent, July 10, 1915, U.S. Senate, 74 Cong., 2d Sess., *Hearings Before the Committee Investigating the Munitions Industry,* 40 vols. (Washington, DC: Government Printing Office, 1934–36), 30:9527; Strong, diary, March 28, 1916, File 1000.2, Strong Papers.

after the First World War, Strong was eager to raise discount rates, advocating stringent monetary policies designed to drive down the soaring wartime cost of living. His friend Russell Leffingwell, then Under Secretary of the Treasury, initially opposed this anti-inflationary policy, probably largely because it would drive up the interest rates on Treasury certificates, thereby making government financing more expensive. In a classic example of bureaucratic politics, the Treasury's primary preoccupation was to reduce and eventually pay off the high national debt that had accumulated during the war years. Carter Glass, the Democratic politician who became Treasury Secretary in late 1918, may also have feared the impact of higher increased rates and consequent deflation on the outcome of the approaching presidential election. Early in 1920, after a lengthy and sometimes heated dispute which nonetheless left their mutual respect for each other undiminished, Leffingwell joined Strong after the Treasury had issued the Liberty bonds to finance long term the outstanding government debt. The two men also sought to check increasing stock market speculation.[37]

A side effect of higher American interest rates was that the dollar rose against other currencies, so that prospective European borrowers found the cost of both American goods and the capital needed to finance economic recovery had risen. European debtors of the United States whose obligations were denominated in dollars also faced increased payments. Intensifying European misery, the financial assistance which Strong and others had earlier urged the American government to provide for European relief and reconstruction never materialized. Federal Reserve rates were by no means the only factor which contributed to the American recession of 1920–1921; tighter fiscal policy and the cessation of most war-related government orders in mid-1919 were also significant, but deflationary rate policies magnified their impact. Still, by December 1920 a visit to London had led Strong to fear the high rate policy had

[37] Strong to Leffingwell, February 6, 28, December 19, 1919, Leffingwell to Strong, February 6, October 8, 1919, File 012.4, Strong Papers; Leffingwell, "Memorandum Concerning Strong's Confidential Letter of December 19, 1919," May 4, 1920, Leffingwell to Charles A. Morss, May 14, 1920, Letterbook 43b, Russell C. Leffingwell Letterbooks, Manuscripts Division, Library of Congress, Washington, DC; numerous other memoranda in the Leffingwell letterbooks for this period, copies of which are usually also in the File Federal Reserve Banks—Discount Rates (Policy Letters) 1918–1920, Box 66, Record Group 56, National Archives II; Rixey Smith and Norman Beasley, *Carter Glass: A Biography* (New York: Longmans Green & Co., 1939), 182–85; Chandler, *Benjamin Strong*, 148–69; Wicker, *Federal Reserve Monetary Policy*, 33–45; Friedman and Schwartz, *Monetary History*, 221–31; Wueschner, *Charting Twentieth-Century Monetary Policy*, 10–17. Leffingwell himself retrospectively minimized the significance of this debate, pointing out that those "trivial variations of rates" Strong suggested would not "have been an appreciable factor towards the control of inflation." He suggested, moreover, that once the Treasury had decided that a genuine inflationary problem existed, it took the initiative in early 1920 in raising discount rates to 6 percent. It was perhaps not entirely coincidental that the Treasury decision to do so coincided with Glass's departure. Leffingwell to S. Parker Gilbert, March 1, 1922, File Federal Reserve Banks—Discount Rates (Policy Letters) 1922, Box 66, Record Group 56, National Archives II.

been carried to the point at which the high price of American capital was endangering the prospects for European recovery, and he was prepared to recommend a decrease in rates. Although for some months afterward American domestic conditions caused him to retreat from this suggestion and leave discount rates as they were, in autumn 1921 the Federal Reserve System adopted, possibly—though this is uncertain—on Strong's suggestion, what he described as "a rather aggressive program towards easing up money conditions, not entirely in our own interest but somewhat in the interest of world recovery."[38]

Over time Strong's commitment to European recovery apparently intensified appreciably, but limits remained. Most significantly, Strong was not prepared to countenance major price inflation in the United States even to facilitate Britain's return to gold. Eichengreen has suggested that a major factor undercutting Britain's return to gold was the Federal Reserve System's policy of "sterilizing" gold imports, i.e., through sales of government securities reducing the money supply by the amount of the additional gold received. By preventing inflation in the United States, which such gold shipments would otherwise have precipitated, these policies made it almost impossible for European countries suffering from a balance of payments deficit to reverse the process, as their own products became cheaper. Had Strong been prepared to countenance inflation in the United States, the price differential between the two countries would have shrunk, making it unnecessary for Britain to adopt such stringent and deflationary monetary policies in the quest to return to gold.[39]

Even though by the mid-1920s this situation had persisted for ten years, Strong may still have regarded—or at least found it convenient to regard—the American gold stockpile as a temporary phenomenon, soon to be liquidated by the vast upsurge in U.S. loans and investments in Europe that began in 1923 and which he believed Britain's return to gold would further encourage. (Like most international bankers, he expected subsequent European recovery to generate increased European exports to the United States.)[40] Moreover, in fairness to Strong, in 1924 he suggested to Andrew Mellon, the Secretary of the Treasury, that to facilitate Britain's return to gold, it would be necessary to have "some small advance in prices here and possibly some small decline

[38] Strong to Federal Reserve Bank, New York, December 12, 1920 (not sent), File 1000.4, Strong Papers; quotation from Strong to William Hailey, October 24, 1921, File 1111.2, ibid.; Strong to Norman, June 27, July 5, November 1, 1921, File 1116.2, ibid.; Chandler, *Benjamin Strong,* 174–177; Friedman and Schwartz, *Monetary History,* 234–35; Wueschner, *Charting Twentieth-Century Monetary Policy,* 17–21; Friedman, "Real and Pseudo Gold Standards," 67–68.

[39] See Eichengreen, *Golden Fetters,* esp. 203–07; Chandler, *Benjamin Strong,* esp. 282–303; Friedman, "Real and Pseudo Gold Standards," 69–70.

[40] Such policies were entirely compatible with central banking theories that, when gold was valued at a fixed price, short-term gold policy could be used to pursue other objectives, such as maintaining stable interest rates or prices. See Marvin Goodfriend, "Central Banking Under the Gold Standard," *Carnegie-Rochester Conference Series on Public Policy* 29 (1988), 85–124.

in their [British] prices. . . . The burden of this readjustment must fall more largely upon us than upon them."[41]

Yet, after making all such allowances, Strong undoubtedly had taboos he would not contemplate breaking, of which countenancing excessive domestic inflation was probably the most pronounced. His reaction to the British economist John Maynard Keynes's mere mention of American policies of "demonetizing gold and locking it up in Washington" was instructive. To Carl Snyder, head of the New York Reserve Bank's research division, Strong tetchily complained that Keynes

> must think we are indeed very stupid people. If we are going to permit this gold, which does its initial damage the minute it arrives here, to do further damage by permitting it to become the basis of a great inflation, he and others of his stripe are consciously or unconsciously looking to this country to indulge in a great inflation for their benefit. We are not going to do it if it can be helped and if they would be sensible enough to get their own houses in order and manage their own damn currency in a sensible, civilized fashion, they would shortly be able to come over here and get the gold they need to present a respectable monetary face to the world. I am thoroughly tired and impatient of the ravings of these inflationists who want us to play the part of cat's paw and pull their chestnuts out of the fire when they haven't the courage to do it themselves.[42]

Not only Strong but many of his American and European compeers were familiar with the economic writings of Keynes, notably *A Tract on Monetary Reform* (1923) and the more polemical *The Economic Consequences of Mr. Churchill* (1925), which suggested that their gold standard and monetary goals were logically incompatible. Keynes specifically opposed sterling's return to gold at the $4.86 parity Norman favored and which, to Norman and many other British officials, was not negotiable. To them, this valuation was not merely an economic goal but a matter of national honor, a symbolic reaffirmation of Britain's prestige and a public demonstration that the country had regained its pre-1914 international position. In the 1920s Keynes, by contrast, remained an economic maverick whom financial authorities, while admitting his brilliance, regarded with considerable suspicion. His fondness for public controversy and invective, most evident in the publication of *The Economic Consequences of the Peace* (1919) with its stinging attacks on Woodrow Wilson, led many British and American bankers to consider him somewhat unstable, while the views expressed therein led him to be labeled undesirably "pro-German" for some years.[43]

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[41] Strong to Mellon, May 27, 1924, File Gold (Miscellaneous), 1922–1925, Box 86, Record Group 56, National Archives II; cf. Chandler, *Benjamin Strong,* 283.

[42] Strong to Carl Snyder, February 4, 1924, File 320.454, Strong Papers.

[43] See Robert Skidelsky, *John Maynard Keynes,* Volume 2: *The Economist as Saviour 1920–1937* (London: Penguin Press, 1994), 189; Hession. This view of Keynes as pro-German pervades

When Norman sent him a copy of Keynes's *Tract on Monetary Reform,* Strong commented "that some of his conclusions are thoroughly unwarranted and show a great lack of knowledge of American affairs and of the Federal Reserve System." Of Keynes himself, he wrote, "I have a great respect for his ability and the freshness and versatility of his mind, but I am much afraid of some of his more erratic ideas, which impressed me as being the product of a vivid imagination without very much practical experience."[44] "Mr. Keynes seems to have rather overdone himself," Norman dismissively responded, "a fact which perhaps comes from his trying to combine the position of financial mentor to this and other countries with that of a high-class speculator (by which I mean one whose sole object is to buy stocks when they are cheap and sell them when they are dear)."[45] Other American bankers shared their skepticism. "Keynes is always perverse, Puckish," Leffingwell wrote in 1931. "He attacks anything sound or established or generally accepted, partly for the fun of it, partly for the purpose of stimulating debate. In doing so he is utterly irresponsible. He doesn't care how much harm he does in giving aid and comfort to the enemies of sound finance."[46] In rejecting Keynes's views, Strong, Norman, and their compeers simply reflected the conventional wisdom of their day.[47]

Two factors help to account for Strong's reluctance to take major risks to facilitate Europe's return to the gold standard. The first was that, like most international bankers of his time, he believed implicitly in the orthodox economic principles of the gold standard, balanced budgets, and stable prices. It is worth noting that Norman, who as a fellow central banker of similarly orthodox economic views likewise detested inflation, found this perspective entirely acceptable and apparently never suggested to his colleague that the United States should tolerate greater inflation, accepting this state of affairs as the price it must pay if European currencies were to return to gold.[48] For

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the correspondence for the early 1920s between the editors of *Foreign Affairs,* Archibald Cary Coolidge and Hamilton Fish Armstrong. Archibald Cary Coolidge Files, Boxes 17–20, Hamilton Fish Armstrong Papers, Mudd Manuscripts Library, Princeton University, Princeton, NJ.

44 Strong to Norman, January 4, 1924, File 1116.4, Strong Papers.

45 Norman to Strong, January 30, 1924, ibid.

46 Leffingwell to Lamont, August 29, 1931, File 103-15, Lamont Papers. By 1945, however, Leffingwell had gained greater respect for Keynes, stating that he was "not popular over here, but he knows his facts and his economics better than anyone else." Leffingwell to Lamont, September 13, 1945, File 104-5, ibid.

47 On the limitations of American economic thinking at this time, see also Chandler, *America's Greatest Depression,* 111–14.

48 Despite his own opposition to Britain's return to gold at pre-1914 parities, Keynes simultaneously expressed apprehension that the United States might jettison its existing policy of accepting gold which it would "maintain . . . at a fixed value" and instead "be overwhelmed by the impetuosity of a cheap money campaign," one which would lead the United States to release all its gold simultaneously, with drastic effects on the international monetary system. John Maynard Keynes, *A Tract on Monetary Reform* (London: Macmillan, 1923), 169, 175–76.

the majority of British and American international bankers and economists in the 1920s, Strong included, their formative years had fallen in the prewar period, when—as Eichengreen demonstrates—the self-regulating international gold standard worked better than in any period before or since.[49] They looked back to that time as a norm whose restoration—including return to gold at prewar parities—was the goal they sought to attain. In this sense they endorsed the presidential campaign slogan of Warren G. Harding in 1920 for a "return to normalcy." It is also worth noting that the profound admiration American international financiers felt for the British financial system made it almost impossible for them to appreciate how weak the British economic position was and how detrimentally the First World War had affected Britain. Notwithstanding some domestic British opposition, both Strong and Norman appear to have taken it as a sine qua non that sterling must return to gold at the prewar parity.[50]

In Strong's defense one should also note that even had he been prepared to acquiesce in far greater U.S. price inflation than occurred in the 1920s, political pressures might well have prevented him implementing such policies. Economic policy is, like politics, the art of the possible. Memories of the inflation and subsequent deflation of the 1917–1921 period helped to ensure that during the 1920s the maintenance of stable prices and the need to avoid either excessive inflation or deflation became a major political concern and was viewed as a primary objective of the Federal Reserve System. (Memories of these previous monetary policies and their political and economic consequences may also have been another reason why, in the late 1920s, the Federal Reserve System hesitated to act decisively in either raising or reducing rates.) Despite Strong's oft expressed belief that central bankers should remain immune from political pressures, in practice, as Wueschner has pointed out, he was highly sensitive to political considerations.[51] Although Strong doggedly resisted attempts to pass legislation demanding that the Federal Reserve System employ rate policy and open market operations to ensure price stability, preferring that Federal Reserve officials should be allowed to use their discretion in attaining this objective, it was a goal he broadly shared.[52] Publicly and in correspondence with Norman he frequently stressed the importance of maintaining price stability.[53] In this, he reflected the views of most central bankers.

Even more broadly, internal political developments throughout Europe jeopardized central bankers' interwar efforts to return to gold. Eichengreen

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[49] See Eichengreen, *Golden Fetters,* ch. 1.

[50] See, e.g., Strong to Norman, June 3, July 9, 1924, Norman to Strong, June 16, October 16, 1924, File 1116.4, Strong Papers.

[51] See Wueschner, *Charting Twentieth-Century Monetary Policy,* xvi, 21, 36–37, 44–45, 50, 64.

[52] Ibid., 54, 79, 119–20; Chandler, *Benjamin Strong,* 199–204; Hetzel, "Rules Versus Discretion Debate," 7–11, 14.

[53] See Kindleberger, *Essays in History,* 12.

plausibly argues that in the 1920s the commitment to defend the international gold standard in difficult times encountered new obstacles in many nations, not just the United States, in the form of domestic policy objectives that interfered with the honoring of the commitment. One major reason was that the post-World War I broadening of the franchise in most European countries due to the spread of universal suffrage had made it far more difficult than before for governments and central bankers to resist electoral pressures for increased social spending and the reduction of interest rates, regardless of such policies' impact upon the international monetary system.[54] French monetary policies appear to give some confirmation to this thesis. Throughout the 1920s and 1930s, the French were far less committed than any other major European nation to maintaining the international gold standard system. Although they finally returned to gold in 1927, they did so—to the regret of Emile Moreau, the governor of the Banque de France—below pre-1914 parities, which effectively subjected the pound to additional deflationary pressures. (Revealingly, Strong showed little interest in the precise par value of the franc.)[55] For much of the Great Depression, French actions, including not only a gold sterilization but, ironically, a tenacious attachment to gold several years after most other countries had abandoned it, continued to compromise the international financial system and efforts to coordinate economic policies, just as French fiscal policies in the early 1920s rejected the balanced budget norms which international financiers demanded. The effective secession of a leading European country from gold standard norms made it commensurately more difficult for others to continue to observe them.[56] Increasingly, countries pursued their own national economic priorities even if the priorities conflicted with efforts to implement coordinated transnational financial cooperation.

[54] See Eichengreen, *Golden Fetters.* Early in his career, the distinguished historian Paul M. Kennedy likewise drew attention to the degree to which the extension of the franchise in early-twentieth-century Britain vastly increased the political constituency for increased social welfare spending, if necessary at the expense of defense budgets. Paul M. Kennedy, *The Realities Behind Diplomacy: Background Influences on British External Policy, 1865–1980* (London: George Allen & Unwin, 1981) 47–51, 236–40.

[55] Melvyn P. Leffler, *The Elusive Quest: America's Pursuit of European Stability and French Security, 1919–1933* (Chapel Hill: University of North Carolina Press, 1979), 166.

[56] Ibid., chs. 4–8; H. Clark Johnson, *Gold, France, and the Great Depression, 1919–1932* (New Haven: Yale University Press, 1997); Eichengreen, *Golden Fetters*, esp. chs. 8–10; Prefaces by Milton Friedman, Stephen D. Stoller and Trevor Roberts, and Jacques Rueff to Moreau, *Golden Franc*, x–xxi, 1–10; Charles P. Kindleberger, *A Financial History of Western Europe*, 2nd ed. (New York: Oxford University Press, 1993), ch. 19; Friedman, "Real and Pseudo Gold Standards," 70. On French budgetary policies in the early 1920s, see also Stephen D. Schuker, *The End of French Predominance In Europe* (Chapel Hill: University of North Carolina Press, 1973).

4. CONCLUSION

Just before he died, Strong felt that the reconstruction of Europe was virtually completed and his policies had been successful.[57] Other leading bankers shared this view. During World War II, his sometime critic Leffingwell reflected, “As I look back over the 1920’s it seems to me that the job we did in the reconstruction of currencies all over the world was a good one.” Expanding this theme, 18 months later he added:

> [T]he British war debt settlement of 1922 or 1923 and gold resumption of 1925 . . . gave hope to the human race which did not altogether disappear until in 1931 the Hawley-Smoot tariff, the veto of the German-Austrian customs union, the failure of Credit Anstalt, Hoover’s panicky defense of his moratorium, and the May and Macmillan reports pulled the plug.[58]

Such optimistic views notwithstanding, between the wars Federal Reserve policies towards European recovery shared the prevailing weaknesses of broader American internationalism, revealing the half-hearted nature of the post-1918 U.S. assumption of a greater world role. Charles P. Kindleberger suggests that between the wars one of the major international economic structural problems was the fact that, while Britain was no longer strong enough to play the role of international economic hegemon, the United States was not prepared to assume the associated burdens and responsibilities of the role it inherited.[59] Warren I. Cohen has described this period as one of “empire without tears,” when the United States wished to enjoy the benefits of international influence at the lowest cost possible, refusing to bind itself to commitments overseas or make the sacrifices almost inherent in a world hegemonic position.[60] The diplomatic historian Melvyn P. Leffler has pointed out that post-World War I American foreign policymakers were subjected to various conflicting and often inconsistent demands, including among others domestic political pressures and calls for fiscal economy at home, which decidedly limited the extent to which U.S. officials were prepared to make concessions to Europeans on such economic issues as war debts, reparations, or trade and tariffs, as well as exchange rates.[61]

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[57] Strong to Owen D. Young, August 17, 1928, File 320.122, Strong Papers.

[58] Leffingwell to Lamont, April 4, 1940, File 103-22, Lamont Papers; Leffingwell to Lamont, October 10, 1941, File 106-11, ibid.; also Leffingwell to Lamont, September 11, 1940, File 103-23, ibid.

[59] See Charles P. Kindleberger, *The World in Depression, 1929–1939* (Berkeley: University of California Press, 1973), 25–29; idem., *Essays in History,* 45–46.

[60] See Warren I. Cohen, *Empire Without Tears: America’s Foreign Relations, 1921–1933* (New York: Knopf, 1987).

[61] See Melvyn P. Leffler, “Political Isolationism, Economic Expansionism or Diplomatic Realism? American Policy toward Western Europe 1921–1933,” *Perspectives in American History* 8 (1974), 428–30; idem., “The Origins of Republican War Debt Policy, 1921–1923: A Case Study in the Applicability of the Open Door Interpretation,” *Journal of American History* 59:4 (December 1972), 585–601.

Numerous other historians, among them Frank Costigliola, Joan Hoff Wilson, and John Braeman, have drawn attention to the tentative, unsystematic, and often contradictory character of American international thinking between the wars, the profound hesitancy with which presidential administrations in the 1920s recognized any American responsibility whatever for managing the international economic and political system, and the degree to which the United States preferred to rely upon the unilateralist policies Wilson terms "independent internationalism."[62] In this context, Strong's determination neither to abandon prewar European currency parities nor to demand economic sacrifices of the United States in support of them epitomizes the halfhearted and hesitant nature of his country's overall interwar international outlook. The Federal Reserve System's own development trajectory closely paralleled the broader pattern of the evolution of the United States as a world power. Mira Wilkins rightly reminds us that between the wars the U.S. government deliberately eschewed formal involvement in European recovery and points out "how new to world finance New York was" and how ill-equipped the inexperienced existing economic institutions were to handle the new international financial challenges.[63] Viewed from this perspective, Strong's efforts to facilitate European interwar economic recovery represented a remarkable departure, especially when one recalls that the Federal Reserve System had only existed since 1913. To paraphrase Samuel Johnson, their significance was not merely that they were flawed, but that they were made at all. If Strong was no more enlightened than his contemporaries, this was because he was a man of his times. A product of the late Victorian era who fundamentally embraced that period's economic norms, he lacked, unlike the brilliant but often exasperating Keynes, the visionary ability to construct a new paradigm of political economy.

Paradoxically, the very failure of Strong and his American and European peers and their principles to provide lasting solutions to international economic difficulties between the wars was high among the factors impelling American officials, when reconstructing the post-1945 world, to follow guidelines very different from those followed in the 1930s. By the end of the Second World War, the U.S. government was prepared to play the leading part in this enterprise; moreover, European nations were then far more dependent economically upon the United States than they had been in the 1920s, which greatly facilitated

[62] See Joan Hoff Wilson, *American Business and Foreign Policy, 1920–1933* (Lexington: University of Kentucky Press, 1971); John Braeman, "Power and Diplomacy: The 1920s Revisited," *Review of Politics* 44:3 (July 1982), 423–469; Frank Costigliola, *Awkward Dominion: American Political, Economic, and Cultural Relations with Europe, 1919–1933* (Ithaca: Cornell University Press, 1984).

[63] See Mira Wilkins, "Cosmopolitan finance in the 1920s: New York's emergence as an international financial centre," in *The State, the Financial System, and Economic Modernization,* eds. Richard Sylla, Richard Tilly, and Gabriel Tortella (Cambridge: Cambridge University Press, 1999), 283; cf. Chandler, *America's Greatest Depression,* 112–14.

American attempts to induce them to cooperate with American-led reconstruction efforts. At that time, the United States insisted upon fixing exchange rates at economically viable levels, and Treasury officials were prepared to accept an outflow of excess gold from the United States in payment for European exports. More broadly, the impact of the Great Depression and the Second World War impelled the United States to play the role of international political, not just economic, hegemon, establishing a range of American-led institutions intended to implement world recovery and stability, including the United Nations, the International Bank for Reconstruction and Development, and the International Monetary Fund. Moreover, when these proved insufficient, the United States quickly instituted supplementary measures, including the Marshall Plan, NATO, individual loans to particular countries, and assorted military and economic international aid programs.

Within the Federal Reserve System itself, Strong's dominance of the System and the acrimony this often generated ultimately helped to bring reform. An institution that could be so susceptible to domination by a single individual, albeit one of great determination and ability, had inherent structural problems. The general dissatisfaction non-East Coast bankers expressed over New York's predominance in the System might in any case have precipitated demands for Federal Reserve reform. Yet it was above all the System's failure to cope with the crisis of the Great Depression that fueled the pressures leading to the 1935 Banking Act's overhaul of the Federal Reserve System. The primary purpose of the Federal Reserve System had been to prevent or at least alleviate the panics and depressions of the pre-1913 period. The operation of Murphy's Law ensured that, by the cruel workings of chance, Strong's disappearance from the System coincided with the period in which the System came under far greater stress than ever before. Given the emphasis its founders had originally placed on decentralizing power within the System, it may well be that the difficulties of the 1920s and the Great Depression were experiences necessary to enable the System's reform.

In his memoirs, Herbert Hoover blamed Benjamin Strong's internationalism for the Depression. According to Hoover and other critics of Strong such as Adolph Miller, the dominating governor of the Federal Reserve Board in Washington, Strong's "easy money" policies designed to assist Britain's return to the gold standard produced a speculative rise in stock prices on the New York Stock Exchange. The inevitable bursting of that speculative bubble led to the Great Depression. But this picture hardly fits the Benjamin Strong who, in his support of the fateful decision in 1928 to raise interest rates and force a monetary contraction to bring down stock prices, was an economic nationalist. High interest rates in the United States pulled capital out of Europe and forced monetary deflation there and elsewhere. The international gold standard that Strong had labored so hard to create became an engine of worldwide deflation.

The truth of the matter is that Strong, in his support of the rate hikes and monetary contraction, was only adhering to the commonly accepted real-bills views of his time. According to these views, central banks should thwart the speculative extension of credit to prevent increases in asset prices that would ultimately collapse and lead to deflation and depression. If Strong was guilty in holding these views, then so too was the entire banking community, commercial and central. The lesson is clear. Instead of looking for a single individual to blame for causing the Great Depression, it is surely more enlightening and productive to recognize the flaws in the views underlying the policies that produced that catastrophic episode. Such recognition is part of a broader understanding of how America's shift from isolationism to internationalism after World War II promoted the more peaceful and prosperous world of the second half of the twentieth century.