CENTRAL BANKS AND GOLD

How Tokyo, London, and New York Shaped the Modern World

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Simon Bytheway / Mark Metzler

This book presents a series of close-up views of national money-creation systems and their interconnections. We concentrate on the triangular connections between Tokyo, London, and New York. Early in the twentieth century, the connection between London and New York emerged as the main axis of global finance. We add Tokyo to this picture and develop a view of the little known Tokyo–London and Tokyo–New York sides of the trilateral. This view illuminates new aspects of the entire international structure.

The focus is on the pivotal age from the late 1890s to the depression of the 1930s. It was then, only a century ago, that the United States established a central bank, and it was then that central banks established regular connections with each other. They did this quietly and often invisibly, and much of the story has been unknown. Central banks created credit capital for private banks, and they functioned as the administrative peaks of national systems of credit creation. Gold, in theory, provided the foundation upon which the system of credit and debt was built. An immense superstructure of social claims and obligations was thus, notionally, built upon the gold bullion stored in central bank vaults. Movements of that physical gold could have major consequences for much larger structures of credit and debt.

In the 1890s, London was the only one of these three financial capitals to function as a truly international center of money and credit creation, and Great Britain was the world's largest creditor country. New York suddenly took a leading international role during the First World War, and the United States became the world's largest net creditor country. Tokyo emerged as an international financial center only seventy years later, in the 1980s, when Japan replaced the United States as the world's largest net creditor country—as it remains at this writing. As early as 1896, however, Japanese money had a surprising and significant role in London itself. By the 1910s, Japanese financial authorities were working to establish Tokyo as an international credit center. The present study thus reveals the beginnings of processes that have since reshaped flows of resources and the distribution of wealth at a global level.

The creation of money is an elaborate social process normally presented to the public as a kind of physical fact, and people speak of money as if it were a physical substance, existing in a definite "supply" which may "flow" from place to place. To insiders, the process was more relational and personal, founded in exclusive institutional networks and close-knit social circles. Decisions made within these circles could have enormously outsized effects. This is the picture revealed in the primary documentary sources we utilize here, drawn from research in the historical archives of all three financial centers. As discussed in the book's conclusion, the questions we address are also matters of living history and of processes that continue to unfold.

1. BEGINNINGS OF CENTRAL BANK COOPERATION: TOKYO AND LONDON, 1895–1914

The Bank of Japan's foreign specie reserve held in the Bank of England / Alliance and war: London lends to Japan / Tokyo and New York: weaker connections / Japan lends to the world's bank of banks

We begin with the question of central bank cooperation. Most specialists date the beginnings of regular central bank cooperation to the First World War or to the 1920s. In fact, the Bank of England and the Bank of Japan began secretly to cooperate in the early years of the century. The Bank of Japan became the Bank of England's largest single depositor; the Bank of England reinforced its hegemonic position by managing these Japanese funds and quietly drawing on them in moments of need. For its part, the Bank of Japan counted these London funds as part of the "specie" reserve for Japan's own national monetary system.

This financial alliance preceded the military alliance between the British and Japanese empires. The military alliance was then given form in the giant loans raised in London for Japan's war with Russia in 1904–05. Japan's victory was followed by an international boom in 1906 and a crash in 1907; this boom-and-bust cycle was most conspicuous in Japan, but its impulses radiated out internationally, mainly via London. The discovery of the details of this connection, based on research into formerly closed archival materials, widens a hitherto Europe-centered view.

2. WORLD WAR AND GLOBALIZATION

De-globalization after 1914? / A US central bank / Wartime origins of multilateral central bank cooperation / New York as in international financial center (Making a market: the trade in trade credits; Creating a global commercial bank: Frank Vanderlip and NCB; The state-bank nexus)

Central bank cooperation became multilateral during the opening weeks of the First World War, when the Bank of England took the initiative to establish a network of Allied central banks. The US Federal Reserve System went into operation shortly after the war began in Europe, and the Federal Reserve Bank of New York (FRBNY) joined the Allied central bank network as soon as it could, well before the United States government entered the war. In early 1915, US private banks backed by the FRBNY began to finance enormous military purchasing programs run by the British and French governments in the United States. The personal friendship between Benjamin Strong of the FRBNY and Montagu Norman of the Bank of England also began in the spring of 1916. A private financial alliance thus preceded the public military alliance. Central banks also gained enormous new powers, as wartime financial demands enhanced their administrative authority and reach. The central banks of the United States and Japan established their own direct tie during the war. The First World War opened a new era of American-centered financial globalization, as seen in a surge of international credit creation by US banks. The flood of credit left behind a heavy burden of debt, which would dominate the years after the war.

3. JAPAN EMERGES AS AN INTERNATIONAL CREDITOR, 1915–1918

What's in a center? / Lending to wartime allies / Lending to China / Some failings of yen diplomacy

The First World War brought a parallel series of economic transformations to Japan and the United States. Both countries registered great export surpluses and piled up a great volume of claims on foreign financial centers. The bankers of both countries ventured into overseas lending in a way unprecedented in the history of either country. In both countries there were initiatives to develop an international financial center on the model of London. Japan during the First World War was temporarily transformed into the country with the second largest surpluses, after the United States, and the yen was one of the world's strongest currencies. Tokyo financial groups lent to Britain and France, as well as to Russia and China. Simultaneously, Japanese central bankers, with their eyes also on New York, began to build the institutional infrastructure of an international credit center. This initiative was relatively unsuccessful. Japan's first, "premature" experience as one of the world's top three creditor countries has been almost unknown, but it was the first sign of a structural shift.

4. POSTWAR ALIGNMENT

A typology of central bank cooperation / A market-making initiative in Tokyo / Spring tide: a flood of gold / Trilateral deflation: crises cooperatively induced

The biennium 1919–1920 was Year One for a new type of multinational financial governance, which has since become hegemonic. After the First World War, the policies of the Japanese, American, and British central banks became aligned as never before, in the world's first internationally coordinated monetary policy. The gold convertibility of national currencies had been suspended during the war, and prices in each of the three countries doubled. The restoration of gold-based monetary systems thus seemed to demand deflation and austerity.

The critical decisions that shaped these outcomes were taken by a very small number of men—the "governors" of the system. Governor Benjamin Strong of the FRBNY, Governor Montagu Norman of the Bank of England, and Governor Inoue Junnosuke of the Bank of Japan each, in turn, directed his own country's restoration of the gold standard—Strong in 1919, Norman in 1925, and Inoue in 1930. Each was blamed for the deflation and depression that followed. Benjamin Strong directed the first move, the return of the US dollar to the gold convertibility on June 26, 1919. One result of this action was a great surge of gold shipments out of the United States. The largest share of this gold went to Japan, where it helped inflate a great credit bubble.

Viewed abstractly, the new central bank cooperation of the 1920s might appear as a triumph of enlightened internationalism. In its substance, however, it represented a socially narrow standpoint, as privately owned central banks, reflecting the outlook and interests of private banking circles, worked together to preserve the enormous structure of debts created by the war. The effort to maintain this structure of debts produced some of the greatest economic, social, and political disasters in modern history.

5. WALL STREET DISCOVERS JAPAN, SPRING 1920

Three Wall Street missions / Benjamin Strong's report on Japan / New York–Tokyo cooperation

At the height of the postwar financial bubble, in a modest pre-play of the late 1980s, an interest in Japan suddenly appeared among Wall Street leaders. Three of Wall Street's top bankers—Thomas W. Lamont of J. P. Morgan and Company, Frank A. Vanderlip of National City Bank, and Benjamin Strong of the Federal Reserve Bank of New York—made separate voyages to Japan in the spring of 1920. Vacationing as a semi-official guest of the Bank of Japan, Strong stayed in Japan the longest and established the closest connections. Ironically, the American bankers came to Japan just at the moment the postwar economic bubble was beginning to collapse. Benjamin Strong had anticipated that his policies would bring on a great deflation, and he took an extended leave from his post. He did not anticipate that the deflationary wave would hit first in Japan, while he was there. Considering the international lines of force that bore upon these personal encounters, and the developments that sprang from them, the moment appears as a pivot in US-Japan relations. Wall Street financiers subsequently became key actors in shaping US-Japan relations during the decade of the 1920s, which, financially speaking, was Japan's first "American" age.

6. PUTTING THE PROGRAM INTO ACTION, 1920–1928

"World deflation has been started" / Global financial governance: the London–New York program / New York and Tokyo / Tokyo and London / Burying gold: Strong and Norman / The central banking family / More cooperation, more debt, more deflation

Montagu Norman, in partnership with Benjamin Strong, turned ad hoc wartime cooperation into a formal agenda. It was Norman who first spelled out the principles of "central bank independence" and "central bank cooperation," in a private manifesto circulated among fellow central bankers in 1921. This was the announcement of a new international order—a kind of central bank sovereignty—encompassing central banks' independence from their national governments, their separation from and supervision of commercial banks, and their continuous cooperation with each other. Central bank cooperation was recognized as a principle at the 1922 Genoa conference. It was also put into practice; this cooperative movement culminated in the establishment of the Bank for International Settlements in 1930.

In its actual content, cooperation focused on the reconstituting of a system of gold-based currencies. The Bank of Japan took part in this movement and helped support Britain's own restoration of the gold standard. Japan itself, however, was delayed in returning to the gold standard. This goal was realized in January 1930. As a consequence of these concerted policies, the purchasing power of gold surged, meaning that the prices of almost everything else declined. The first wave of international deflation began in 1920 and the second in 1925. In 1930, the world was thus entering a third round of postwar deflation—deflation on top of deflation—with disastrous effects on the non-financial economy.

7. MAKING A MARKET: LONDON AND GOLD IN THE 1920S

The Bank of England as London's gold market before 1919 / Gold afloat / The founding of London's "free" gold market / The gold market during the years of the floating pound, 1919–1925 / "Second to none": Kuhn Loeb and Rothschilds / 1925: the central banks take control / Channeling free gold

The deployment of physical gold, via the London gold market, was quietly at the center of much of this drama. Chapter 7 opens a window onto the questions of gold production, commoditization, and trade via the hitherto obscure story of how British authorities created a market for this master commodity. During the First World War, central banks came to control most of the world's gold, which could not be freely traded and was no longer a commodity in any normal sense.

When the pound sterling formally went off gold and began to float against the US dollar in 1919, the Bank of England invited N. M. Rothschild and Sons to open a "free" market for gold in London. In this marketplace at the center of the international payments system, only five brokers were present, representing anonymous clients. It was a closed, ritualized, and hierarchical affair, and its documentary traces are few. London was in fact the channel for some two-thirds of the world's gold production, and international movements of this gold could induce enormous economic shifts.

8. THE RUSH FOR GOLD

New York: an inflated inverted pyramid / A world central bank? / The end game begins / Boom times in the London gold market / De-globalization

When he advocated for the new Federal Reserve System in 1914, Paul Warburg admiringly depicted the modern financial system as a "huge skyscraper based on a comparatively small foundation of gold." By 1929 he judged it to have become an "inflated inverted pyramid." The supposed foundation material of this financial superstructure would now, in a rush, be cashed in by banks that held large paper claims—gold indeed "flowed" freely in 1930 and 1931, as advocates of the revived gold standard said it ought to do. This movement began with a run on the Japanese yen in 1930. Under the press of these runs on gold, gold-based monetary systems collapsed in the latter part of 1931. Credit-led globalization thus gave way to the globally synchronized debt-destruction crisis now known as the Great Depression. There followed a many-faceted reaction against financial globalization. In Japan itself, the depression undermined pro-Western liberalism as a whole system and opened the way for the fascistic turn of national life in the 1930s. The period holds many lessons for our own times.

We note here another remarkable fact. The greatest international financial crises of the era—1907, 1920, 1929—broke out first in Tokyo, having on onset some three to six months earlier than in New York and London. The contradictory faces of these world movements were manifested especially sharply in Japan, making Tokyo markets a sensitive leading indicator.

CONCLUSION: PRIVATE NETWORKS AND THE PUBLIC INTEREST

Hierarchical markets / "Capitals of capital" / Capital city bubbles

The book concludes by considering the hierarchical nature of the markets in capital, which constitute the peak markets of the world capitalist system. Markets are places where people meet to buy and sell. Here, we are dealing with *meta-markets*, where people buy and sell the means to purchase in other markets. Many social scientists treat markets and hierarchies as opposites. At the apex of the market system, however, markets themselves become less marketlike. Operations at these peak levels involve just a few organizations, which are often modestly staffed. State agencies and private agencies often blend together at these levels. These operations are framed by elaborate, ideologically dense social codes that need the attention of anthropologists as well as economists, sociologists, and historians.

In a century of violent changes, the central bank connections between Tokyo, London, and New York have been vital links within a larger set of world-city geographies. These "capital city" geographies have been remarkably persistent. In recent decades, Tokyo, New York, and London have been the centers of credit bubbles of historically unprecedented magnitude. The Tokyo bubble of 1989–90 was at its time the largest bubble in international financial history. It now seems relatively localized next to the New York and London bubbles of 2007–08. We see here some extraordinary departures and some unexpected continuities. We see also the quiet but surprisingly central place of Japan, whose position in the international credit system remains an open historical situation, with a significance that is yet to be truly understood. Recent bubbles again reveal the centrality of the central banks, whose ongoing systemic bailouts have taken on a quasi-permanent aspect. In their aftermath, the questions unresolved at the origins of the central bank project—of openness and accountability, of who governs and in whose interest—are more pressing than ever. These questions concern the provision of money as an essential public utility. The ability to create credit-money yields enormous profits and its governance involves highly specialized knowledge, often expressed in language that serves more to hide the distribution of gains and losses than to make it visible and understood. Our study of historical origins seeks to clarify these issues.